NEKTAR THERAPEUTICS
Form 10-Q
November 07, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2005

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	**94-3134940**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

150 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 x No ¨

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

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

Applicable Only to Corporate Issuers

The number of outstanding shares of the registrant s Common Stock, $0.0001 par value, was 87,623,905 on October 31, 2005.

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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 1934 Act). All statements other than statements of historical fact are forward-looking statements for purposes of this report, including any projections of earnings, revenues 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 and any statement 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, potentia continue, or the negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained in this report 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 position and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including but not limited to the cautionary factors set forth in this report and for the reasons described elsewhere in this report. 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.

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PART I: FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

NEKTAR THERAPEUTICS

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share information)

	September 30, 2005	December 31, 2004
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 357,217	$ 32,064
Short-term investments	263,111	386,676
Accounts receivable, net of allowance for doubtful accounts and sales returns of $212 and $43 at September 30, 2005 and December 31, 2004, respectively.	14,551	12,842
Inventory, net	13,152	10,691
Other current assets	10,178	12,266
Total current assets	658,209	454,539
Property and equipment, net	144,716	151,247
Goodwill	129,986	130,120
Other intangible assets, net	3,075	6,456
Deposits and other assets	10,924	2,559
Total assets	$ 946,910	$ 744,921
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 8,708	$ 7,141
Accrued expenses	14,550	15,065
Other accrued liabilities	992	15
Interest payable	1,364	2,010
Capital lease obligations - current	444	1,532
Deferred revenue	21,767	29,890
Total current liabilities	47,825	55,653
Convertible subordinated notes and debentures	417,653	173,949
Capital lease obligations - noncurrent	20,419	23,568
Other long-term liabilities	24,838	22,292
Accrued rent	2,071	2,117
Commitments and contingencies		
Stockholders equity:		

Preferred Stock, 10,000 shares authorized		
Series A, $0.0001 par value: 3,100 shares designated; no shares issued or outstanding at September 30, 2005 and December 31, 2004.		
Convertible Series B, $0.0001 par value: 40 shares designated; 20 shares issued and outstanding at September 30, 2005 and December 31, 2004; Liquidation preference of $19,945 at September 30, 2005 and December 31, 2004.		
Common stock, $0.0001 par value; 300,000 authorized; 87,608 shares and 84,572 shares issued and outstanding at September 30, 2005 and December 31, 2004, respectively.	9	8
Capital in excess of par value	1,232,718	1,187,575
Deferred compensation	(3,423)	(2,764)
Accumulated other comprehensive loss	(1,207)	(356)
Accumulated deficit	(793,993)	(717,121)
Total stockholders equity	434,104	467,342
Total liabilities and stockholders equity	$ 946,910	$ 744,921

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

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share information)

(unaudited)

	Three-Months Ended September 30,		Nine-Months Ended September 30,	
	2005	2004	2005	2004
Revenue:				
Contract research revenue	$ 23,657	$ 23,556	$ 62,737	$ 67,167
Product sales and royalty revenue	8,450	4,990	20,313	15,737
Exubera® commercialization readiness revenue	4,247		10,348	
Total revenue	36,354	28,546	93,398	82,904
Operating costs and expenses:				
Cost of goods sold	6,125	4,477	16,813	13,746
Exubera® commercialization readiness costs	3,075		8,035	
Research and development	38,591	34,534	109,321	99,476
General and administrative	10,948	7,382	30,193	22,281
Amortization of other intangible assets	982	981	2,945	2,944
Total operating costs and expenses	59,721	47,374	167,307	138,447
Loss from operations	(23,367)	(18,828)	(73,909)	(55,543)
Loss on extinguishment of debt	(303)		(303)	(9,258)
Other income (expense), net	(32)	(128)	(1,435)	303
Interest income	2,899	1,763	7,683	4,617
Interest expense	(2,992)	(3,259)	(8,908)	(22,603)
Loss before provision for income taxes	(23,795)	(20,452)	(76,872)	(82,484)
Provision for income taxes				(132)
Net loss	$ (23,795)	$ (20,452)	$ (76,872)	$ (82,616)
Basic and diluted net loss per share	$ (0.28)	$ (0.24)	$ (0.90)	$ (1.08)
Shares used in computing basic and diluted net loss per share	86,228	83,853	85,331	76,550

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Nine-Months ended September 30,	
	2005	**2004**
Cash flows used in operating activities:		
Net loss	$ (76,872)	$ (82,616)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	13,368	8,651
Amortization of other intangible assets	3,381	3,381
Amortization of debt issuance costs	624	739
Amortization of deferred compensation	1,380	918
Amortization of gain related to sale of building	(715)	
Loss on termination of capital lease	1,137	
Non-cash compensation for employee retirement plans	1,096	772
Non-cash compensation for employee severance		60
Stock-based compensation for services rendered	179	424
Gain on sale of assets		(133)
Loss on early extinguishment of debt	303	9,258
Increase in provision for doubtful accounts and sales returns reserve	169	51
Increase in inventory reserve	1,314	1,542
Changes in assets and liabilities:		
Decrease (increase) in trade accounts receivable	(1,893)	459
Increase in inventories	(3,774)	(3,457)
Decrease (increase) in prepaids and other assets	1,894	(37)
Increase (decrease) in accounts payable	1,587	(3,117)
Increase (decrease) in accrued expenses	179	(3,829)
Decrease in interest payable	(646)	(209)
Decrease in deferred revenue	(4,536)	(2,649)
Decrease in other liabilities	(48)	(945)
Net cash used in operating activities	(61,873)	(70,737)
Cash flows from investing activities:		
Purchases of short-term investments	(150,327)	(463,725)
Sales of short-term investments	88,950	130,377
Maturities of investments	184,885	170,990
Purchase of long-term investments		(28)
Sales of long-term investments		12,470
Purchases of property and equipment	(11,261)	(20,291)
Disposal of property and equipment		42
Proceeds from interest in partnership		22,450
Net cash provided by (used in) investing activities	112,247	(147,715)

Cash flows from financing activities:		
Proceeds from debt and capital lease financing		3,666
Payments of loan and capital lease obligations	(1,722)	(9,377)
Proceeds from convertible subordinated notes	305,645	
Repurchase of convertible subordinated notes	(70,964)	(376)
Issuance of common stock, net of issuance costs	31,563	196,412
Issuance of common stock related to employee stock purchase plan	1,239	1,284
Issuance of common stock related to employee stock option exercises	9,029	8,758
Net cash provided by financing activities	274,790	200,367
Effect of exchange rates on cash and cash equivalents	(11)	
Net increase (decrease) in cash and cash equivalents	325,153	(18,085)
Cash and cash equivalents at beginning of period	32,064	44,446
Cash and cash equivalents at end of period	$ 357,217	$ 26,361
Non-cash Investing and Financing Activities		
Conversion of debt into common stock	$	$ 141,017
Deferred compensation related to the issuance of restricted stock units	$ 2,039	$ 3,902

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2005

(unaudited)

Note 1 Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation

Our Company was originally incorporated in California in 1990. We were reincorporated in Delaware in 1998. In January 2003, we changed our name from Inhale Therapeutic Systems, Inc. to Nektar Therapeutics.

Our business is to advance therapeutics through improved drug delivery. We operate in one business segment. We have three drug delivery technology platforms that are designed to improve the performance of molecules and drug delivery. These platforms are Nektar Advanced PEGylation Technology, Nektar Pulmonary Technology and Nektar Supercritical Fluid (SCF) 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 generally accepted accounting principles in United States of America (U.S. GAAP) can be condensed or omitted. In the opinion of management, the financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of our financial position and operating results. Certain prior year amounts have been reclassified to conform to the current period financial statement presentation.

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 accompanying notes included in our Annual Report on Form 10-K/A, as amended, for the year ended December 31, 2004.

Restatement

Certain amounts reported in our Quarterly Reports on Form 10-Q for the three-month and nine-month periods ended September 30, 2004 have been restated to correct for certain misapplications of our accounting policies under U.S. GAAP.

Specifically, we have reclassified approximately $2.9 million and $8.4 million for the three-month and nine-month periods ended September 30, 2004, respectively, from research and development expenses to general and administrative expenses. This reclassification included legal

expenses related to our intellectual property portfolio and a portion of finance, information systems, and human resource expenses that were not clearly related to research and development and are required to be classified outside of research and development expenses under Statement Financial Accounting Standards No. 2, *Accounting for Research and Development Costs*.

In addition, we reclassified approximately $0.2 million and $0.7 million for the three-month and nine-month periods ended September 30, 2004 from general and administrative expenses to interest expense. This reclassification was made to record the amortization of debt issuance costs to interest expense as required under Accounting Principles Board No. 21, *Interest on Receivables and Payables* and EITF 86-15, *Increasing-Rate Debt*.

These reclassifications did not result in any change to our cash position, revenue, or net loss during the three-month or nine-month periods ended September 30, 2004.

Use of Estimates

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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation

Our consolidated financial statements include the financial position and results of operations and cash flows of our wholly-owned subsidiaries: Nektar Therapeutics AL, Corporation (Nektar AL), Nektar Therapeutics UK, Ltd. (Nektar UK), Inhale Therapeutic Systems Deutschland GmbH (Inhale Germany), and Nektar Therapeutics (India) Private Limited.

Our 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. The process by which each foreign subsidiary s financial results are translated into U.S. dollars is as follows: income statement accounts are translated at average exchange rates for the period; balance sheet asset and

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liability accounts are translated at end of period exchange rates; and equity accounts are translated at historical exchange rates. Translation of the balance sheet in this manner results in an accumulated other comprehensive gain (loss) in the stockholders equity section. To date, such cumulative translation adjustments have not been material to our consolidated financial position.

Significant Concentrations

Cash equivalents and short-term investments are financial instruments that potentially subject us to concentration of risk. We limit our concentration of risk by diversifying our investment amount among a variety of industries and issuers and by limiting the average maturity to approximately one year. Our professional portfolio managers adhere to this investment policy as approved by our Board of Directors.

Our customers are primarily pharmaceutical and biotechnology companies that are located in the U.S. and Europe. Our accounts receivable balance contains trade receivables from product sales and royalties, collaborative research agreements, and commercialization readiness revenue. We provide for a general allowance for doubtful accounts by reserving for specifically identified doubtful accounts plus a percentage of past due amounts. We have not experienced significant credit losses from our accounts receivable or collaborative research agreements, and none is currently expected. We perform a regular review of our customer s payment history and associated credit risk. We do not require collateral from our customers.

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

We are dependent on Pfizer as the source of a significant proportion of our revenue. The termination of our collaboration arrangement with Pfizer would have a material adverse effect on our financial position and results of operations. Should the Pfizer collaboration be discontinued prior to the launch of Exubera®, we will need to find alternative funding sources to replace the collaboration revenue and will need to reassess the realizability of assets capitalized. Additionally, we may have contingent payments to our contract manufacturers to reimburse them for their capital outlay to the extent that they cannot re-deploy their assets and may incur additional liabilities. At the present time, it is not possible to estimate the loss that will occur as a result of these obligations should the Pfizer collaboration be discontinued or Exubera® not be approved.

Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (FASB) released Statement of Financial Accounting Standard (SFAS) No. 154, *Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3,* (FAS 154). FAS 154 requires retrospective application to prior periods financial statements for any change in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The statement defines retrospective application as the application of a different accounting principle to prior accounting periods as if that principle had always been used or as the adjustment of previously issued financial statements to reflect a change in the reporting entity. The statement also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. The statement carries forward without change the guidance contained in Opinion 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. We will be required to adopt FAS 154 for any accounting changes or corrections of errors on or after January 1, 2006. We do not expect the adoption of FAS 154 to have a material impact on our consolidated financial position, results of operations, or cash flows.

In March 2005, the SEC released Staff Accounting Bulletin (SAB) 107, Share Based Payment SAB 107 provides the SEC staff position regarding the application of SFAS No. 123R. SAB 107 contains interpretative guidance related to the interaction between SFAS No. 123R and certain SEC rules and regulations, as well as provides the Staff s views regarding the valuation of share-based payment arrangements for public companies. SAB 107 also highlights the importance of disclosures made related to the accounting for share-based payment transactions. The Company is currently reviewing the effect of SAB 107 on its condensed consolidated financial statements as it prepares to adopt SFAS 123R.

In December 2004, the FASB released a revision to SFAS No. 123, *Accounting for Stock-Based Compensation* (FAS 123R). FAS 123R addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. The statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees, and generally would require instead that such transactions be accounted for using a fair-value-based method. We will be required to adopt FAS 123R on January 1, 2006. When we adopt the new statement, we will have to recognize substantially more compensation expense. This is expected to have a material adverse impact on our financial position and results of operations. We are currently in the process of evaluating the effect of adopting FAS 123R.

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In November 2004, the FASB released SFAS No. 151, *Inventory Costs An Amendment to ARB No. 43* (FAS 151). This Statement amends the guidance in ARB No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal as defined by ARB No. 43, Chapter 4, *Inventory Pricing*. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. We will be required to adopt SFAS No. 151 on January 1, 2006. We are currently in the process of evaluating the effect of adopting SFAS No. 151.

Cash, Cash Equivalents and Investments

We consider all highly liquid investments with a remaining maturity on the date of purchase of three months or less to be cash equivalents. Cash and cash equivalents include demand deposits held in banks, interest bearing money market funds, commercial paper, federal and municipal government securities, corporate bonds, and repurchase agreements.

Short-term investments consist of federal and municipal government securities, corporate bonds, and commercial paper with A1, F1, or P1 short-term ratings and A or better long-term ratings with remaining maturities at date of purchase of greater than 90 days. Investments with maturities greater than one year are classified as short-term when they represent investments of cash that are reasonably expected to be realized in cash and are available for use in current operations.

At September 30, 2005, all short-term investments are designated as available-for-sale and are carried at fair value, with unrealized gains and losses reported in stockholders equity as accumulated other comprehensive income (loss). Short-term investments are adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities, if any, are included in other income (expense). The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest income.

At September 30, 2005 and December 31, 2004, we had outstanding letters of credit arrangements totaling $2.2 million in connection with arrangements with certain vendors, including our landlord, which are secured by investments in similar amounts.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market. Cost is computed using standard cost, which approximates actual costs on a first-in, first-out basis.

Inventories consist of the following (in thousands):

	September 30, 2005	December 31, 2004

Raw material	$ 7,383	$ 4,848
Work-in-process	3,411	4,552
Finished goods	2,358	1,291
Total inventories	$ 13,152	$ 10,691

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Goodwill

Goodwill is tested for impairment at the respective business unit level least annually, or on an interim basis if an event occurs or circumstances change that would more-likely-than-not reduce the fair value below our carrying value. During the three-month and nine-month periods ended September 30, 2005 and 2004, we recorded no impairment charges under SFAS No. 142, *Goodwill and Other Intangible Assets*, as no indicators of impairment were identified by management.

Derivative Instruments

We are exposed to foreign currency exchange rate fluctuations and interest rate changes in the normal course of our business. As part of our risk management strategy, we may use derivative instruments, including forwards, swaps and options to hedge certain foreign currency and interest rate exposures. We do not use derivative contracts for speculative purposes. To date, we have not entered into any such derivative instruments other than the interest rate swap discussed below which was accounted for in accordance with SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

To limit our exposure to foreign currency exchange rate fluctuations with respect to British Pounds, we have periodically purchased British Pounds on the spot market and held them in a U.S. bank account. At September 30, 2005 and at December 31, 2004, we held British Pounds valued at approximately $1.4 and $8.4 million, respectively, using the exchange rate as of period end. Such amount is included in cash and cash equivalents on our balance sheet. During the three-month and nine-month periods ended September 30, 2005, a loss of approximately nil and $0.3 million resulting from revaluing British Pounds at the current exchange rate was included in other income (expense).

