

NEKTAR THERAPEUTICS

Form 10-Q

August 05, 2009

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

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2009  
or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number: 0-24006**

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

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

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

**201 Industrial Road  
San Carlos, California 94070  
(Address of principal executive offices)  
650-631-3100**

**(Registrant's telephone number, including area code)  
(Former name, former address and former fiscal year, if changed since last report)**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting  
company ☐

(Do not check if a smaller  
reporting company)

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

The number of outstanding shares of the registrant's Common Stock, \$0.0001 par value, was 92,657,711 on July 31, 2009.

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

**Trademarks**

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

**Table of Contents****PART I: FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements    Unaudited:****NEKTAR THERAPEUTICS****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except per share information)

(Unaudited)

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 114,992	\$ 155,584
Short-term investments	179,311	223,410
Accounts receivable, net of allowance of nil and \$92 at June 30, 2009 and December 31, 2008, respectively	8,473	11,161
Inventory	10,110	9,319
Other current assets	5,317	6,746
Total current assets	\$ 318,203	\$ 406,220
Property and equipment, net	75,024	73,578
Goodwill	76,501	76,501
Other assets	3,270	4,237
Total assets	\$ 472,998	\$ 560,536
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 4,931	\$ 13,832
Accrued compensation	6,883	11,570
Accrued clinical trial expenses	12,110	17,622
Accrued expenses	7,201	9,923
Deferred revenue, current portion	8,770	10,010
Other current liabilities	5,421	5,417
Total current liabilities	\$ 45,316	\$ 68,374
Convertible subordinated notes	214,955	214,955
Capital lease obligations	19,616	20,347
Deferred revenue	52,696	55,567
Deferred gain	5,463	5,901
Other long-term liabilities	4,354	5,238
Total liabilities	\$ 342,400	\$ 370,382
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.0001 par value; 10,000 shares authorized Series A; 3,100 shares designated; no shares issued or outstanding at June 30, 2009 and December 31, 2008		
Common stock, \$0.0001 par value; 300,000 shares authorized; 92,561 shares and 92,503 shares issued and outstanding at June 30, 2009 and	9	9

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December 31, 2008, respectively

Capital in excess of par value	1,317,577	1,312,796
Accumulated other comprehensive income	978	1,439
Accumulated deficit	(1,187,966)	(1,124,090)
Total stockholders' equity	130,598	190,154
Total liabilities and stockholders' equity	\$ 472,998	\$ 560,536

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

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

(In thousands, except per share information)

(Unaudited)

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Revenue:				
Product sales and royalties	\$ 10,525	\$ 9,010	\$ 16,995	\$ 19,381
Collaboration and other	2,463	11,391	5,704	21,012
Total revenue	12,988	20,401	22,699	40,393
Operating costs and expenses:				
Cost of goods sold	10,231	5,444	15,330	12,671
Other cost of revenue		1,487		6,821
Research and development	24,150	33,500	48,040	70,873
General and administrative	9,087	13,328	20,107	25,275
Total operating costs and expenses	43,468	53,759	83,477	115,640
Loss from operations	(30,480)	(33,358)	(60,778)	(75,247)
Non-operating income (expense):				
Interest income	950	3,190	2,600	8,203
Interest expense	(2,948)	(3,929)	(6,285)	(7,847)
Other income, net	203	769	248	1,071
Total non-operating income (expense)	(1,795)	30	(3,437)	1,427
Loss before provision for income taxes	(32,275)	(33,328)	(64,215)	(73,820)
(Benefit) provision for income taxes	(206)	47	(339)	260
Net loss	\$ (32,069)	\$ (33,375)	\$ (63,876)	\$ (74,080)
Basic and diluted net loss per share	\$ (0.35)	\$ (0.36)	\$ (0.69)	\$ (0.80)
Shares used in computing basic and diluted net loss per share	92,556	92,400	92,536	92,365

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



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

(In thousands)

(Unaudited)