Comprehensive Loss

Comprehensive loss is comprised of net loss and other comprehensive gain (loss). Other comprehensive gain included unrealized gains (losses) on available-for-sale securities, translation adjustments, and unrealized gains (losses) on available-for-sale securities using the specific identification method. The comprehensive loss consists of the following components net of related tax effects (in thousands):

	Three-Months Ended September 30,		Nine-Months Ended September 30,	
	2005	2004	2005	2004
Net loss, as reported	$ (23,795)	$ (20,452)	$ (76,872)	$ (82,616)
Change in net unrealized gains (losses) on available-for-sale securities	(169)	698	15	(1,552)
Net unrealized (gains) losses reclassified into earnings		(1)		(23)
Translation adjustment	(171)	(67)	(866)	230
Total comprehensive loss	$ (24,135)	$ (19,822)	$ (77,723)	$ (83,961)

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

	September 30, 2005	December 31, 2004
Unrealized losses on available-for-sale securities	(1,841)	$ (1,856)
Translation adjustment	634	1,500
Total accumulated other comprehensive loss	$ (1,207)	$ (356)

Stock-Based Compensation

We currently apply the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for those plans. Under this opinion, no stock-based employee compensation expense is charged for options that were granted at an exercise price that was equal to the market value of the underlying common stock on the date of grant. Stock compensation costs are immediately recognized to the extent the exercise price is below the fair value on the date of grant and no future vesting criteria exist.

For stock awards issued below our market price on the grant date, we record deferred compensation representing the difference between the price per share of stock award issued and the fair value of the Company s common stock at the time of issuance or grant, and we amortize this amount over the related vesting periods on a straight-line basis.

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Pro forma information regarding net income and earnings per share required by SFAS 123, *Accounting for Stock-Based Compensation*, as amended by SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, regarding the fair value for employee options was estimated at the date of grant using a Black-Scholes option valuation model with the following weighted-average assumptions:

	Three-Months Ended September 30,		Nine-Months Ended September 30,	
	2005	2004	2005	2004
Risk-free interest rate	4.01%	3.5%	3.79%	3.5%
Dividend yield	0.0%	0.0%	0.0%	0.0%
Volatility factor	0.70	0.68	0.73	0.62
Weighted average expected life	4.5 years	5 years	4.5 years	5 years

Pro forma information regarding net income and earnings per share required by SFAS 123, as amended by SFAS 148, regarding the fair value for employee stock purchase plan shares was estimated at the date of grant using a Black-Scholes valuation model with the following weighted-average assumptions:

	Three-Months Ended September 30,		Nine-Months Ended September 30,	
	2005	2004	2005	2004
Risk-free interest rate	2.95%	1.05%	2.40%	1.05%
Dividend yield	0.0%	0.0%	0.0%	0.0%
Volatility factor	0.44	0.49	0.65	0.49
Weighted average expected life	0.33	0.49	0.42	0.54

The Black-Scholes options valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. We have presented the pro forma net loss and pro forma basic and diluted net loss per common share using the assumptions noted above.

The following table illustrates the effect on net loss and net loss per share if we had applied the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation (in thousands, except per share information):

	Three-Months Ended September 30,		Nine-Months Ended September 30,	
	2005	2004	2005	2004
Net loss, as reported	$ (23,795)	$ (20,452)	$ (76,872)	$ (82,616)
Add: stock-based employee compensation included in reported net loss	474	340	1,380	918
	(5,943)	(8,606)	(20,313)	(23,322)

Deduct: total stock-based employee compensation expense determined under fair value methods for all awards				
Net loss, pro forma	$ (29,264)	$ (28,718)	$ (95,805)	$ (105,020)
Net loss per share				
Basic and diluted, as reported	$ (0.28)	$ (0.24)	$ (0.90)	$ (1.08)
Basic and diluted, pro forma	$ (0.34)	$ (0.34)	$ (1.13)	$ (1.37)

Stock compensation expense for options granted to non-employees has been determined in accordance with SFAS 123 and EITF No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in conjunction with Selling, Goods or Services,* as the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measured. The fair value of options granted to non-employees is re-measured as the underlying options vest. Non-employee option awards are accounted for under FIN 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.*

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Revenue Recognition

We recognize revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, Revenue Recognition in Financial Statements (SAB 104). Effective July 1, 2003, we adopted the provisions of Emerging Issues Task Force, Issue No. 00-21, Revenue Arrangements with Multiple Deliverables (EITF 00-21) on a prospective basis.

Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed and determinable, and collectability is reasonably assured. Allowances are established for uncollectible amounts.

We enter into collaborative research and development arrangements with pharmaceutical and biotechnology partners that may involve multiple deliverables. For multiple-deliverable arrangements entered into after July 1, 2003 judgment is required in the areas of separability of units of accounting and the fair value of individual elements. The principles and guidance outlined in EITF No. 00-21 provide a framework to (a) determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, and (b) determine how the arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. Our arrangements generally may contain the following elements: collaborative research, milestones, manufacturing and supply, royalties and license fees. For each separate unit of accounting we have objective and reliable evidence of fair value using available internal evidence for the undelivered item(s) and our arrangements generally do not contain a general right of return relative to the delivered item. In accordance with the guidance in EITF No. 00-21, the Company uses the residual method to allocate the arrangement consideration when it does not have fair value of a delivered item(s). Under the residual method, the amount of consideration allocated to the delivered item equals the total arrangement consideration less the aggregate fair value of the undelivered items.

Contract revenue from collaborative research and feasibility agreements is recorded when earned based on the performance requirements of the contract. Advance payments for research and development revenue received in excess of amounts earned are classified as deferred revenue until earned. Revenue from collaborative research and feasibility arrangements are recognized as the related costs are incurred. Amounts received under these arrangements are generally non-refundable if the research effort is unsuccessful.

Payments received for milestones achieved are deferred and recorded as revenue ratably over the next period of continued development. Management makes its best estimate of the period of time until the next milestone is reached. This estimate affects the recognition of revenue for completion of the previous milestone. The original estimate is periodically evaluated to determine if circumstances have caused the estimate to change and if so, amortization of revenue is adjusted prospectively.

Product sales are derived primarily from cost-plus manufacturing and supply contracts for our PEG Reagents with individual customers in our industry. Sales terms for specific PEG Reagents are negotiated in advance. Revenues related to our product sales are recorded in accordance with the terms of the contracts. We provide for a general allowance for sales returns by reserving a percentage of product sales based on our recent experience with product returns. The allowance for sales returns was $0.2 million and nil as of September 30, 2005 and December 31, 2004, respectively.

Research and Development

Research and development costs are expensed as incurred and include salaries, benefits, and other operating costs such as outside services, supplies, and allocated overhead costs. We perform research and development for our proprietary products and technology development and for others pursuant to feasibility agreements and development and license agreements. For our proprietary products and internal technology development programs, we may invest our own funds without reimbursement from a collaborative partner. Under our feasibility agreements, we are generally reimbursed for the cost of work performed. Feasibility agreements are designed to evaluate the applicability of our technologies to a particular molecule and therefore are generally completed in less than one year. Under our development and license agreements, products developed using our technologies may be commercialized by a collaborative partner. Under these development and license agreements, we may be reimbursed for development costs, may also be entitled to milestone payments when and if certain development and/or regulatory milestones are achieved, and may be compensated for the manufacture and supply of clinical and commercial product. All of our research and development agreements are generally cancelable by the partner without significant financial penalty.

Accounting for Income Taxes

We account for income taxes under SFAS No. 109, *Accounting for Income Taxes*. Under SFAS No. 109, the liability method is used in accounting for income taxes. 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

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expected to be in effect when the differences are expected to reverse. Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Because of our lack of earnings history, the net deferred tax assets for our operations outside of Alabama have been fully offset by a valuation allowance.

We recorded a provision of $0.1 million for the nine-month period ended September 30, 2004 relating entirely to state taxes on our Alabama subsidiary. We did not record a provision for income taxes for the three-month or nine-month periods ended September 30, 2005 because our Alabama subsidiary had a net loss for both the three-month and nine-month periods ended September 30, 2005.

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, less the weighted-average shares outstanding which are subject to the Company s right of repurchase.

The following table sets forth the computation of basic and diluted net loss per share (in thousands, except per share data):

	Three-Months Ended September 30,		Nine-Months Ended September 30,	
	2005	2004	2005	2004
Numerator:				
Net loss	$ (23,795)	$ (20,452)	$ (76,872)	$ (82,616)
Denominator:				
Weighted average number of common shares outstanding	86,228	83,853	85,331	76,550
Net loss per share basic and diluted	$ (0.28)	$ (0.24)	$ (0.90)	$ (1.08)

Diluted earnings per share would give effect to the dilutive impact of common stock equivalents which consists of convertible preferred stock and convertible subordinated debt (using the as-if converted method), and stock options and warrants (using the treasury stock method). Potentially dilutive securities have been excluded from the diluted earnings per share computations in all years presented as such securities have an anti-dilutive effect on loss per share due to the Company s net loss. Potentially dilutive securities included the following (in thousands):

	September 30, 2005	September 30, 2004
Warrants	21	56
Options and restricted stock units	16,779	17,410
Convertible preferred stock	1,023	875
Convertible debentures and notes	16,896	3,831

Total	34,719	22,172

Note 2 - Segment, Significant Customer and Geographic Information

We report segment information in accordance with SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*. The Company is managed as one operating segment. The entire business is comprehensively managed by our Executive Committee that reports to the Chief Executive Officer. The Executive Committee is our chief operating decision maker. We have multiple technologies, all of which are marketed to a common customer base (pharmaceutical and biotechnology companies which are typically located in the U.S. and Europe).

Our research revenue is derived primarily from clients in the pharmaceutical and biotechnology industries. Revenue from Pfizer represented 71% and 59% of our total revenue for the three-month periods ended September 30, 2005 and 2004, respectively. Revenue from Pfizer represented 68% and 59% of our total revenue for the nine-month periods ended September 30, 2005 and 2004, respectively. Deferred revenue from Pfizer represented 59% and 76% of total deferred revenue as of September 30, 2005 and December 31, 2004, respectively. Product and royalty revenues are primarily derived from our Advanced PEGylation Technology relationships.

Our accounts receivable balance contains trade receivables from product sales and royalties, collaborative research agreements, and Exubera® commercialization readiness revenue. On September 30, 2005, three different customers represented 24%, 34%, and 18% of our accounts receivable, respectively. At December 31, 2004, four different customers represented 25%, 23%, 16%, and 10% of our accounts receivable, respectively.

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We primarily receive contract research revenue from, and provide product sales to, customers located within the United States. Revenues are derived from customers in the following geographic areas (in thousands):

	Three Months Ended September		Nine Months Ended September	
	2005	2004	2005	2004
Contract research revenue				
United States	$ 22,250	$ 23,441	$ 59,421	$ 66,639
All other countries	1,407	115	3,316	528
Total contract research revenue	23,657	23,556	62,737	67,167
Product sales and royalty revenues				
United States	5,149	2,199	12,913	8,664
European countries	2,421	2,706	5,652	5,677
All other countries	880	85	1,748	1,396
Total product sales	$ 8,450	$ 4,990	$ 20,313	$ 15,737
Exubera® commercialization readiness revenue				
United States	$ 4,247	$	$ 10,348	$
Total revenue	$ 36,354	$ 28,546	$ 93,398	$ 82,904

Note 3 Financial Instruments

As of September 30, 2005 and December 31, 2004, we held a portfolio of debt securities. Certain of these securities have a fair value less than their amortized cost. In accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and EITF 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, we have recorded the difference between the amortized cost and fair value as a component of accumulated other comprehensive income. Management has concluded that no impairment should be recognized related to these investments because the unrealized losses incurred to date are not considered other than temporary. Management has reached this conclusion based upon its intention to generally hold all debt investments with an unrealized loss until maturity at which point they are redeemed at full par value, a history of actually holding the majority of our investments to maturity, and our strategy of aligning the maturity of our debt investments to meet our cash flow needs. Therefore, we will, in most cases, have the ability to hold all of our debt investments to maturity.

We determine the fair value amounts by using available market information. As of September 30, 2005 and December 31, 2004, the average portfolio duration was approximately one year, and the contractual maturity of any single investment did not exceed twenty-four months with the exception of auction rate securities which we held only as of December 31, 2004. Investments with maturities greater than one year are classified as short-term when they represent investments of cash that are reasonably expected to be realized in cash and are available for use in current operations. Gross unrealized gains on available for sales securities were less than $0.1 million at September 30, 2005 and December 31, 2004. The gross unrealized losses on available for sale securities at September 30, 2005 and December 31, 2004 amounted to approximately $1.8 million and approximately $1.9 million, respectively. As of September 30, 2005, there were 65 securities that had been in a loss position for

twelve months or more and which had a fair value $112.3 million and an unrealized loss of $0.8 million. As of December 31, 2004, there were 21 securities that had been in a loss position for twelve months or more and which had a fair value $31.4 million and an unrealized loss of $0.1 million.

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The following is a summary of operating cash and available-for-sale securities as of September 30, 2005 (in thousands):

	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash and Available-for-Sale Securities				
Obligations of U.S. government agencies	$ 119,210	$	$ (838)	$ 118,372
U.S. corporate commercial paper	27,115	4	(12)	27,107
Obligations of U.S. state and local agencies	8,923		(7)	8,916
Obligations of U.S. corporations	129,864		(979)	128,885
Obligations of non U.S. corporations	2,970		(9)	2,961
Repurchase agreements	177,553			177,553
Cash and other debt securities	156,534			156,534
	$ 622,169	$ 4	$ (1,845)	$ 620,328
Amounts included in cash and cash equivalents	$ 357,223	$ 4	$ (10)	$ 357,217
Amounts included in short-term investments (less than one year to maturity)	192,680		(1,169)	191,511
Amounts included in short-term investments (one to two years to maturity)	72,266		(666)	71,600
	$ 622,169	$ 4	$ (1,845)	$ 620,328

The following is a summary of operating cash and available-for-sale securities as of December 31, 2004 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and Available-for-Sale Securities				
Obligations of U.S. government agencies	$ 164,883	$ 1	$ (923)	$ 163,961
Obligations of U.S. state and local government agencies	1,150			1,150
Obligations of U.S. corporations	147,114		(918)	146,196
Obligations of non U.S. corporations	4,033		(16)	4,017
Repurchase agreements	14,200			14,200
Auction rate securities	72,350			72,350
Cash	16,866			16,866
Total Cash and Available-for-Sale Securities	$ 420,596	$ 1	$ (1,857)	$ 418,740
Amounts included in cash and cash equivalents	$ 32,064	$	$	$ 32,064
Amounts included in short-term investments (less than one year to maturity)	212,586		(916)	211,670
Amounts included in short-term investments (one to two years to maturity)	103,596	1	(941)	102,656
Amounts included in short-term investments (more than 2 years to maturity)	72,350			72,350
Total Cash and Available-for-Sale Securities	$ 420,596	$ 1	$ (1,857)	$ 418,740

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Note 4 - Other Intangible Assets

The components of our other intangible assets at September 30, 2005, are as follows (in thousands, except for years):

	Useful Life in Years	Gross Carrying Amount	Accumulated Amortization	Net
Core technology	5	$ 8,100	$ 6,885	$ 1,215
Developed product technology	5	2,900	2,465	435
Intellectual property	5-7	7,301	6,460	841
Supplier and customer relations	5	5,140	4,556	584
Total		$ 23,441	$ 20,366	$ 3,075

Amortization expense related to other intangible assets totaled $1.1 million for both of the three-month periods ended September 30, 2005 and 2004 and $3.4 million for both the nine-month periods ended September 30, 2005 and 2004. The following table presents expected future amortization expense for other intangible assets until they are fully amortized (in thousands):

Years Ending December 31,	
Remainder of 2005	$ 1,126
2006	1,949
Total	$ 3,075

Note 5 - Commitments and Contingencies

Legal Matters

On July 12, 2005, a complaint was filed by The Board of Trustees of the University of Alabama (UAH) against Nektar Therapeutics AL, Corporation, and Nektar Therapeutics (Defendants) in the United States District Court for the Northern District of Alabama. Among other things, the complaint alleges patent infringement, breach of contract license, violation of the Alabama Trade Secrets Act and unjust enrichment. Generally, the complaint alleges that Defendants refusal to pay royalties based upon UAH patented and licensed technology represents a breach of an exclusive license agreement between UAH and Nektar Therapeutics AL, Corporation (formerly Shearwater Corporation) and that Defendants have infringed and are infringing UAH s patent. On August 3, 2005, UAH amended its complaint to add J. Milton Harris, a Nektar employee, as a party to the litigation, add certain additional claims, seek declaratory judgment on patents assigned to Defendants, and seek compensatory, treble and punitive damages, all in unspecified amounts. Defendants have served UAH with answers to the complaint denying any wrongdoing. Following submission of these answers to UAH, Defendants filed a counter-claim seeking a refund of patent royalties that Defendants allege were erroneously paid to UAH. The parties are currently in the process of scheduling the litigation calendar. The litigation is at too early a stage to make an assessment about the probability of the outcome in the case. We intend to vigorously defend ourselves in this

litigation.

From time to time, we are party to various other litigation matters, including several that relate to our patent and intellectual property rights. We cannot predict with certainty the eventual outcome of any pending litigation or potential future litigation, and we might have to incur substantial expense in defending these or future lawsuits or indemnifying third parties with respect to the results of such litigation. 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 and/or liquidity.

Letters of Credit

At September 30, 2005 and December 31, 2004, we had outstanding letters of credit totaling $2.2 million in connection with arrangements with certain vendors, including our landlord, which are secured by investments in similar amounts.

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Director and Officer Indemnifications

As permitted under Delaware law, and as set forth in our Certificate of Incorporation and our Bylaws, we indemnify our directors, executive officers, other officers, employees, and other agents for certain events or occurrences that arose while in such capacity. The maximum potential amount of future payments we could be required to make under this indemnification is unlimited; however, we have insurance policies that may limit our exposure and may enable us to recover a portion of any future amounts paid. Assuming the applicability of coverage, the willingness of the insurer to assume coverage, and subject to certain retention, loss limits, and other policy provisions, we believe any obligations under this indemnification are not material, other than an initial $500,000 per incident retention deductible per our insurance policy. However, no assurances can be given that the covering insurers will not attempt to dispute the validity, applicability, or amount of coverage without expensive litigation against these insurers, in which case we may incur substantial liabilities as a result of these indemnification obligations. Because the obligated amount of this agreement 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 on our balance sheet as of September 30, 2005 or December 31, 2004.

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 agreement, 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. 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 of this agreement 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 on our balance sheet as of September 30, 2005 or December 31, 2004.

License, Manufacturing and Supply Agreements for Products Based on our Advanced PEGylation Technology

As part of our license, manufacturing, and supply agreements with our partners for the development and/or manufacture and supply of PEG reagents based on our Advanced PEGylation Technology, we generally agree to defend, indemnify, and hold harmless our partners from and against third party liabilities arising out of the agreement, 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. 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 of this agreement 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 on our balance sheet as of September 30, 2005 or December 31, 2004.

Note 6 Deferred Compensation

During the three-month period ended March 31, 2005, we issued restricted stock unit awards totaling 110,000 shares of our common stock to certain employees. The restricted stock unit awards are settled by delivery of shares of our common stock on or shortly after the date the awards

vest. The restricted stock unit awards become fully vested over a period of 47 months. In connection with these restricted stock unit awards, we recorded deferred compensation of $2.0 million, which represents the intrinsic value of the restricted stock units on the date of grant. We are recognizing the stock compensation expense on a straight line basis over the vesting term of 47 months.

During the three-month period ended March 31, 2004, we issued restricted stock unit awards totaling 206,666 shares of our common stock to certain employees. The restricted stock unit awards are settled by delivery of shares of our common stock on or shortly after the date the awards vest. The restricted stock unit awards become fully vested over a period of 34 months. In connection

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with these restricted stock unit awards, we recorded deferred compensation of $3.9 million, which represents the intrinsic value of the restricted stock units on the date of grant. We are recognizing the stock compensation expense on a straight line basis over the vesting term of 34 months.

For the three-month period ended September 30, 2005 and 2004, we recognized expense related to these restricted stock unit grants of approximately $0.5 million and approximately $0.3 million, respectively. For the nine-month period ended September 30, 2005 and 2004, we recognized expense related to these restricted stock grants of approximately $1.4 million and approximately $0.9 million, respectively.

Note 7 Stockholders Equity

Issuance of Common Stock

On August 15, 2005, we entered into a Common Stock Purchase Agreement with Mainfield Enterprises Inc. pursuant to which we sold approximately 1.9 million shares of our common stock at an average price of $16.95 per common share for proceeds of approximately $31.6 million, net of issuance costs.

Changes in Stockholders equity for the nine-months ended September 30, 2005

Beginning balance December 31, 2004		$ 467,342
Common stock issued upon exercise of stock options	$ 9,029	
Common stock issued in secondary offering, net of issuance costs	31,563	
Stock based compensation	1,544	
Shares issued for employee stock purchase plan and retirement plans	2,334	
Exercise of warrants	15	
Other comprehensive income (loss)	(851)	
Net income (loss)	(76,872)	
		(33,238)
Stockholders equity September 30, 2005		$ 434,104

Note 8 Convertible Subordinated Notes

Issuance of 3.25% convertible subordinated notes

In September 2005, we issued $315.0 million in aggregate principal amount of our 3.25% Convertible Subordinated Notes (the 3.25% Notes) due September 2012. Interest on the 3.25% notes is payable semiannually in arrears on March 28 and September 28 of each year. The 3.25% Notes are unsecured and subordinate in right to all our existing and future indebtedness. The notes are convertible at the option of the holder, at

any time on or prior to maturity into shares of our common stock at a conversion rate of 46.4727 shares per $1,000 principal amount of the 3.25% notes, which is equal to an initial conversion price of approximately $21.52. Beginning on September 28, 2008 we may redeem the 3.25% notes in whole or in part for cash at a redemption price equal to 100% of the principal amount of the 3.25% notes plus any accrued but unpaid interest if the closing price of the common stock has exceeded 150% of the conversion price of the 3.25% notes for at least 20 days in any consecutive 30 day trading period.

At any time prior to maturity, if a fundamental change as defined in the 3.25% subordinated debt indenture occurs, we may be required to pay a make-whole premium on notes converted in connection therewith by increasing the conversion rate applicable to the notes. The amount of the make-whole premium will be determined in accordance with a table showing the make-whole premium that would apply at various common stock prices and fundamental change effective dates.

Retirement of certain 3.5% and 5% convertible subordinated notes

In September 2005, we retired $25.4 million and $45.9 million aggregate principle amount of our outstanding 5% and 3.5% convertible subordinate notes due February 2007 and October 2007, respectively, in cash, in privately negotiated transactions. As a result of the transactions we recognized losses related to the early extinguishment of the 5% and 3.5% of approximately $0.3 million and nil, for the three month periods ended September 30, 2005 and 2004, respectively.

As a result of the transactions related to convertible subordinated debt during the quarter ended September 30, 2005 our total contractual obligation with regard to convertible subordinated debt has increased from $173.9 million at December 31, 2004 to $417.7 million at September 30, 2005.

The following summarizes our outstanding convertible subordinated debt as of September 2005:

Class	Maturity	Amount Outstanding	Conversion Price
5%	February 2007	$ 36.1 million	$ 38.36
3.5%	October 2007	$ 66.6 million	$ 50.46
3.25%	September 2012	$ 315.0 million	$ 21.52

Note 9 Exubera® Commercialization Readiness and Costs

Exubera® commercialization readiness revenue represents reimbursement, by Pfizer, of certain agreed upon operating costs relating to our Exubera® drug powder manufacturing facilities in preparation for commercial production, plus a markup on such costs. Such reimbursable revenue will not necessarily equal actual costs incurred which are expensed as Exubera® commercialization readiness costs.

Note 10 Loss on Termination of Capital Lease

Effective January 11, 2005, Nektar and BMR-201 Industrial Road LLC (landlord), entered into an agreement to terminate our obligation in the Amended and Restated Built-To-Suit Lease dated August 17, 2004 related to a portion of our office space located at our San Carlos location. In connection with the termination agreement, we have recorded other expense of approximately $1.1 million. This amount represents the write-off of the capital asset related to this space partially offset by a reduction in the present value of our liability related to this space.

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Note 11 Subsequent Events

Exubera FDA Review Extension

On October 28, 2005, Pfizer and sanofi-aventis announced that the U.S. Food and Drug Administration notified the companies that it is extending its original review period for Exubera® by three months (approximately January 27, 2006) to review additional technical chemistry data.

Aerogen Acquisition

On October 20, 2005 the Company completed its acquisition of Aerogen, Inc. (Aerogen) pursuant to a definitive agreement and plan of merger dated August 12, 2005. Under the terms of the agreement we elected to pay cash for Aerogen, Inc. The purchase price consisted of cash paid of $32 million, plus expenses associated with the transaction and any liabilities incurred by the Company resulting from the transaction. The Company has engaged an independent valuation team to assist in determining the fair value of the respective Aerogen assets, and the allocation of the purchase price to those respective assets.

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 under the heading Risk Factors at the end of this section.

Overview

Our business is to create high value products through the application of advanced drug delivery. We have three drug delivery technology platforms that are designed to improve the performance of molecules. These platforms are: Nektar Advanced PEGylation Technology, Nektar Pulmonary Technology, and Nektar Supercritical Fluid (SCF) Technology.

Our mission is to develop superior therapeutics to make a difference in patients lives. We pursue our mission in two ways. First, we partner with pharmaceutical and biotechnology companies that seek to improve and differentiate their products. In addition, we are in the early-stages of development of our own proprietary products. We are working to become one of the world s leading drug delivery products companies.

To date, the revenues we have received from the sales of our products and in connection with our collaborative arrangements have been insufficient to meet our operating and other expenses. The development of a successful product is dependent upon several factors that are outside of our control. These include, among other things, the need to obtain regulatory approval to market these products and our dependence upon our

collaborative partners. As a result of these or other risks, potential products for which we have invested substantial amounts in research and development may never produce revenues or income.

We have generally been compensated for research and development expenses during initial feasibility work performed under collaborative arrangements for all three of our technologies: Nektar Advanced PEGylation Technology, Nektar Pulmonary Technology, and Nektar Supercritical Fluid Technology. Prior to commercialization of pulmonary delivery and Advanced PEGylation products, we receive revenues from our partners for partial or full funding of research and development activities and progress payments upon achievement of certain developmental milestones. In a typical Advanced PEGylation Technology collaboration, we manufacture and supply the polyethylene glycol (PEG) reagents and receive manufacturing revenues and possible royalties from sales of the commercial product. In a typical Pulmonary Technology collaboration, our partner will provide the active pharmaceutical ingredient (the majority of which are already approved by the FDA in another delivery form), fund clinical and formulation development, obtain regulatory approvals, and market the resulting commercial product. We may manufacture and supply the drug delivery approach or drug formulation, and may receive revenues from drug manufacturing, as well as royalties from sales of most commercial products. In addition, for products using our Pulmonary Technology, we may receive revenues from the supply of our device for the product along with revenues for any applicable drug processing or filling. In addition to our partner-funded programs, we are applying our technologies independently through internal proprietary product development efforts. To achieve and sustain profitable operations, we, alone or with others, must successfully develop, obtain regulatory approval for, manufacture, introduce, market, and sell products using our drug delivery and other drug delivery systems. There can be no assurance that we can generate sufficient product or contract research revenue to become profitable or to sustain profitability.

To fund the substantial expense related to 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, 2005, we had approximately $417.7 million in long-term convertible subordinated notes, $20.4 million in non-current capital lease obligations, and $11.4 million in other long-term debt. Our ability to meet the repayment obligations of this debt is dependent upon our ability to develop successful products without significant delays. Even if we are successful in this regard, we may require additional capital to repay our debt obligations.

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We do not expect that sales of our currently marketed products will be sufficient for us to achieve profitability. Our ability to achieve profitability is dependent on the approval of and successful marketing of products with significant markets, and for which we realize relatively higher royalties.

Recent Developments

On July 12, 2005, a complaint was filed by The Board of Trustees of the University of Alabama (UAH) against Nektar Therapeutics AL, Corporation, and Nektar Therapeutics (Defendants) in the United States District Court for the Northern District of Alabama. Among other things, the complaint alleges patent infringement, breach of contract license, violation of the Alabama Trade Secrets Act and unjust enrichment. Generally, the complaint alleges that Defendants refusal to pay royalties based upon UAH patented and licensed technology represents a breach of an exclusive license agreement between UAH and Nektar Therapeutics AL, Corporation (formerly Shearwater Corporation) and that Defendants have infringed and are infringing UAH s patent. On August 3, 2005, UAH amended its complaint to add J. Milton Harris, a Nektar employee, as a party to the litigation, add certain additional claims, seek declaratory judgment on patents assigned to Defendants, and seek compensatory, treble and punitive damages, all in unspecified amounts. Defendants have served UAH with answers to the complaint denying any wrongdoing. Following submission of these answers to UAH, Defendants filed a counter-claim seeking a refund of patent royalties that Defendants allege were erroneously paid to UAH. The parties are currently in the process of scheduling the litigation calendar. The litigation is at too early a stage to make an assessment about the probability of the outcome in the case. We intend to vigorously defend ourselves in this litigation.

On September 8, 2005 a U.S. Food and Drug Administration (FDA) advisory committee panel recommended the approval of Exubera® (insulin[rDNA] powder for oral inhalation), for the treatment of adults with type 1 and type 2 diabetes. The FDA is not obligated to follow the recommendation of the advisory committee.

On September 29, 2005 we announced an agreement with subsidiaries of Baxter International Inc. to develop PEGylated therapeutic forms of blood clotting proteins for patients with hemophilia, in order to reduce the frequency of injections required to treat blood clotting disorders such as hemophilia A. Baxter will be responsible for the development and commercialization of products and we will be responsible for the technology development used in the products including the provision of clinical and commercial PEG reagents. Under the terms of the agreement, we will receive milestone payments, funding of R&D, and manufacturing revenues during research, clinical development, and commercialization. In addition, we will receive royalties on end product sales.

On September 29, 2005 we announced that we are developing an inhaled amphotericin B product for preventing fatal pulmonary fungal infections in immunosuppressed patients to reduce the incidence, morbidity, mortality and high cost of treating these infections. Using a small proprietary pocket size product, we have conducted two Phase I trials and have long-term toxicity studies underway to support the planned pivotal trials.

On September 29, 2005 we also announced that we are developing Inhaled ICU antibiotics for the prevention of ventilator-associated pneumonia (VAP) in the intensive care unit. VAP is a form of hospital-acquired, or nosocomial pneumonia, occurring in patients on mechanical ventilators. Our novel drug-device system uses a nebulizer and proprietary adapter technology, along with a unique formulation of liquid antibiotics, to target the lungs directly with preventative doses of medicine in a ventilated patient. The product is designed to work with a full range of ventilator types and settings making it easy-to-use for hospital practitioners. A proof-of- principle study sponsored by us demonstrated that aerosolized antibiotics reduces the persistence of VAP after its onset by approximately half as compared to placebo. We expect to initiate a Phase II dose confirmation study in mid-2006.

On October 5, 2005 we announced the initiation of clinical testing in the Phase III program evaluating tobramycin inhalation powder (TIP), an investigational inhaled antibiotic being developed in collaboration with Chiron. The TIP Phase III program includes two clinical trials and will evaluate the efficacy and safety of TIP in the treatment of lung infections caused by Pseudomonas aeruginosa in patients living with cystic fibrosis (CF). The first trial, called ASPIRE I, is currently underway.

On October 13, 2005 the Committee for Medicinal Products for Human Use (CHMP) of the European Medicines Evaluation Agency (EMEA) recommended approval of Exubera® (insulin human), for the treatment of type 1 and type 2 diabetes. The proposed therapeutic indication for Exubera is for the treatment of adult patients with type 2 diabetes mellitus not adequately controlled with oral antidiabetic agents and requiring insulin therapy; and for the treatment of adult patients with type 1 diabetes mellitus, in addition to long or intermediate acting subcutaneous insulin, for whom the potential benefits of adding inhaled insulin outweigh the potential safety concerns.

On October 20, 2005 the Company completed its acquisition of Aerogen, Inc. (Aerogen) pursuant to a definitive agreement and plan of merger dated August 12, 2005. Under the terms of the agreement we elected to pay cash for Aerogen. The total purchase price for the transaction will consist of cash of $32 million, plus expenses associated with the transaction and any liabilities incurred by us resulting from the transaction. We believe that the acquisition of Aerogen will broaden our pulmonary technology base and strengthen capabilities for treatment in the acute care setting. We expect the valuation to be completed in November 2005, and that a significant portion of the purchase price will be assigned to in process research and development and other intangible assets. We anticipate that a substantial amount of the in process research and development and other intangibles assigned to the purchase prices will be expensed in the period ending December 31, 2005.