	<b>Six months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (63,876)	\$ (74,080)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	7,359	11,820
Stock-based compensation	4,691	3,863
Other non-cash transactions	56	(309)
Changes in assets and liabilities:		
Decrease (increase) in trade accounts receivable	2,362	9,570
Decrease (increase) in inventory	(791)	2,021
Decrease (increase) in other assets	1,284	(6,026)
Increase (decrease) in accounts payable	(5,513)	(1,727)
Increase (decrease) in accrued compensation	(4,687)	(3,676)
Increase (decrease) in accrued clinical trial expenses	(5,512)	10,160
Increase (decrease) in accrued expenses to contract manufacturers		(40,444)
Increase (decrease) in accrued expenses	(1,344)	(1,061)
Increase (decrease) in deferred revenue	(4,111)	(5,321)
Increase (decrease) in other liabilities	(995)	(1,215)
Net cash used in operating activities	\$ (71,077)	\$ (96,425)
<b>Cash flows from investing activities:</b>		
Purchases of investments	(186,016)	(334,685)
Sales of investments	7,627	28,590
Maturities of investments	221,948	369,337
Transaction costs from Novartis pulmonary asset sale	(4,440)	
Purchases of property and equipment	(7,999)	(10,349)
Net cash provided by investing activities	\$ 31,120	\$ 52,893
<b>Cash flows from financing activities:</b>		
Payments of loan and capital lease obligations	(616)	(1,151)
Proceeds from issuances of common stock	90	383
Net cash used in financing activities	\$ (526)	\$ (768)
Effect of exchange rates on cash and cash equivalents	(109)	(164)
Net decrease in cash and cash equivalents	\$ (40,592)	\$ (44,464)
Cash and cash equivalents at beginning of period	155,584	76,293
Cash and cash equivalents at end of period	\$ 114,992	\$ 31,829

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

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**NEKTAR THERAPEUTICS**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**June 30, 2009**  
**(Unaudited)**

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

**Organization**

We are a clinical-stage biopharmaceutical company headquartered in San Carlos, California and incorporated in Delaware. We are developing a pipeline of drug candidates that utilize our PEGylation and advanced polymer conjugate technology platforms designed to improve the therapeutic benefits of drugs.

**Basis of Presentation and Principles of Consolidation**

Our condensed consolidated financial statements include the financial position, results of operations and cash flows of our wholly-owned subsidiaries: Nektar Therapeutics AL, Corporation (Nektar AL), Nektar Therapeutics (India) Private Limited, Nektar Therapeutics UK, Ltd. (Nektar UK) and Aerogen, Inc. The merger of Nektar AL, an Alabama corporation, with and into its parent corporation, Nektar Therapeutics, was made effective July 31, 2009. As of the effective date, the separate existence of the Alabama corporation ceased, and all rights, privileges, powers and franchises of the Alabama corporation are vested in Nektar Therapeutics, the surviving corporation. All intercompany accounts and transactions have been eliminated in consolidation.

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

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

Revenues, expenses, assets, and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim Condensed Consolidated Financial Statements may not be the same as those for the full year. We completed the sale of certain assets related to our pulmonary business, associated technology and intellectual property to Novartis Pharma AG and Novartis Pharmaceuticals Corporation (together referred to as Novartis) on December 31, 2008; as a result, our results of operations for the three and six months ended June 30, 2009 are not comparable to the three and six month periods ended June 30, 2008.

The accompanying Condensed Consolidated Balance Sheet as of June 30, 2009, the Condensed Consolidated Statements of Operations for the three months and six months ended June 30, 2009 and 2008, and the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2009 and 2008 are unaudited. The Condensed Consolidated Balance Sheet data as of December 31, 2008 was derived from the audited consolidated financial statements which are included in our Annual Report on Form 10-K filed with the SEC on March 6, 2009. The information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and the accompanying notes to those financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008.

We evaluated subsequent events through August 5, 2009, the date on which this Quarterly Report on Form 10-Q was filed with the Securities and Exchange Commission.

**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 revenue and expenses during the reporting period. Actual results could differ from these estimates.

**Reclassifications**

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

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### **Segment Information**

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

### **Significant Concentrations**

Our customers are primarily pharmaceutical and biotechnology companies that are located in the U.S. and Europe. Our accounts receivable balance contains billed and unbilled trade receivables from product sales and royalties and collaborative research agreements. We provide for an allowance for doubtful accounts by reserving for specifically identified doubtful accounts. We generally do not require collateral from our customers. We regularly review our customers' payment histories and associated credit risk. We have not experienced significant credit losses from our accounts receivable.

We are dependent on our partners and vendors 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 and produce our products could be impaired, which could have a material adverse effect on our business, financial condition and results of operations.

### **Collaborative Research and Development Arrangements**

We enter into collaborative research and development arrangements with pharmaceutical and biotechnology partners that may involve multiple deliverables. Our arrangements may contain the following elements: upfront fees, contract research, milestone payments, manufacturing and supply, royalties and license fees. We recognize revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104 (SAB 104), *Revenue Recognition in Financial Statements* and Emerging Issues Task Force, Issue No. 00-21 (EITF 00-21), *Revenue Arrangements with Multiple Deliverables*.