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Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (FASB) released Statement of Financial Accounting Standard (SFAS) No. 154, *Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3,* (FAS 154). FAS 154 requires retrospective application to prior periods financial statements for any change in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The statement defines retrospective application as the application of a different accounting principle to prior accounting periods as if that principle had always been used or as the adjustment of previously issued financial statements to reflect a change in the reporting entity. The statement also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. The statement carries forward without change the guidance contained in Opinion 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. We will be required to adopt FAS 154 for any accounting changes or corrections of errors on or after January 1, 2006. We do not expect the adoption of FAS 154 to have a material impact on our consolidated financial position, results of operations, or cash flows.

In March 2005, the SEC released Staff Accounting Bulletin (SAB) 107, Share Based Payment SAB 107 provides the SEC staff position regarding the application of SFAS No. 123R. SAB 107 contains interpretative guidance related to the interaction between SFAS No. 123R and certain SEC rules and regulations, as well as provides the Staff s views regarding the valuation of share-based payment arrangements for public companies. SAB 107 also highlights the importance of disclosures made related to the accounting for share-based payment transactions. We are currently reviewing the effect of SAB 107 on our condensed consolidated financial statements as it prepares to adopt SFAS 123R.

In December 2004, the FASB released a revision to SFAS No. 123, *Accounting for Stock-Based Compensation* (FAS 123R). FAS 123R addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. The statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees, and generally would require instead that such transactions be accounted for using a fair-value-based method. We will be required to adopt FAS 123R on January 1, 2006. When we adopt the new statement, we will have to recognize substantially more compensation expense. This will have a material adverse impact on our financial position and results of operations. We are currently in the process of evaluating the effect of adopting FAS 123R.

In November 2004, the FASB released SFAS No. 151, *Inventory Costs An Amendment to ARB No. 43* (FAS 151). This Statement amends the guidance in ARB No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal as defined by ARB No. 43, Chapter 4, *Inventory Pricing*. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. We will be required to adopt SFAS No. 151 on January 1, 2006. We are currently in the process of evaluating the effect of adopting SFAS No. 151.

Restatement

Certain amounts reported in our Quarterly Reports on Form 10-Q for the three-month and nine-month periods ended September 30, 2004 have been restated to correct for certain misapplications of our accounting policies under U.S. GAAP.

Specifically, we have reclassified approximately $2.9 million and $8.4 million for the three-month and nine-month periods ended September 30, 2004, respectively, from research and development expenses to general and administrative expenses. This reclassification included legal expenses related to our intellectual property portfolio and a portion of finance, information systems, and human resource expenses that were not clearly related to research and development and are required to be classified outside of research and development expenses under Statement Financial Accounting Standards No. 2, *Accounting for Research and Development Costs*.

In addition, we reclassified approximately $0.2 million and $0.7 million for the three-month and nine-month periods ended September 30, 2004 from general and administrative expenses to interest expense. This reclassification was made to record the amortization of debt issuance costs to interest expense as required under Accounting Principles Board No. 21, *Interest on Receivables and Payables* and EITF 86-15, *Increasing-Rate Debt*.

These reclassifications did not result in any change to our cash position, revenue, or net loss during the three-month or nine-month periods ended September 30, 2004.

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Results of Operations

Three-Month and Nine-Month Periods Ended September 30, 2005 and 2004:

Revenue (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Increase/ Decrease 2005 vs 2004
Contract revenue	$ 23,657	$ 23,556	$ 101	0%
Product and royalty revenue	8,450	4,990	3,460	69%
Exubera® commercialization readiness revenue	4,247		4,247	N/A
Total revenue	$ 36,354	$ 28,546	$ 7,808	27%

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Contract revenue	$ 62,737	$ 67,167	$ (4,430)	(7)%
Product and royalty revenue	20,313	15,737	4,576	29%
Exubera® commercialization readiness revenue	10,348		10,348	N/A
Total revenue	$ 93,398	$ 82,904	$ 10,494	13%

Contract research revenue includes reimbursed research and development expenses as well as the amortization of deferred up-front signing and milestone payments received from our collaborative partners. Contract revenues are expected to fluctuate from year to year, and future contract revenue is difficult to predict accurately. The level of contract revenues depends in part upon future success in obtaining feasibility studies, the continuation of existing collaborations, and achievement of milestones under current and future agreements. Contract research revenue for the three-month period ended September 30, 2005 was approximately $23.7 million compared to $23.6 million for the three-month period ended September 30, 2004. Contract research revenue for the nine-month period ended September 30, 2005, was approximately $62.7 million compared to approximately $67.2 million for the nine-month period ended September 30, 2004, The decrease in contract research revenue for the nine-month period ended September 30, 2005 was primarily due to reduced contract research revenue related to Exubera®. In addition, during the nine month period ended September 30, 2004, we recognized $2.1 million in revenue from a one-time payment related to Aventis termination of a collaboration with us.

Product pricing is generally determined on a cost plus basis and is dependent on the manufacturing agreement specific to each partner. Product and royalty revenue for the three-month period ended September 30, 2005 was approximately $8.5 million compared to approximately $5.0 million for the three-month period ended September 30, 2004, reflecting an increase of approximately $3.5 million or 69%. The increase was primarily due to increased product revenue of $1.6 million and increased royalty revenue of $1.9 million. Product and royalty revenue for the nine-month period ended September 30, 2005, was approximately $20.3 million compared to approximately $15.7 million for the nine-month

period ended September 30, 2004. The 29% increase was primarily due to increased product revenue of $1.8 and increased royalty revenue of $2.8 million.

Exubera® commercialization readiness revenue represents reimbursement, by Pfizer, of certain agreed upon operating costs relating to our Exubera® drug powder manufacturing facilities in preparation for commercial production, plus a markup on such costs. Such reimbursable revenue will not necessarily equal actual costs incurred and expensed as Exubera® commercialization readiness costs.

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Cost of Goods Sold (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Increase/ Decrease 2005 vs 2004
Cost of goods sold	$ 6,125	$ 4,477	$ 1,648	37%
Product and royalty gross margin	$ 2,325	$ 513	$ 1,812	353%

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Cost of goods sold	$ 16,813	$ 13,746	$ 3,067	22%
Product and royalty gross margin	$ 3,500	$ 1,991	$ 1,509	76%

Cost of goods sold is associated with product sales and royalties and was approximately $6.1 million for the three-month period ended September 30, 2005 based on product and royalty revenue of approximately $8.5 million, representing a gross margin of approximately 28%. Cost of goods sold for the three-month period ended September 30, 2004 was approximately $4.5 million based on product and royalty revenue of approximately $5.0 million, representing a gross margin of approximately 10%. The increase in gross margins is primarily due to increased royalty revenues which yield incrementally greater gross margins.

Cost of goods sold was approximately $16.8 million for the nine-month period ended September 30, 2005 based on product and royalty revenue of approximately $20.3 million, representing a gross margin of approximately 17%. Cost of goods sold for the nine-month period ended September 30, 2004 was approximately $13.7 million based on product and royalty revenue of approximately $15.7 million, representing a gross margin of approximately 13%. The increase in gross margins is primarily due to increased royalty revenues which yield incrementally greater gross margins.

Exubera® commercialization readiness costs (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Exubera® commercialization readiness costs	$ 3,075	$	$ 3,075	N/A

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Exubera® commercialization readiness costs	$ 8,035	$	$ 8,035	N/A

Exubera® commercialization readiness costs are start-up manufacturing costs we have incurred in our Exubera® drug powder manufacturing facility in preparation for commercial production for the three-month and nine-month periods ended September 30, 2005.

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Research and Development Expenses (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Research and development	$ 38,591	$ 34,534	$ 4,057	12%

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Research and development	$ 109,321	$ 99,476	$ 9,845	10%

We expense all research and development expenses as they are incurred. Research and development expenses are associated with three general categories: (i) collaborative agreements under which a portion of spending is reimbursed by our partners; (ii) spending attributed to internally funded programs; and (iii) infrastructure costs.

Research and development expenses were approximately $38.6 million and approximately $34.5 million for the three-month periods ended September 30, 2005 and 2004, respectively. Research and development expenses were approximately $109.3 million and approximately $99.5 million for the nine-month periods ended September 30, 2005 and 2004, respectively. The increase for the three-month period ended September 30, 2005 was primarily due to annual salary increases and increased expenses related to validation testing of our Exubera drug delivery device and outside services related to our proprietary programs. The increase for the nine-month period ended September 30, 2005 was primarily due to annual salary increases, a one time expense of $1.4 million associated with the buy-out of our potential future royalty and milestone obligations with a partner, increased expenses related to validation testing of our Exubera drug delivery device and outside services related to our proprietary programs.

We expect research and development spending to continue to increase over the next few years as we advance our proprietary products.

We have reclassified approximately $2.9 million and $8.4 million for the three-month and nine-month periods ended September 30, 2004, respectively, from research and development expenses to general and administrative expenses. This reclassification included legal expenses related to our intellectual property portfolio and a portion of finance, information systems, and human resource expenses that were not clearly related to research and development and are required to be classified outside of research and development expenses under Statement Financial Accounting Standards No. 2, *Accounting for Research and Development Costs*.

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General and Administrative Expenses (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
General and administrative	$ 10,948	$ 7,382	$ 3,566	48%

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
General and administrative	$ 30,193	$ 22,281	$ 7,912	36%

General and administrative expenses are associated with administrative staffing, business development, and marketing efforts. General and administrative expenses were approximately $10.9 million and approximately $7.4 million for the three-month periods ended September 30, 2005 and 2004, respectively. General and administrative expenses were approximately $30.2 million for the nine-month period ended September 30, 2005 and approximately $22.3 million for the nine-month period ended September 30, 2004. The increase for both the three-month and nine-month periods was primarily due to increased outside legal and patent fees, increased compensation, and outside accounting fees.

We have reclassified approximately $2.9 million and $8.4 million for the three-month and nine-month periods ended September 30, 2004, respectively, from research and development expenses to general and administrative expenses. This reclassification included legal expenses related to our intellectual property portfolio and a portion of finance, information systems, and human resource expenses that were not clearly related to research and development and are required to be classified outside of research and development expenses under Statement Financial Accounting Standards No. 2, *Accounting for Research and Development Costs*.

In addition, we reclassified approximately $0.2 million and $0.7 million for the three-month and nine-month periods ended September 30, 2004 from general and administrative expenses to interest expense. This reclassification was made to record the amortization of debt issuance costs to interest expense as required under Accounting Principles Board No. 21, *Interest on Receivables and Payables* and EITF 86-15, *Increasing-Rate Debt*.

Amortization of Other Intangible Assets (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Amortization of other intangible assets	$ 982	$ 981	$ 1	0%

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Amortization of other intangible assets	$ 2,945	$ 2,944	$ 1	0%

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The components of our other intangible assets at September 30, 2005, are as follows (in thousands, except for years):

	Useful Life in Years	Gross Carrying Amount	Accumulated Amortization	Net
Core technology	5	$ 8,100	$ 6,885	$ 1,215
Developed product technology	5	2,900	2,465	435
Intellectual property	5-7	7,301	6,460	841
Supplier and customer relations	5	5,140	4,556	584
Total		$ 23,441	$ 20,366	$ 3,075

Amortization expense related to other intangible assets totaled $1.1 million ($0.1 million included in cost of sales) for both of the three-month periods ended September 30, 2005 and 2004 and $3.4 million ($0.4 million included in cost of sales) for both the nine-month periods ended September 30, 2005 and 2004. The following table presents expected future amortization expense for other intangible assets until they are fully amortized (in thousands):

Years Ending December 31,	
Remainder of 2005	$ 1,126
2006	1,949
Total	$ 3,075

Loss on Debt Extinguishment (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Loss on debt extinguishment	$ (303)	$	$ (303)	

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Loss on debt extinguishment	$ (303)	$ (9,258)	$ 8,955	(97)%

During the three-month period ended September 30, 2005, we recognized a loss on debt extinguishment of approximately $0.3 million in connection with the retirement of $25.4 million and $45.9 million aggregate principle amount of our outstanding 5% and 3.5% convertible subordinate notes due February 2007 and October 2007, respectively, in cash, in privately negotiated transactions. As a result of the debt

retirement we wrote off approximately $0.1 million and $0.5 million of capitalized debt issuance costs related the 5% and 3.5% convertible subordinated notes, respectively. Prior to the retirement we had outstanding principle balances of $61.4 million and $112.5 million of our 5% and 3.5% convertible subordinated notes, respectively. Our outstanding obligation at September 30, 2005 was $36.1 million for the 5% notes, and $66.6 million for 3.5% notes.

During the nine-month period ended September 30, 2004, we recognized a loss on debt extinguishment of approximately $9.3 million in connection with two privately negotiated transactions to convert our outstanding convertible subordinated notes into shares of our common stock. In January 2004, certain holders of our outstanding 3.5% convertible subordinated notes due October 2007 completed an exchange and cancellation of $9.0 million in aggregate principal amount of the notes for the issuance of 575,605 shares of our common stock in a privately negotiated transaction. In February 2004, certain holders of our outstanding 3% convertible subordinated notes due June 2010 converted approximately $36.0 million in aggregate principal amount of such notes for approximately 3.2 million shares of our common stock and a cash payment of approximately $3.1 million in the aggregate in privately negotiated transactions. As a result of these transactions, we recognized losses on debt extinguishment of approximately $7.8 million and $1.5 million, respectively, in accordance with SFAS No. 84, *Induced Conversions of Convertible Debt.*

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Other Income (Expense) (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Other income (expense)	$ (32)	$ (128)	$ 96	(75)%

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Other income (expense)	$ (1,435)	$ 303	$ (1,738)	(574)%

Other expense was approximately nil and $0.1 million for the three month periods ended September 30, 2005 and 2004, respectively. Other income and expense for the three month periods ended September 30, 2005 and 2004 includes gains and losses from our marketable securities and transactions denominated in foreign currencies of less than $0.1 million. Other expense for the three month period ended September 30, 2004 includes one time charges of less than $0.1 million related to the termination of a building lease, partially offset by a gain from the termination of a real estate partnership in the like amount.

Other expense was $1.4 million for the nine-month period ended September 30, 2005 compared to other income of $0.3 million for the nine-month period ended September 30, 2004. Effective January 11, 2005, Nektar and BMR-201 Industrial Road LLC (landlord), entered into an agreement to terminate our obligation in the Amended and Restated Built-To-Suit Lease dated August 17, 2004 related to 45,574 square feet of space located at our headquarters. In connection with the termination agreement, we have recorded other expense of approximately $1.1 million during the nine-month period ended September 30, 2005. This amount represents the write-off the capital asset related to this space partially offset by a reduction in the present value of our liability related to this space. In addition, other income for the nine-month period ended September 30, 2004 included $0.7 million of income related to our real estate partnership which was dissolved in September 2004.

Interest Income (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Interest income	$ 2,899	$ 1,763	$ 1,136	64%

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Interest income	$ 7,683	$ 4,617	$ 3,066	66%

Interest income was approximately $2.9 million for the three-month period ended September 30, 2005, as compared to approximately $1.8 million for the three-month period ended September 30, 2004. Interest income was approximately $7.7 million for the nine-month period ended September 30, 2005, as compared to approximately $4.6 million for the nine-month period ended September 30, 2004. The increase in interest income for both the three-month and nine-month periods ended September 30, 2005 was primarily due to increases in average daily cash balances as a result of net proceeds of approximately $31.6 million and $196.4 million from the sale of common stock received in August 2005 and September 2004, respectively. In addition, there were higher prevailing interest rates during 2005 compared to 2004.

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Interest Expense (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Interest expense	$ (2,992)	$ (3,259)	$ 267	(8)%

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Interest expense	$ (8,908)	$ (22,603)	$ 13,695	(61)%

Interest expense is primarily related to our outstanding convertible subordinated notes and capital lease obligations. Interest expense was approximately $3.0 million for the three-month period ended September 30, 2005 and $3.3 million for the three-month period ended September 30, 2004. The decrease is primarily due to reductions of our capital lease obligations for the quarter ended September 30, 2005.

Interest expense was approximately $8.9 million and approximately $22.6 million for the nine-month periods ended September 30, 2005 and 2004, respectively. For the nine-month period ended September 30, 2004, interest expense included a payment of approximately $12.7 million in interest made to certain holders of our outstanding 3.0% convertible subordinated notes due June 2010 which completed an exchange of $169.3 million in aggregate principal amount of the notes held by such holders for the issuance of approximately 14.9 million shares of our common stock. The remaining decrease of $0.9 million in the nine-month period ended September 30, 2005 is primarily due to reductions in our capital lease obligations.

We expect interest expense to increase in future periods as a result of our $315.0 million convertible subordinated notes issued in September 2005. We have reclassified approximately $0.2 million and $0.7 million for the three-month and nine-month periods ended September 30, 2004 from general and administrative expenses to interest expense. This reclassification was made to record the amortization of debt issuance costs to interest expense as required under Accounting Principles Board No. 21, *Interest on Receivables and Payables* and EITF 86-15, *Increasing-Rate Debt*.

Benefit (Provision) for Income Taxes (in thousands except percentages)

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ Decrease 2005 vs 2004	Percentage Increase/ Decrease 2005 vs 2004
Benefit (provision) for income taxes	$	$	$	N/A

	Nine Months Ended	Nine Months Ended	Increase/ Decrease	Percentage Increase/

	September 30, 2005	September 30, 2004	2005 vs 2004	Decrease 2005 vs 2004
Benefit (provision) for income taxes	$	$ (132)	$ 132	N/A

We account for federal income taxes under SFAS No. 109, *Accounting for Income Taxes*. Under SFAS No. 109, the liability method is used in accounting for income taxes. 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, if any, the timing and amount of which are uncertain. Because of our lack of earnings history, the net deferred tax assets for our operations outside of Alabama have been fully offset by a valuation allowance.

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Liquidity and Capital Resources

We have financed our operations primarily through public and private placements of our debt and equity securities, revenue from development contracts, product sales and short-term research and feasibility agreements, financing of equipment acquisitions and tenant improvements, and interest income earned on our investments of cash. At September 30, 2005 we had cash, cash equivalents, and short-term investments of approximately $620.3 million.

At September 30, 2005 and December 31, 2004, we had outstanding letters of credit totaling $2.2 million in connection with arrangements with certain vendors, including our landlord, which are secured by investments in similar amounts.

Our operations used cash of $61.9 million for the nine-month period ended September 30, 2005 as compared to cash used of $70.7 million for the nine-month period ended September 30, 2004. During the nine-month period ended September 30, 2005, cash used in operations was primarily due to a net loss of $76.9 million partially offset by depreciation and amortization of $18.8 million. During the nine-month period ended September 30, 2004, cash used in operations was primarily due to a net loss of $82.6 million partially offset by depreciation and amortization of $13.7 million.

Cash provided by investing activities was $112.2 million for the nine-month period ended September 30, 2005 as compared to cash used of $147.7 million for the nine-month period ended September 30, 2004. Purchases, sales and maturities of short term investments, net, for the nine-month period ended September 30, 2005 provided approximately $123.4 million, compared to the nine-month period ended September 30, 2004 in which we used $162.4 million. We purchased property and equipment of approximately $11.3 million and $20.3 million during the nine-month periods ended September 30, 2005 and 2004, respectively. The decrease in purchased property and equipment of $9.0 million was primarily due to the expansion of our facility in Alabama, which was substantially completed during the year ended December 31, 2004. In the nine-month period ended September 30, 2004 we received a one time distribution from the termination of a partnership which provided $22.5 million.

Cash flows provided by financing activities were $274.8 million for the nine-month period ended September 30, 2005 compared to cash provided of $200.4 million for the nine-month period ended September 30, 2004. During the nine-month period ended September 30, 2005 cash provided by financing activities was primarily due to the sale of approximately 1.9 million shares of our common stock in August and September 2005 at an average price of $16.95 per common share for proceeds of approximately $31.6 million, net of issuance costs, and net proceeds of $305.6 million from the sale of our 3.25% convertible subordinated notes in September 2005. During the nine-month period ended September 30, 2005, we used approximately $25.5 million and $45.5 million to retire a portion of our outstanding 5% and 3.25% convertible subordinated notes, respectively. During the nine-month period ended September 30, 2004, cash provided by financing activities was primarily due to the sale of 9.5 million shares of our common stock in March 2004 at a price of $20.71 per common share for proceeds of approximately $196.4 million, net of issuance costs. In addition, cash received from employee exercises of stock options totaled $9.0 million and $8.8 million for the nine-month periods ended September 30, 2005 and 2004, respectively. Cash used to pay down loans and capital lease obligations was $1.7 million and $9.4 million in the nine-month periods ended September 30, 2005 and 2004 respectively.

In August 2005, we entered into a Common Stock Purchase Agreement with an institutional investor in which we sold approximately 1.9 million shares of our common stock at an average price of $16.95 per common share for proceeds of approximately $31.6 million, net of issuance costs. The proceeds were used to acquire Aerogen, Inc.

In September 2005, we completed the sale of $315.0 million aggregate principle amount of our 3.25% convertible subordinated notes due 2012. The associated costs of the financing was approximately $9.4 million. The notes bear interest at a rate of 3.25% per annum and will be converted into shares of our common stock at an initial conversion rate of 46.4727 per $1000 principle amount of notes which is equivalent to an initial conversion price of approximately $21.52 per share.

In September 2005, the Company used cash of $71.0 million to retire $25.4 million and $45.9 million aggregate principle amount of our outstanding 5% and 3.5% convertible subordinated notes due February 2007 and October 2007, in privately negotiated transactions. We recorded a loss on the early extinguishment of debt in the nine month period ended September 30, 2005 of approximately $0.3 million.

In April 2004, we called for redemption of all of our outstanding 6 3/4% convertible subordinated notes due October 2006. Holders of all but $10,000 in principal amount converted their notes prior to the redemption date, resulting in the issuance of approximately 0.5 million shares of our common stock. We redeemed the $10,000 in principal amount not converted into equity for cash in the amount of $10,000. The aggregate amount of notes converted was approximately $7.8 million.

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In March 2004, we entered into an underwriting agreement with Lehman Brothers Inc. pursuant to which we sold 9.5 million shares of our common stock at a price of $20.71 per common share for proceeds of approximately $196.4 million, net of issuance costs. The proceeds are to be used for general corporate purposes, which may include:

- investing in or accelerating various product development programs, including Exubera®;
- undertaking potential acquisitions;
- developing technologies; and
- retiring our outstanding debt.

In March 2004, we called for the full redemption of our outstanding 3% convertible subordinated notes due June 2010. The aggregate principal amount outstanding of the notes at the time of the call for redemption was $133.3 million, all of which was converted into approximately 11.7 million shares of common stock prior to the redemption date. In connection with the conversion, we agreed to pay $75.00 per $1,000 of the notes to be converted, for an aggregate payment of approximately $10.0 million. This payment was recorded as interest expense.

In February 2004, certain holders of our outstanding 3% convertible subordinated notes due June 2010 converted approximately $36.0 million in aggregate principal amount of such notes into approximately 3.2 million shares of our common stock and a cash payment of approximately $3.1 million in the aggregate in privately negotiated transactions.

In January 2004, certain holders of our outstanding 3.5% convertible subordinated notes due October 2007 completed an exchange and cancellation of $9.0 million in aggregate principal amount of the notes for the issuance of approximately 0.6 million shares of our common stock in a privately negotiated transaction.

As a result of the transactions related to convertible subordinated debt during the nine-month period ended September 30, 2005, our total contractual obligation with regard to convertible subordinated debt has increased from $173.9 million at December 31, 2004 to $417.7 million at September 30, 2005. Aggregate principal amount of $102.7 million and $315.0 million of our outstanding convertible subordinated debt as of September 30, 2005 will mature in 2007 and 2012, respectively.

The following summarizes our outstanding convertible subordinated debt as of September 2005:

Class	Maturity	Amount Outstanding	Conversion Price
5%	February 2007	$ 36.1 million	$ 38.36
3.5%	October 2007	$ 66.6 million	$ 50.46
3.25%	September 2012	$ 315.0 million	$ 21.52

Given our current cash requirements, we forecast that we will have sufficient cash to meet our net operating expense requirements through at least the end of 2007. We plan to continue to invest in our growth and the need for cash will be dependent upon the timing of these investments. Our capital needs will depend on many factors, including continued progress in our research and development arrangements, progress with preclinical and clinical trials of our proprietary and partnered products, the time and costs involved in obtaining regulatory approvals, the costs of developing and scaling up manufacturing operations of our technologies, the timing and cost of our clinical and commercial production facilities, the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims, the need to acquire licenses to new technologies, and the status of competitive products. To date we have been primarily dependent upon equity and convertible debt financings for capital and have incurred substantial debt as a result of our issuances of subordinated notes and debentures that are convertible into our common stock. Our substantial debt, the market price of our securities, and the general economic climate, among other factors, could have material consequences for our financial position and could affect our sources of short-term and long-term funding. There can be no assurance that additional funds, if and when required, will be available to us on favorable terms, if at all.

Issuer Purchases of Equity Securities

There were no purchases of any class of our equity securities by us or any affiliate pursuant to any publicly announced repurchase plan in the three-month or nine-month periods ended September 30, 2005.

In September 2005, the Company retired $25.4 million and $45.9 million aggregate principle amount of our outstanding 5% and 3.5% convertible subordinate notes due February 2007 and October 2007, respectively, in cash, in privately negotiated transactions.

Approval of Non-Audit Services

During the three-month and nine-month periods ended September 30, 2005, the Audit Committee of the Board of Directors approved $134,291 and $235,291, respectively, for non audit related services provided by Ernst & Young LLP, our independent registered public accounting firm.

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RISK FACTORS

The following section should be read carefully in connection with evaluating our business. Any of the following factors could materially and adversely affect our business, financial position, or results of operations.

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

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

- synthesize active pharmaceutical ingredients to be used as medicines;
- design and conduct large scale clinical studies;
- prepare and file documents necessary to obtain government approval to sell a given drug product; and/or
- market and sell our products when and if they are approved.

Reliance on collaborative relationships poses a number of risks, including:

- the potential inability to control whether and the extent to which our collaborative partners will devote sufficient resources to our programs or products;
- disputes which may arise in the future with respect to the ownership of rights to technology and/or intellectual property developed with collaborative partners;
- disagreements with collaborative partners which could lead to delays in or termination of the research, development or commercialization of product candidates, or result in litigation or arbitration;
- the potential for contracts with our collaborative partners to fail to provide significant protection or to be effectively enforced if one of these partners fails to perform. Collaborative partners have considerable discretion in electing whether to pursue the development of any additional products and may pursue alternative technologies or products either on their own or in collaboration with our competitors;
- the potential for collaborative partners with marketing rights to choose to devote fewer resources to the marketing of our products than they do to products of their own development;

risks related to the ability of our collaborative partners to pay us; and

the potential for collaborative partners to terminate their agreements with us unilaterally for any or no reason.

Given these risks, there is a great deal of uncertainty regarding the success of our current and future collaborative efforts.

We have entered into collaborations in the past that have been subsequently terminated. If other collaborations are suspended or terminated, our ability to commercialize certain other proposed products could also be negatively impacted. If our collaborations fail, our product development or commercialization of products could be delayed and our financial position and results of operations would be significantly harmed.

If the FDA does not timely approve the NDA filed for Exubera®, if the EMEA does not timely approve a marketing authorization application for Exubera®, or if our collaboration with Pfizer is discontinued prior to the commercial launch of Exubera®, then our financial position and results of operations will be significantly harmed.

We are developing with Pfizer an inhaleable version of insulin, Exubera®, for the treatment of Type 1 and Type 2 diabetes that will be administered using our Pulmonary Technology. Exubera® is currently in extended Phase III clinical trials. We currently depend on Pfizer as the source of a significant portion of our revenues. For the three-month periods ended September 30, 2005 and 2004, revenue from Pfizer accounted for approximately 71% and approximately 59% of our total revenue, respectively. For the nine-

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month periods ended September 30, 2005 and 2004, revenue from Pfizer accounted for approximately 68% and approximately 59% of our total revenue, respectively. On September 8, 2005, Pfizer and Sanofi-Aventis jointly announced that the FDA Advisory Committee recommended approval of Exubera. However, the FDA is not obligated to follow the recommendation of the Advisory Committee. On October 13, 2005, the CHMP of the European Medicines Evaluation Agency (EMEA) recommended approval of Exubera for the treatment of Type 1 and Type 2 diabetes. The EMEA is also not obligated to follow recommendation of the CHMP. There can be no assurance that Exubera® will be approved for marketing and/or commercial use in the U.S. or E.U. Among the factors that may delay the approval of the NDA, to market Exubera® in the U.S., the approval by the EMEA to market Exubera® in the E.U., or the commercial launch of Exubera® in the U.S. or the E.U., or that may impact a decision to proceed at all with respect to any of the foregoing, are the following:

- Pfizer is currently conducting studies to generate controlled long-term safety data with respect to Exubera®, in particular its effect on lung function, and the results of the studies may impact regulatory approvals and product labeling.

- We and/or Pfizer may experience difficulties with respect to the processing of the dry powder formulation of inhaleable insulin and the filling and packaging of the inhaleable insulin powder for the large-scale commercial production of Exubera®.

- We, with our contract manufacturers, may experience difficulties with respect to the production of the pulmonary inhaler device for Exubera®, including the design, scale-up and automation of the commercial manufacture of the pulmonary inhaler device for Exubera®, and any such difficulties may delay the filing and approval of the NDA or the approval to market in the E.U. Our contract manufacturers may also experience difficulties with respect to manufacturing the device in high volumes for commercial use.

- Pfizer may elect for marketing or other reasons, to delay or not proceed with the commercial launch of Exubera®, once approved.

If the approval by the FDA of the NDA is substantially delayed beyond the internal estimates we have made for purposes of budgeting and resource allocation, we may not have the financial ability to continue supporting the Exubera® program or be able to meet our contractual obligations relating to the commercial launch of Exubera®. In the event of any such delay, we may also elect to divert resources away from Exubera® related activities or otherwise reduce our activities relating to the Exubera® program. Any material delay in receiving regulatory approval (which in some countries includes pricing approval), or failure to receive regulatory approval for Exubera® at all, would affect our contract research revenue from Pfizer, may result in the payment by us of substantial reimbursements to the contract manufacturers of our proprietary inhaler device with respect to the capital they have deployed in support of such activity, and would significantly harm our financial position and results of operations. Furthermore, should the collaboration with Pfizer be discontinued, our financial position and results of operations will be significantly harmed.

In December 2004, Aventis, Pfizer s partner with respect to the manufacture, co-development, and co-marketing of Exubera®, announced that its stockholders had approved all resolutions relating to the proposed merger with and into Sanofi. As a consequence of the merger, the agreement by and between Pfizer and Sanofi-Aventis is being challenged and is the subject of litigation. Although we are not a party to this litigation, any disruption or delays to the Exubera® program could adversely affect the ability to market this product if and when it is approved for use, which would materially and adversely impact our business.

If we fail to establish future successful collaborative relationships, then our financial results may suffer and our product development efforts may be delayed or unsuccessful.

We intend to seek future collaborative relationships with pharmaceutical and biotechnology partners to fund some of our research and development expenses and to develop and commercialize potential products. Further, we anticipate that the timing of drug development programs under existing collaborative agreements with our partners will continue to affect our revenues from such agreements. We may not be able to negotiate acceptable collaborative arrangements in the future, and any arrangements we do negotiate may not be successful. If we fail to establish additional collaborative relationships, we will be required to undertake research, development, marketing, and manufacturing of our proposed products at our own expense or discontinue or reduce these activities.

Our increasing investment in the development and commercialization of new products prior to seeking collaborative arrangements may be unsuccessful and adversely impact our operating results, financial condition, and liquidity.

We intend to fund significant development expenses associated with the development and commercialization of new products, including clinical trials, developed through our Proprietary Products Group prior to seeking collaborative relationships with pharmaceutical and biotechnology partners. While we believe this strategy may result in improved economics for any products ultimately developed and approved, it will require us to invest significant funds in developing these products without reimbursement from a collaborative partner. If we are ultimately not able to negotiate acceptable collaborative arrangements with respect to these products, or any arrangements we do negotiate are not successful, we will not receive an adequate return on these investments and our

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operating results and financial condition would suffer. Even if our development efforts are ultimately acceptable, our increased investment in the development of these products could adversely impact our results of operations and liquidity prior to their commercialization.

We may not be successful in conducting human clinical trials for products developed by our Proprietary Products Group.

Historically, we have engaged in drug development in partnership with larger pharmaceutical and biotechnology companies. Those companies typically have been responsible for designing and conducting human clinical trials and obtaining regulatory approvals. We have begun, and intend in the future, to develop certain drugs, including designing and conducting human clinical trials for such drugs, without the assistance of such pharmaceutical and biotechnology partners. We have limited experience in designing and conducting human clinical trials and obtaining regulatory approvals, and may not be successful in those endeavors.

If our drug delivery technologies are not commercially feasible, then our revenues and results of operations will be impacted negatively.

We are in an early stage of development with respect to most of our products. There is a risk that our technologies will not be commercially feasible. Even if our technologies are commercially feasible, they may not be commercially accepted across a range of large and small molecule drugs. None of the products using our Pulmonary Technology has been approved for use. Although our Advanced PEGylation Technology has been incorporated in seven products, most of the products incorporating this technology are still in clinical trials. Our Supercritical Fluid Technology is primarily in an early stage of feasibility testing. Our potential products require extensive research, development, and preclinical and clinical testing. Our potential products also may involve lengthy regulatory reviews and require regulatory approval before they can be sold. We do not know if, and cannot provide assurance that, any of our potential products will prove to be safe and effective, accomplish the objectives that we or our collaborative partners are seeking through the use of our technologies, meet regulatory standards or continue to meet such standards if already approved. There is a risk that we, or our collaborative partners, may not be able to produce any of our potential products in commercial quantities at acceptable costs, or market them successfully. Failure to achieve commercial feasibility, demonstrate safety, achieve clinical efficacy, obtain regulatory approval for, or successfully market products will negatively impact our revenues and results of operations.

If our research and development efforts are delayed or unsuccessful, then we will experience delay or be unsuccessful in having our products commercialized, and our business will suffer.

Except for products using our Advanced PEGylation Technology that have already been approved by the FDA or other regulatory agencies, our product candidates are still 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 this testing, and failure can occur at any stage in the process. Success in preclinical testing and early clinical trials does not ensure that later clinical trials will be successful. A number of companies in the pharmaceutical and biotechnology industries have suffered significant setbacks in later stage clinical trials, even after promising results in earlier trials.

Any clinical trial may fail to produce results satisfactory to us, our collaborative partners, the FDA, or other regulatory authorities. Preclinical and clinical data can be interpreted in different ways, which could delay, limit, or prevent regulatory approval or commercialization. Negative or inconclusive results or adverse medical events during a clinical trial could cause a clinical trial to be repeated or a program to be terminated. We typically rely on collaborative partners and third-party clinical investigators to conduct clinical trials of our products and, as a result, we may face additional delaying factors outside our control.

We do not know if any of our research and development efforts, including preclinical testing or clinical trials, will adhere to our planned schedules or be completed on a timely basis or at all. Typically, there is a high rate of attrition for product candidates in preclinical and clinical trials.

If our drug delivery technologies do not satisfy certain basic feasibility requirements such as total system efficiency, then our products may not be competitive.

We may not be able to achieve the total system efficiency for products based on our Pulmonary Technology that is needed to be competitive with alternative routes of delivery or formulation technologies. We determine total system efficiency by the amount of drug loss during manufacture, in the delivery system, and in reaching the ultimate site at which the drug exhibits its activity. We would not consider a drug to be a good candidate for development and commercialization using our Pulmonary Technology if drug loss is excessive at any one stage or cumulatively in the manufacturing and delivery process.

Our ability to efficiently attach PEG polymer chains to a drug molecule is the initial screen for determining whether drug formulations using our Advanced PEGylation Technology are commercially feasible. We would not consider a drug formulation to be a good candidate for development and commercialization using our Advanced PEGylation Technology if we could not efficiently attach a PEG polymer chain to such drug to result in an efficacious drug.

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For our Supercritical Fluid Technology, solubility characteristics of a drug and the solvents, which may be incorporated in the manufacturing process, provide the initial screen for whether drug formulations using this technology are commercially feasible. We would not consider a drug to be a good candidate for this technology if its solubility characteristics were such that the application of our technology results in very low efficiency in manufacturing of drug powders.

If our drug formulations are not stable, then we will not be able to develop or commercialize products.

We may not be able to identify and produce powdered or other formulations of drugs that retain the physical and chemical properties needed to work effectively with our inhaler devices for deep lung delivery using our Pulmonary Technology, or through other methods of drug delivery using our Advanced PEGylation or Supercritical Fluid Technologies. Formulation stability is the physical and chemical stability of the drug over time and under various storage, shipping, and usage conditions. Formulation stability will vary with each drug formulation and the type and amount of ingredients that are used in the formulation. Since our drug formulation technology is new and largely unproven, we do not know if our drug formulations will retain the needed physical and chemical properties and performance of the drugs. Problems with formulated drug powder stability in particular would negatively impact our ability to develop products based on our Pulmonary Technology or Supercritical Fluid Technology, or obtain regulatory approval for or market such products.

If our drug delivery technologies are not safe, then regulatory approval of our (or our partners) products may not be obtained, or our (or our partners) products may not be developed or marketed of our (or our partners) products may be suspended following commercialization.

We, or our collaborative partners, may not be able to prove that potential products using our drug delivery technologies are safe. Our products require lengthy laboratory, animal and human testing. We cannot be certain that these products, and our technology that developed these products, are safe or will not produce unacceptable adverse side effects. The safety of our formulations will vary with each drug and the ingredients used in our formulation. If any product is found not to be safe, the product will not be approved for marketing or commercialization. In addition, even if a product is approved and commercialized, regulatory authorities could still later suspend or terminate the license to market the product if it is determined that the product does not meet safety or other standards.

If product liability lawsuits are brought against us, we may incur substantial liabilities.

The manufacture, testing, marketing, and sale of medical products entail an inherent risk of product liability. If product liability costs exceed our liability insurance coverage, we may incur substantial liabilities. Whether or not we were ultimately successful in product liability litigation, such litigation would consume substantial amounts of our financial and managerial resources, and might result in adverse publicity, all of which would impair our business. We may not be able to maintain our clinical trial insurance or product liability insurance at an acceptable cost, if at all, and this insurance may not provide adequate coverage against potential claims or losses.

If the products using our Pulmonary Technology do not provide consistent doses of medicine, then we will not be able to develop, and we or our partners will not be able to obtain regulatory approval for and commercialize products.

We may not be able to provide reproducible dosing of stable formulations of drug compounds. Reproducible dosing is the ability to deliver a consistent and predictable amount of drug into the bloodstream over time both for a single patient and across patient groups. Reproducible

dosing of drugs based on our Pulmonary Technology requires the development of:

- an inhalation or other device that consistently delivers predictable amounts of dry powder to the deep lung;
- accurate unit dose packaging of dry powder; and
- moisture resistant packaging.

Since our Pulmonary Technology is still in development and is yet to be used in commercialized products, we cannot be certain that we will be able to develop reproducible dosing of any potential product.

If we or our partners do not obtain regulatory approval for our products on a timely basis, then our revenues and results of operations may be affected negatively.

There is a risk that we, or our partners, will not obtain regulatory approval (which in some countries includes pricing approval) for unapproved products on a timely basis, or at all. Unapproved products must undergo rigorous animal and human testing and an extensive FDA mandated or equivalent foreign authorities review process. This process generally takes a number of years and requires the expenditure of substantial resources. The time required for completing such testing and obtaining such approvals is uncertain. The FDA and other U.S. and foreign regulatory agencies also have substantial discretion to terminate clinical trials, require

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additional testing, delay or withhold registration and marketing approval, and mandate product withdrawals including recalls. Even though our partners have obtained regulatory approval for some of our products, these products and our manufacturing processes are subject to continued review by the FDA and other regulatory authorities. 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. In addition, any marketed products and manufacturing facilities used in the manufacture of such products will be subject to continual review and periodic inspections. Later discovery from such review and inspection of previously unknown problems may result in restrictions on marketed products or on us, including withdrawal of such products from the market. The failure to obtain timely regulatory approval of products, any product marketing limitations, or a product withdrawal would negatively impact our revenues and results of operations.

In addition, we may encounter delays or rejections based upon changes in FDA regulations or policies, including policies relating to cGMP, during the period of product development. We or our partners may encounter similar delays in other countries.

If our technologies cannot be integrated successfully to bring products to market, then our or our partners ability to develop, obtain approval for, or market products, may be delayed or unsuccessful.

We may not be able to integrate all of the relevant technologies to provide complete drug delivery and formulation systems. In particular, our development of drugs based on our Pulmonary Technology relies upon the following several different but related technologies:

- dry powder formulations;
- dry powder processing technology;
- dry powder packaging technology; and
- deep lung delivery devices.

Our other technologies may face similar challenges relating to the integration of drug formulation, processing, packaging and delivery device technologies. At the same time we or our partners must:

- perform laboratory, pre-clinical, and clinical testing of potential products; and
- scale-up manufacturing processes.

All of these steps must be accomplished without delaying any aspect of product development. Any delay in one component of product or business development could delay our or our partners ability to develop, obtain approval for, or market products using our delivery and formulation technologies.

If we are not able to manufacture our products in commercially feasible quantities or at commercially feasible costs, then our products will not be successfully commercialized.

Nektar Advanced PEGylation Technology and Supercritical Fluid Technology

We are currently expanding our Advanced PEGylation Technology manufacturing capacity and anticipate having to add additional Supercritical Fluid Technology manufacturing capacity. If we are not able to scale-up to large clinical trials or commercial manufacturing for products incorporating either of these technologies in a timely manner or at a commercially reasonable cost, we risk not meeting our customers supply requirements or our contractual obligations. Our failure to solve any of these problems could delay or prevent late stage clinical testing, regulatory approval for, and commercialization of our products and could negatively impact our revenues and results of operations.

Production problems encountered during the second and third quarters of 2004 resulted in the temporary shutdown of our manufacturing facility with respect to our Advanced PEGylation products. This resulted in a decrease in product revenues and gross margin compared to 2003. Although we believe we have addressed these manufacturing problems, our failure to satisfactorily address these issues or additional production problems may negatively impact our product revenues and results of operations in future periods.

Nektar Pulmonary Technology

The manufacture of products using Nektar Pulmonary Technology involves multiple processes, all of which involve substantial risk.

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Powder Processing. We have no experience manufacturing powder products for commercial purposes. With respect to drugs based on our Pulmonary Technology, we have only performed powder processing on the scale needed for testing formulations, and for early stage and larger clinical trials. We may encounter manufacturing and control problems as we attempt to scale-up powder processing facilities. We may not be able to achieve such scale-up in a timely manner or at a commercially reasonable cost, if at all, and the powder processing system we implement may not be applicable for other drugs. Our failure to solve any of these problems could delay or prevent some late stage clinical testing and commercialization of our products and could negatively impact our revenues and results of operations.

To date, we rely primarily on two particular methods of powder processing. There is a risk that these technologies will not work with all drugs or that the cost of drug production with this processing will preclude the commercial viability of certain drugs. Additionally, there is a risk that any alternative powder processing methods we may pursue will not be commercially practical for aerosol drugs or that we will not have, or be able to acquire the rights to use, such alternative methods.

Powder Packaging. Our fine particle powders and small quantity packaging utilized for drugs based on our Pulmonary Technology require special handling. We have designed and qualified automated filling equipment for small and moderate quantity packaging of fine powders. We face significant technical challenges in scaling-up an automated filling system that can handle the small dose and particle sizes of our powders in commercial quantities. There is a risk that we will not be able to scale-up our automated filling equipment in a timely manner or at commercially reasonable costs. Any failure or delay in such scale-up would delay product development or bar commercialization of products based on our Pulmonary Technology and would negatively impact our revenues and results of operations.

There can be no assurance we will be able to manufacture products on our autofiller system in a timely manner or at a commercially reasonable cost; any delay or failure in further developing such technology would delay product development or inhibit commercialization of our products and would have a materially adverse effect on us.

Nektar Pulmonary Inhaler Device. We face many technical challenges in developing our pulmonary inhaler device to work with a broad range of drugs, to produce such devices in sufficient quantities, and to adapt the devices to different powder formulations. Our pulmonary inhaler device being used with Exubera® is still in clinical testing. Additional design and development work may be required to optimize the device for regulatory approval, field reliability, or other issues that may be important to its commercial success.

Additional design and development work may lead to a delay in regulatory approval for any product that incorporates the device. In addition, we are attempting to develop a smaller inhaler device, which presents particular technical challenges. There is a risk that we will not successfully achieve any of these challenges. Our failure to overcome any of these challenges would negatively impact our revenues and results of operations.

For late stage clinical trials and initial commercial production, we intend to use one or more contract manufacturers to produce our pulmonary inhaler devices. There is a risk that we will not be able to maintain arrangements with our contract manufacturers on commercially acceptable terms or at all, or effectively scale-up production of our pulmonary inhaler devices through contract manufacturers. Our failure to do so would negatively impact our revenues and results of operations. Dependence on third parties for the manufacture of our pulmonary inhaler devices and their supply chain may adversely affect our cost of goods and ability to develop and commercialize products on a timely or competitive basis. Because our manufacturing processes and those of our contract manufacturers are very complex and subject to lengthy governmental approval processes, alternative qualified production sources or capacity may not be available on a timely basis or at all. Disruptions or delays in our manufacturing processes or those of our contract manufacturers for existing or new products could result in increased costs, loss of revenues or market share, or damage to our reputation.

In August 2000, we entered into a Manufacturing and Supply Agreement with our contract manufacturers to provide for the manufacturing of our pulmonary inhaler device for Exubera®. Under the terms of the Agreement, we may be obligated to reimburse the contract manufacturers for the actual unamortized and unrecovered portion of any equipment procured or facilities established and the interest accrued for their capital overlay in the event that Exubera® does not gain FDA approval to the extent that the contract manufacturers cannot re-deploy the assets. While such payments may be significant, at the present time, it is not possible to estimate the loss that will occur should Exubera® not be approved. We have also agreed to defend, indemnify, and hold harmless the contract manufacturers from and against third party liability arising out of the agreement, including product liability and infringement of intellectual property. There is no limitation on the potential amount of future payments we could be required to make under these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities.

There is no assurance that devices designed by us and built by contract manufacturers will be approved or will meet approval requirements on a timely basis or at all, or that any of our device development will be successful or commercially viable.

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If Pfizer is not able to fill the bulk drug powders for Exubera® in commercially feasible quantities, then Exubera® will not be successfully commercialized and would negatively impact our revenues and results of operations.

We have developed a high capacity automated filling technology, which when validated, we believe will be capable of filling blisters on a production scale for moderate and large volume products using our Pulmonary Technology. The high capacity automated filling technology has been transferred to Pfizer who will have the responsibility of packaging and filling the bulk drug powders for Exubera®. There are significant technical challenges in scaling-up an automated filling system that can handle the small dose and particle sizes of our powders in commercial quantities. In addition, there is the additional risk that Pfizer has no backup manufacturing facility for this process. Any failure or delay in the manufacturing facility or process would delay product development or bar commercialization of Exubera® and would negatively impact our revenues and results of operations.

If we are not able to manufacture our dry powder inhaler device in commercially feasible quantities or at commercially feasible costs, then our Pulmonary Technology products may not be successfully commercialized.

In addition to our inhaler device being used with Exubera®, we are developing a breath actuated compact dry powder inhaler device (DPI). We are developing the DPI device to be appropriate for the delivery of either large or small molecules for short-term use. We face many unique technical challenges in developing the DPI device to work with a broad range of drugs, producing the DPI device in sufficient quantities, and adapting the DPI device to different powder formulations. Our DPI device is still in clinical testing and production scale-up work is ongoing. Further design and development will be required to obtain regulatory approval for the DPI device, enable commercial manufacturing, insure field reliability, or manage other issues that may be important to its commercial success. Such additional design and development work may lead to a delay in efforts to obtain regulatory approval for any product that incorporates the DPI device, or could delay the timeframe within which the device could be ready for commercial launch. There is a risk that we will not successfully achieve any of these challenges. Our failure to overcome any of these challenges would negatively impact our revenues and results of operations.

We depend on sole or exclusive suppliers for our pulmonary inhaler devices, bulk active pharmaceutical ingredients and PEG polymer chains and if such suppliers fail to supply when required, then our product development efforts may be delayed or unsuccessful and our commercial supply obligations may be compromised.

We agreed to subcontract the manufacture of our pulmonary inhaler devices used with Exubera® before commercial production. We have identified contract manufacturers that we believe have the technical capabilities and production capacity to manufacture such device and which can meet the requirements of cGMP. We are not certain that we will be able to maintain satisfactory contract manufacturing on commercially acceptable terms, if at all. Our failure to maintain ongoing commercial relationships with our existing contract manufacturers may subject us to significant reimbursement obligations upon termination of such relationships. Our dependence on third parties for the manufacture of our pulmonary inhaler devices may negatively impact our cost of goods and our ability to develop and commercialize products based on our Pulmonary Technology on a timely and competitive basis.

For the most part, we obtain the bulk active pharmaceutical ingredients we use to manufacture products using our technologies from sole or exclusive sources of supply. For example, with respect to our source of bulk insulin, we have entered into a collaborative agreement with Pfizer that has, in turn, entered into an agreement with Sanofi-Aventis to manufacture regular human insulin. Under the terms of their agreement, Pfizer and Sanofi-Aventis agreed to construct a jointly owned manufacturing plant in Frankfurt, Germany. Until needed, Pfizer will provide us with insulin from Sanofi-Aventis s existing plant. We obtain our supply of PEG polymer chains that we use in our products that incorporate our Advanced PEGylation Technology from a single supplier. If our sole or exclusive source suppliers fail to provide either active pharmaceutical ingredients or PEGylation materials in sufficient quantities when required, our revenues and results of operations may be negatively impacted.

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If the market does not accept products using our drug delivery technologies, then our revenues and results of operations will be adversely affected.

The commercial success of our potential products depends upon market acceptance by health care providers, third-party payors like health insurance companies and Medicare and patients. Our products under development use new drug delivery technologies and there is a risk that the market will not accept our potential products. Market acceptance will depend on many factors, including:

- the safety and efficacy of products demonstrated in clinical trials;
- favorable regulatory approval and product labeling;
- the frequency of product use;
- the ease of product use;
- the availability of third-party reimbursement;
- the availability of alternative technologies; and
- the price of our products relative to alternative technologies.

There is a risk that health care providers, patients, or third-party payors will not accept products using our drug delivery and formulation technologies. If the market does not accept our potential products, our revenues and results of operations would be significantly and negatively impacted.

If our products are not cost effective, then government and private insurance plans may not pay for them and our products may not be widely accepted, which will adversely affect our revenues and results of operations.

In both domestic and foreign markets, sales of our products under development will depend in part upon pricing approvals by government authorities and the availability of reimbursement from third-party payors, such as government health administration authorities, managed care providers, private health insurers and other organizations. In addition, such third-party payors are increasingly challenging the price and cost effectiveness of medical products and services. Significant uncertainty exists as to the pricing approvals for, and the reimbursement status of, newly approved health care products. Moreover, legislation and regulations affecting the pricing of pharmaceuticals may change before regulatory agencies approve our proposed products for marketing. Adoption of such legislation and regulations could further limit pricing approvals for, and reimbursement of, medical products. A government or third-party payor decision not to approve pricing for, or provide adequate coverage and reimbursements of, our products would limit market acceptance of such products.

If our competitors develop and sell better drug delivery and formulation technologies, then our products or technologies may be uncompetitive or obsolete and our revenues and results of operations will be adversely affected.

We are aware of other companies engaged in developing and commercializing drug delivery and formulation technologies similar to our technologies. Some of our competitors with regard to our Pulmonary Technology include Alexza MDC, Alkermes, Inc., Aradigm Corporation, 3M, MannKind Corporation, Microdose Technologies Inc., Quadrant Technologies Limited, Skyepharma, and Vectura. In the non-invasive delivery of insulin, we have direct competition from companies such as Aradigm Corporation, Alkermes, Inc., Microdose Technologies Inc., Quadrant Technologies Limited, and MannKind Corporation, all of which are working on pulmonary products and most with announced pharmaceutical partners. Our competitors with regard to our Advanced PEGylation Technology include Dow Chemical Company, SunBio Corporation, Mountain View Pharmaceuticals, Inc., Neose, NOF Corporation, and Valentis, Inc., and there may be several chemical, biotechnology, and pharmaceutical companies also developing PEGylation technologies. Some of our competitors with regard to our Supercritical Fluid Technology include Alkermes, Battelle Memorial Institute, Ethypharm SA, Ferro Corp., Lavipharm SA, and RxKinetics. Some of these companies license or provide the technology to other companies, while others are developing the technology for internal use. Many of these companies have greater research and development capabilities, experience, manufacturing, marketing, financial and managerial resources than we do and represent significant competition for us. Acquisitions of or collaborations with competing drug delivery companies by large pharmaceutical or biotechnology companies could enhance our competitors financial, marketing and other resources. Accordingly, our competitors may succeed in developing competing technologies, obtaining regulatory approval for products or gaining market acceptance before us. Developments by others could make our products or technologies uncompetitive or obsolete. Our competitors may introduce products or processes competitive with or superior to our products or processes.

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If any of our pending patent applications do not issue or following issuance are deemed invalid or if any of our patents are deemed invalid, we may lose valuable intellectual property protection. If any of our products infringe third-party intellectual property rights, we may suffer adverse effects to our ability to develop and commercialize products and to our revenues and results from operations.

We have filed patents applications (and we plan to file additional patent applications) covering, among other things, aspects of: (i) our Pulmonary Technology (in general and as it relates to specific molecules) including, without limitation, our powder processing technology, our powder formulation technology, and our inhalation device technology; (ii) our Advanced PEGylation Technology; and (iii) our Supercritical Fluid Technology. As of September 30, 2005, we owned 964 issued U.S. and foreign patents that cover various aspects of our technologies, and we have a number of patent applications pending.

The patent positions of pharmaceutical, biotechnology and drug delivery companies, including ours, are uncertain and involve complex legal and factual issues. There can be no assurance that patents we apply for will be issued, or that patents that are issued will be valid and enforceable. Even if such patents are enforceable, we anticipate that any attempt to enforce our patents could be time consuming and costly. Additionally, the coverage claimed in a patent application can be significantly reduced before the patent is issued. As a consequence, we do not know whether any of our pending patent applications will be granted with broad coverage or whether the claims that eventually issue or that have issued will be circumvented. Since publication of discoveries in scientific or patent literature often lag behind actual discoveries, we cannot be certain that we were the first inventor of inventions covered by our issued patents or pending patent applications or that we were the first to file patent applications for such inventions. Moreover, we may have to participate in interference proceedings declared by the U.S. Patent and Trademark Office, which could result in substantial cost to us, even if the eventual outcome is favorable. 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.

Numerous pending and issued U.S. and foreign patent rights and other proprietary rights owned by third parties relate to pharmaceutical compositions and reagents, 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 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. The failure to obtain licenses if needed would have a material adverse effect on us.

We also rely upon trade secret protection for our confidential and proprietary information. No assurance can be given that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets or disclose such technology, or that we can meaningfully protect our trade secrets.

Third parties from time to time have asserted or may assert that we are infringing their proprietary rights based upon issued patents, trade secrets or know-how that they believe cover our technology. In addition, future patents may be issued to third parties that our technology may infringe. We could incur substantial costs in defending ourselves and our partners against any such claims. Furthermore, parties making such claims may be able to obtain injunctive or other equitable relief, which could effectively block our ability to develop or commercialize some or all of our products in the United States and abroad, and could result in the award of substantial damages. In the event of a claim of infringement, we and our partners may be required to obtain one or more licenses from third parties. There can be no assurance that our partners and we will be able to obtain such licenses at a reasonable cost, if at all. Defense of any lawsuit or failure to obtain any such required license could have a material adverse effect on us.

Access, or our partners access, to drugs to be formulated using our various delivery technologies affects our ability to develop and commercialize our technologies. For our collaborative arrangements, we intend generally to rely on the ability of our partners to provide access

to drugs that we formulate for pulmonary and other forms of delivery. There is a risk that our partners will not be able to provide access to such drugs. This situation is complex, and as such, the ability of any one company, including us, to commercialize a particular drug is unpredictable.

In addition, formulations of drugs that are presently under development by us, as well as our drug formulation and delivery technologies, may be subject to issued U.S. and foreign patents (and may be subject in the future to patents that issue from pending patent applications) owned by competitors. Therefore, even if our partners provide access to drugs for the formulation of pulmonary and other forms of delivery, there is a risk that third parties will accuse, and possibly a court or a governmental agency will determine, that we and/or our partners infringe third party patent rights covering such drugs and/or the formulation or delivery technologies utilizing such drugs, and we will be prohibited from working with the drug or formulation or delivery technology, or we will be found liable for damages that may not be subject to indemnification, or we may elect to pay such third party royalties under a license to such patent rights if one is available. Any such restrictions on access to drugs, liability for damages, prohibition, or payment of royalties would negatively impact our revenues and results of operations.

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We may incur material litigation costs, which may adversely affect our business and results of operations.

On July 12, 2005, a complaint was filed by The Board of Trustees of the University of Alabama (UAH) against Nektar Therapeutics AL, Corporation, and Nektar Therapeutics (Defendants) in the United States District Court for the Northern District of Alabama. Among other things, the complaint alleges patent infringement, breach of contract license, violation of the Alabama Trade Secrets Act and unjust enrichment. Generally, the complaint alleges that Defendants refusal to pay royalties based upon UAH patented and licensed technology represents a breach of an exclusive license agreement between UAH and Nektar Therapeutics AL, Corporation (formerly Shearwater Corporation) and that Defendants have infringed and are infringing UAH s patent. On August 3, 2005, UAH amended its complaint to add J. Milton Harris, a Nektar employee, as a party to the litigation, add certain additional claims, seek declaratory judgment on patents assigned to Defendants, and seek compensatory, treble and punitive damages, all in unspecified amounts. Defendants have served UAH with answers to the complaint denying any wrongdoing. Following submission of these answers to UAH, Defendants filed a counter-claim seeking a refund of patent royalties that Defendants allege were erroneously paid to UAH. The parties are currently in the process of scheduling the litigation calendar. The litigation is at too early a stage to make an assessment about the probability of the outcome in the case. We intend to vigorously defend ourselves in this litigation.

From time to time, we are party to various other litigation matters, including several that relate to our patent and intellectual property rights. We cannot predict with certainty the eventual outcome of any pending litigation or potential future litigation, and we might have to incur substantial expense in defending these or future lawsuits or indemnifying third parties with respect to the results of such litigation.

If earthquakes, tornadoes, hurricanes and other catastrophic events strike, our business may be negatively affected.

Our corporate headquarters, including a substantial portion of our research and development operations, are located in the San Francisco Peninsula, a region known for seismic activity. A significant natural disaster such as an earthquake could have a material adverse impact on our business, operating results, and financial condition. There are no backup facilities for some of our manufacturing operations located in the San Francisco Peninsula. Certain of our other facilities, such as our facility in Huntsville, Alabama and certain of our collaborative partners located elsewhere may also be subject to catastrophic events such as hurricanes and tornadoes, any of which could have a material adverse effect on our business, operating results, and financial condition.

Investors should be aware of industry-wide risks, which are applicable to us and may affect our revenues and results of operations.

In addition to the risks associated specifically with us described above, investors should also be aware of general risks associated with drug development and the pharmaceutical and biotechnology industries. These include, but are not limited to:

- changes in and compliance with government regulations;
- handling and disposal of hazardous materials;
- workplace health and safety requirements;

hiring and retaining qualified people; and

insuring against product liability claims.

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

As of September 30, 2005, we had approximately $417.7 million in long-term convertible subordinated notes and debentures, $20.4 million in non-current capital lease obligations, and $11.4 million in other long-term debt. Our substantial long-term indebtedness, which totaled $449.5 million as of September 30, 2005, has and will continue to impact us by:

making it more difficult to obtain additional financing; and

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

Currently we are not generating positive cash flow. Delay in the approval of Exubera®, or other adverse occurrences related to our product development efforts will adversely impact our ability to meet our obligations to repay the principal amounts on our convertible subordinated notes and debentures when due. In addition, if the market price of our common stock is below the related conversion price, the holders of the related outstanding convertible subordinated notes and debentures will not likely convert such securities to equity in accordance with their existing terms. If we are unable to satisfy our debt service requirements, substantial liquidity problems could result. As of September 30, 2005 we had cash, cash equivalents, and short-term investments valued at approximately $620.3 million. We expect to use a substantial portion of these assets to fund our on-going operations over the next few years. As of September 30, 2005, we had approximately $417.7 million outstanding convertible subordinated notes and

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debentures, of which $102.7 million and $315.0 million will mature in 2007 and 2012 respectively. If we do not generate sufficient cash from operations to repay our convertible subordinated notes and debentures or satisfy any other of these obligations when they become due we will need to raise additional funds from the sale of equity or debt securities or otherwise restructure our obligations in order to do so. There can be no assurance that any such financing or restructuring will be available to us on commercially acceptable terms, if at all.

If we cannot raise additional capital our financial condition may suffer.

Our capital needs may change as a result of numerous factors, and may result in additional funding requirements. In addition, we may choose to raise additional capital due to market conditions or strategic considerations. To the extent that additional capital is raised through the sale of equity or convertible debt securities, the issuance of such securities could result in dilution to our stockholders.

We have no material credit facility or other material committed sources of capital. To the extent operating and capital resources are insufficient to meet future requirements, we will have to raise additional funds to continue the development and commercialization of our technologies and products. Such funds may not be available on favorable terms, or at all. In particular, our substantial leverage may limit our ability to obtain additional financing. In addition, as an early stage biotechnology company, we do not qualify to issue investment grade debt and therefore any financing we do undertake will likely involve the issuance of equity, convertible debt instruments, and/or high-yield debt. These sources of capital may not be available to us in the event we require additional 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 negatively impact our business.

If we fail to manage our growth effectively, our business may suffer.

Our ability to offer commercially viable products, achieve our expansion objectives, manage our growth effectively and satisfy our commitments under our collaboration agreements depends on a variety of factors, all of which must be successfully managed. Key factors include our ability to develop products internally, enter into strategic partnerships with collaborators, attract and retain skilled employees and effectively expand our internal organization to accommodate anticipated growth including integration of any potential businesses that we may acquire. If we are unable to manage some or all of these factors effectively, our business could grow too slowly or too quickly to be successfully sustained, thereby resulting in material adverse effects on our business, financial condition and results of operations.

If we acquire additional companies, products, or technologies, we may not be able to effectively integrate personnel and operations and such failure may disrupt our business and results of operations.

We have acquired companies, products, and/or technologies in the past, and may continue to acquire or make investments in complementary companies, products, or technologies in the future. We may not receive the anticipated benefits of these acquisitions or investments. We may face risks relating to difficult integrations of personnel, technology and operations, uncertainty whether any integration will be successful and whether earnings will be negatively affected, and potential distractions to our management with respect to these acquisitions. In addition, our earnings may suffer because of acquisition-related costs.

We expect to continue to lose money for the next few years and may not reach profitability if our products do not generate sufficient revenue.

We have never had a profitable year and, through September 30, 2005, we have an accumulated deficit of approximately $794.0 million. We expect to continue to incur substantial and potentially increasing losses over at least the next few years as we expand our research and development efforts, testing activities and manufacturing operations, and as we further expand our late stage clinical and early commercial production facilities. Most of our potential products are in the early stages of development. Except for the approved products incorporating our Advanced PEGylation Technology, we have generated no revenues from product sales. Our revenues to date have consisted primarily of payments under short-term research and feasibility agreements and development contracts.

To achieve and sustain profitable operations, we must, alone or with others, successfully develop, obtain regulatory approval for, manufacture, introduce, market and sell products using our drug delivery technologies. There is risk that we will not generate sufficient product or contract research revenue to become profitable or to sustain profitability.

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Anti-takeover provisions in our charter documents and under Delaware law may make it more difficult to acquire us.

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. 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 expect our stock price to remain volatile.

Our stock price is volatile. In the twelve-month period ending September 30, 2005, based on closing bid prices on The NASDAQ National Market, our stock price ranged from $14.74 to $16.95. We expect our stock price to remain volatile. A variety of factors may have a significant effect on the market price of our common stock, including:

- clinical trial results or product development delays or delays in product approval or launch;
- announcements by collaboration partners as to their plan or expectations related to products using our technologies;

announcement or termination of collaborative relationships by us or our competitors;

fluctuations in our operating results;

developments in patent or other proprietary rights;

announcements of technological innovations or new therapeutic products;

governmental regulation;

public concern as to the safety of drug formulations developed by us or others; and

general market conditions.

Any litigation brought against us as a result of this volatility could result in substantial costs and a diversion of our management s attention and resources, which could negatively impact our financial condition, revenues, results of operations, and the price of our common stock.

New and potential new accounting pronouncements may impact our future financial position and results of operations.

There may be potential new accounting pronouncements or regulatory rulings, which may have an impact on our future financial position and results of operations. For example, in December 2004, the FASB issued an amendment to SFAS No. 123, *Accounting For Stock-Based Compensation* (FAS 123R). We will be required to implement FAS 123R beginning January 1, 2006.

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The cumulative effect of adoption, if any, applied on a modified prospective basis, would be measured and recognized on January 1, 2006. SFAS No. 123R would eliminate the ability to account for share-based compensation transactions using Accounting Principles Board Opinion No. 25 (APB 25), and would instead require companies to recognize compensation expense using a fair-value based method for costs related to share-based payments including stock options and employee stock purchase plans. The adoption of SFAS No. 123R will materially and adversely impact our financial position and results of operations.

Our business is subject to changing regulation of corporate governance and public disclosure that has increased both our costs and the risk of noncompliance.

We are subject to rules and regulations of federal, state, and financial market exchange entities charged with the protection of investors and the oversight of companies whose securities are publicly traded. These entities, including the Public Company Accounting Oversight Board, the SEC and NASDAQ, have recently issued new requirements and regulations and continue to develop additional regulations and requirements in response to recent laws enacted by Congress, most notably The Sarbanes-Oxley Act of 2002 (SOX). Our efforts to comply with these new regulations have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention to SOX compliance activities.

In particular, our efforts to comply with Section 404 of SOX and the related regulations regarding our required assessment of our internal controls over financial reporting and our external auditors audit of that assessment has required, and continues to require, the commitment of significant financial and managerial resources. Our management has determined, as of the year ended December 31, 2004, that we had a material weakness in our internal control over financial reporting and that our disclosure controls and procedures were not effective. Efforts to remedy these deficiencies has required significant additional financial and managerial resources. In addition, such deficiencies may result in a loss of investor confidence and may adversely affect the price of our common stock. Although progress has been made and certain corrective actions have been implemented to our internal controls over financial reporting, we have not yet determined whether the identified material weakness in internal control over financial reporting will be resolved by the end of this fiscal year. In addition we are searching for additional finance staff, including a Chief Financial Officer. This effort may be time-consuming, expensive, and ultimately not successful.

Moreover, because these laws, regulations, and standards are subject to varying interpretations, their application in practice may evolve over time as new guidance becomes available. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by ongoing revisions to our disclosure and governance practices. The continuing uncertainty that we will meet or continue to meet the requirements of these laws, regulations, and standards, may negatively impact our business operations and financial position.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our market risks at September 30, 2005 have not changed significantly from those discussed in Item 7A of our Annual Report on Form 10-K/A, as amended, for the year ended December 31, 2004 on file with the Securities and Exchange Commission.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. Under the supervision and with the participation of management, including our Chief Executive Officer and our Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the 1934 Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as a result of the material weakness in our financial close process as disclosed in our Annual Report on Form 10-K/A, as amended, for the year ended December 31, 2004, our disclosure controls and procedures were not effective as of the end of the period covered by this quarterly report.

As of December 31, 2004 we had concluded that we had a material weakness in our financial statement close process, including insufficient review of the following:

- the application of our accounting policies and
- disclosures in the notes to our financial statements.

This material weakness in our financial statement close process rose from staff with inadequate proficiency to apply the Company s accounting policies in accordance with U.S. generally accepted accounting principles.

This material weakness impacted our ability to report financial information in conformity with U.S. generally accepted accounting principles, which could affect all significant financial statement accounts and has resulted in:

- a restatement of the 2002 and 2003 consolidated financial statements to reflect reclassifications of certain amounts between research and development expense, general and administrative expense, and interest expense;
- a restatement of all four quarters of 2003 and the first three quarters of 2004 to reflect reclassifications of certain amounts between research and development expense, general and administrative expense; and
- the restatement of the 2003 consolidated financial statements to reduce the gain on debt extinguishment.

We are in the process of implementing a remediation plan to support our ongoing efforts to improve our internal controls and procedures to address the material weakness described above. Our remediation plan is:

- to improve the skills, knowledge and experience available to the Company of our financial close and reporting process;
- to increase the level of review of the preparation of the quarterly and annual financial statements;
- to identify and evaluate non-routine and complex transactions on a regular basis; and
- to research, identify, analyze, document, and review applicable accounting principles.

We are in the process of executing this remediation plan.

Changes in Internal Controls. We have taken the following actions during the period ended September 30, 2005 as part of our remediation plan:

- we continue to recruit and hire additional accounting staff with technical expertise to enhance the preparation and review of the financial statements and disclosures as well as the research and analysis of applicable accounting principles;
- we continue to enhance our review of non-routine and complex transactions through enhanced identification and review procedures; and

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we have established a management sub certification process to identify and document matters that might require additional financial statement or disclosure consideration.

Other than as described above, there have been no changes in our internal control over financial reporting during the three-month period ended September 30, 2005 that have materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

Our principal executive officer and principal financial officer have concluded that, although progress has been made and certain corrective actions have been implemented to our internal controls over financial reporting, as identified above, we will not be in a position to adequately and thoroughly assess whether the identified material weakness in internal control over financial reporting has been resolved until we conduct our fiscal-year-end processes and reviews. As a result, we may identify additional changes that are required to remediate or improve our internal controls over financial reporting. As such, our principal executive officer and principal financial officer were unable to conclude that the material weaknesses described above were corrected as of September 30, 2005, and as such, such officers were unable to conclude that the Company s disclosure controls and procedures were effective as of September 30, 2005.

Limitations on the Effectiveness of Controls. Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls 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 error or mistake. 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, control 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.

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PART II: OTHER INFORMATION

Item 1. Legal Proceedings

On July 12, 2005, a complaint was filed by The Board of Trustees of the University of Alabama (UAH) against Nektar Therapeutics AL, Corporation, and Nektar Therapeutics (Defendants) in the United States District Court for the Northern District of Alabama. Among other things, the complaint alleges patent infringement, breach of contract license, violation of the Alabama Trade Secrets Act and unjust enrichment. Generally, the complaint alleges that Defendants refusal to pay royalties based upon UAH patented and licensed technology represents a breach of an exclusive license agreement between UAH and Nektar Therapeutics AL, Corporation (formerly Shearwater Corporation) and that Defendants have infringed and are infringing UAH s patent. On August 3, 2005, UAH amended its complaint to add J. Milton Harris, a Nektar employee, as a party to the litigation, add certain additional claims, seek declaratory judgment on patents assigned to Defendants, and seek compensatory, treble and punitive damages, all in unspecified amounts. Defendants have served UAH with answers to the complaint denying any wrongdoing. Following submission of these answers to UAH, Defendants filed a counter-claim seeking a refund of patent royalties that Defendants allege were erroneously paid to UAH. The parties are currently in the process of scheduling the litigation calendar. The litigation is at too early a stage to make an assessment about the probability of the outcome in the case. We intend to vigorously defend ourselves in this litigation.

From time to time, we are party to various other litigation matters, including several that relate to our patent and intellectual property rights. We cannot predict with certainty the eventual outcome of any pending litigation or potential future litigation, and we might have to incur substantial expense in defending these or future lawsuits or indemnifying third parties with respect to the results of such litigation. 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 and/or liquidity.

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

On September 28, 2005, we issued and sold $315 million principal amount of 3.25% Convertible Subordinated Notes due September 28, 2012 (3.25% Notes) pursuant to an exemption from registration pursuant to Section 4(2) of the Securities At of 1933, as amended, as described in our Current Report on Form 8-K filed on September 28, 2005.

In September 2005, the Company retired $25.4 million and $45.9 million aggregate principal amount of its outstanding 5% and 3.5% convertible subordinated notes due February 2007 and October 2007, respectively, in cash, in privately negotiated transactions.

Item 3. Defaults Upon Senior Securities

None.

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

None.

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Item 5. Other Information

None.

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Item 6. Exhibits and Reports on Form 8-K

(a) 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.

Exhibit Number		Description of Documents
2.1	(1)	Agreement and Plan of Merger, dated June 4, 1998, by and between Inhale Therapeutic Systems, a California corporation, and Inhale Therapeutic Systems (Delaware), Inc., a Delaware corporation.
2.2	(5)	Recommended Offer, dated December 21, 2000, by Cazenove & Co. on behalf of Nektar Therapeutics for Bradford Particle Design plc.
2.3	(8)	Agreement and Plan of Merger and Reorganization, dated May 22, 2001, by and among Nektar Therapeutics, Square Acquisition Corp., Shearwater Corporation, Certain Shareholders of Shearwater Corporation and J. Milton Harris as Shareholders Agent.
2.4	(8)	Amendment to Agreement and Plan of Merger and Reorganization, dated June 21, 2001, by and among Nektar Therapeutics, Square Acquisition Corp., Shearwater Corporation, J. Milton Harris, as Shareholders Agent and a Designated Shareholder, and Puffinus, L.P.
2.5	(13)	Agreement and Plan of Merger, dated August 12, 2005, among Nektar Therapeutics, Oski Acquisition Corporation, and Aerogen, Inc.
3.1	(1)	Certificate of Incorporation of Inhale Therapeutic Systems (Delaware), Inc.
3.2	(1)	Bylaws of Nektar Therapeutics.
3.3	(3)	Certificate of Amendment of the Amended Certificate of Incorporation of Nektar Therapeutics.
3.4	(7)	Certificate of Designation of Series A Junior Participating Preferred Stock of Nektar Therapeutics.
3.5	(9)	Certificate of Designation of Series B Convertible Preferred Stock of Nektar Therapeutics.
3.6	(10)	Certificate of Ownership and Merger of Nektar Therapeutics.
4.1		Reference is made to Exhibits 3.1, 3.2, 3.3, 3.4, 3.5 and 3.6.
4.2	(2)	Indenture, dated February 8, 2000, by and between Nektar Therapeutics, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.3	(10)	Specimen Common Stock certificate.
4.4	(4)	Specimen warrants to purchase shares of Common Stock.
4.5	(6)	Indenture, dated October 17, 2000, by and between Nektar Therapeutics, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.6	(7)	Rights Agreement, dated as of June 1, 2001, by and between Nektar Therapeutics and Mellon Investor Services LLC., as Rights Agent.
4.7	(7)	Form of Right Certificate.
4.8	(11)	Resale Registration Rights Agreement, dated June 30, 2003, by and among Nektar Therapeutics, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc., Friedman, Billings, Ramsey & Co. Inc. and SG Cowen Securities Corporation

4.9	(12)	Resale Registration Rights Agreement, dated October 9, 2003, by and among Nektar Therapeutics and the entities named therein.
4.10	(14)	Common Stock Purchase Agreement dated as of August 15, 2005, by and between Nektar Therapeutics and Mainfield Enterprises, Inc.
4.11	(15)	Indenture, dated September 28, 2005, by and between Nektar Therapeutics, as Issuer, and J.P. Morgan Trust Company, and National Association, as Trustee.
4.12	(15)	Registration Right Agreement, dated as of September 28, 2005, among Nektar Therapeutics and entities named therein.
10.1	(15)	Purchase Agreement, dated as of September 22, 2005, by and among Nektar Therapeutics and the purchasers listed in Schedule I thereto.
31.1	(16)	Certification of Nektar Therapeutics principal executive officer required by Rule 13a-14(a) or Rule 15d-14(a).
31.2	(16)	Certification of Nektar Therapeutics principal financial officer required by Rule 13a-14(a) or Rule 15d-14(a).
32.1	(16)	Section 1350 Certifications.

(1) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Quarterly Report on Form 10-Q for the quarter ended June 30, 1998.

(2) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Annual Report on Form 10-K for the year ended December 31, 1999.

(3) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Quarterly Report on Form 10-Q for the quarter ended June 30, 2000.

(4) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Quarterly Report on Form 10-Q for the quarter ended September 30, 2000.

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(5) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Current Report on Form 8-K, filed on January 11, 2001.
(6) Incorporated by reference to Nektar Therapeutics Registration Statement on Form S-3 (No. 333-53678), filed on January 12, 2001.
(7) Incorporated by reference to Nektar Therapeutics Current Report on Form 8-K, filed on June 4, 2001.
(8) Incorporated by reference to Nektar Therapeutics Current Report on Form 8-K, filed on July 10, 2001.
(9) Incorporated by reference to Nektar Therapeutics Current Report on Form 8-K, filed on January 8, 2002.
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(12) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Current Report on Form 8-K, filed on November 3, 2003.
(13) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Current Report on Form 8-K, filed on August 16, 2005.
(14) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Current Report on Form 8-K, filed on August 17, 2005.
(15) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Current Report on Form 8-K, filed on September 28, 2005.
(16) Filed herewith.

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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/ AJIT S. GILL

Ajit S. Gill
Chief Executive Officer,

President and Director

Date: November 7, 2005

By: /s/ AJAY BANSAL

Ajay Bansal
Chief Financial Officer and Vice President, Finance and Administration

Date: November 7, 2005

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EXHIBIT INDEX

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.

Exhibit Number		Description of Documents
2.1	(1)	Agreement and Plan of Merger, dated June 4, 1998, by and between Inhale Therapeutic Systems, a California corporation, and Inhale Therapeutic Systems (Delaware), Inc., a Delaware corporation.
2.2	(5)	Recommended Offer, dated December 21, 2000, by Cazenove & Co. on behalf of Nektar Therapeutics for Bradford Particle Design plc.
2.3	(8)	Agreement and Plan of Merger and Reorganization, dated May 22, 2001, by and among Nektar Therapeutics, Square Acquisition Corp., Shearwater Corporation, Certain Shareholders of Shearwater Corporation and J. Milton Harris as Shareholders Agent.
2.4	(8)	Amendment to Agreement and Plan of Merger and Reorganization, dated June 21, 2001, by and among Nektar Therapeutics, Square Acquisition Corp., Shearwater Corporation, J. Milton Harris, as Shareholders Agent and a Designated Shareholder, and Puffinus, L.P.
2.5	(13)	Agreement and Plan of Merger, dated August 12, 2005, among Nektar Therapeutics, Oski Acquisition Corporation, and Aerogen, Inc.
3.1	(1)	Certificate of Incorporation of Inhale Therapeutic Systems (Delaware), Inc.
3.2	(1)	Bylaws of Nektar Therapeutics.
3.3	(3)	Certificate of Amendment of the Amended Certificate of Incorporation of Nektar Therapeutics.
3.4	(7)	Certificate of Designation of Series A Junior Participating Preferred Stock of Nektar Therapeutics.
3.5	(9)	Certificate of Designation of Series B Convertible Preferred Stock of Nektar Therapeutics.
3.6	(10)	Certificate of Ownership and Merger of Nektar Therapeutics.
4.1		Reference is made to Exhibits 3.1, 3.2, 3.3, 3.4, 3.5 and 3.6.
4.2	(2)	Indenture, dated February 8, 2000, by and between Nektar Therapeutics, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.3	(10)	Specimen Common Stock certificate.
4.4	(4)	Specimen warrants to purchase shares of Common Stock.
4.5	(6)	Indenture, dated October 17, 2000, by and between Nektar Therapeutics, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.6	(7)	Rights Agreement, dated as of June 1, 2001, by and between Nektar Therapeutics and Mellon Investor Services LLC., as Rights Agent.
4.7	(7)	Form of Right Certificate.
4.8	(11)	Resale Registration Rights Agreement, dated June 30, 2003, by and among Nektar Therapeutics, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc., Friedman, Billings, Ramsey & Co. Inc. and SG Cowen Securities Corporation
4.9	(12)	Resale Registration Rights Agreement, dated October 9, 2003, by and among Nektar Therapeutics and the entities named therein.
4.10	(14)	Common Stock Purchase Agreement dated as of August 15, 2005, by and between Nektar Therapeutics and Mainfield Enterprises, Inc.

4.11	(15)	Indenture, dated September 28, 2005, by and between Nektar Therapeutics, as Issuer, and J.P. Morgan Trust Company, and National Association, as Trustee.
4.12	(15)	Registration Right Agreement, dated as of September 28, 2005, among Nektar Therapeutics and entities named therein.
10.1	(15)	Purchase Agreement, dated as of September 22, 2005, by and among Nektar Therapeutics and the purchasers listed in Schedule I thereto.
31.1	(16)	Certification of Nektar Therapeutics principal executive officer required by Rule 13a-14(a) or Rule 15d-14(a).
31.2	(16)	Certification of Nektar Therapeutics principal financial officer required by Rule 13a-14(a) or Rule 15d-14(a).
32.1	(16)	Section 1350 Certifications.

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