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

Upfront fees received are recognized ratably over the expected benefit of the arrangement. Management makes its best estimate of the period over which we expect to benefit from the arrangement. The shortest reasonable period is the end of the development period (estimated to be 4 to 6 years) and the longest period is the contractual life of the agreement, which is generally 10 to 12 years from the first commercial sale, or the end of the patent life, which is frequently 15 to 17 years. Given the uncertainties of research and development collaborations, significant judgment is required to determine the duration of the arrangement.

Contract research revenue from collaborative research and development arrangements 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. Amounts received under these arrangements are generally non-refundable even if the research effort is unsuccessful.

Payments received for milestones achieved are deferred and recorded as revenue ratably over the period of time from the achievement of the milestone for which we received payment and our estimate of the date on which the next milestone will be achieved. Management makes its best estimate of the period of time until the next milestone is reached. The 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. Final milestone payments are recorded and recognized upon achieving the respective milestone, provided that collection is reasonably assured.

### **Income Taxes**

We account for income taxes under the liability method in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109), and FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* (FIN 48). Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax reporting bases of

assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Realization of deferred tax assets is dependent upon future earnings, the timing and amount of which are uncertain.

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For the six months ended June 30, 2009, we have recorded an overall benefit of \$0.3 million for income taxes, comprised of a U.S. federal and state income tax benefit of \$0.4 million relating primarily to a refundable credit under the American Recovery and Reinvestment Tax Act of 2009 and a foreign income tax provision for India of \$0.1 million. The effective tax rate for India is approximately 34%.

As of June 30, 2009, we have net deferred tax assets for temporary differences related to our operations in India and we continue to provide a full valuation allowance against our U.S. net deferred tax assets.

We maintain liabilities for uncertain tax benefits within our non-current income taxes payable accounts. These liabilities involve judgment and estimation and are monitored by management based on the best information available including changes in tax regulations, the outcome of relevant court cases and other information. As of December 31, 2008, we had \$11.7 million of unrecognized tax benefits. There were no material changes to these amounts during the six months ended June 30, 2009. Any adjustments to our uncertain tax positions would result in an adjustment of our net operating loss or tax credit carry forwards rather than resulting in a cash outlay. We currently have a full valuation allowance against our net deferred tax asset which would impact the timing of the effective tax rate benefit should any of these uncertain tax positions be favorably settled in the future. It is reasonably possible that certain unrecognized tax benefits may increase or decrease within the next twelve months. We do not anticipate any significant changes to unrecognized tax benefits over the next twelve months.

### **Recent Accounting Pronouncements**

#### *SFAS No. 168*

In June 2009, the Financial Accounting Standards Board (FASB) issued SFAS No. 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162* (SFAS 168). The statement confirmed that the *FASB Accounting Standards Codification* (the Codification) will become the single official source of authoritative U.S. GAAP (other than guidance issued by the SEC), superseding existing FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force (EITF), and related literature. After that date, only one level of authoritative U.S. GAAP will exist. All other literature will be considered non-authoritative. The Codification does not change U.S. GAAP; instead, it introduces a new structure that is organized in an easily accessible, user-friendly online research system. The Codification, which changes the referencing of financial standards, becomes effective for interim and annual periods ending on or after September 15, 2009. We will apply the Codification beginning in the third quarter of 2009. We do not expect the adoption of SFAS 168 to have any substantive impact on our Condensed Consolidated Financial Statements or related footnotes.

#### *SFAS No. 165*

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This statement sets forth the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements. SFAS 165 also requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date that is, whether that date represents the date the financial statements were issued or were available to be issued. This statement is effective for interim or annual reporting periods ending after June 15, 2009. We adopted SFAS 165 during the quarter ended June 30, 2009, which did not have a material impact on our financial position or results of operations.

#### *FASB Staff Position No. 157-4*

In April 2009, the FASB issued FASB Staff Position No. 157-4 (FSP 157-4), *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, which provides guidance on determining fair value when there is no active market or where the price inputs being used represent distressed sales. FSP 157-4 is effective for interim and annual periods ending after June 15, 2009. We adopted the provisions of FSP 157-4 during the quarter ended June 30, 2009, which did not have a material impact on our financial position or results of operations.

#### *FASB Statement of Position No. 115-2 and 124-2*

In April 2009, the FASB issued FASB Staff Position No. 115-2 and 124-2 (FSP 115-2 and 124-2), *Recognition and Presentation of Other-Than-Temporary Impairments*, which provides operational guidance for determining other-than-temporary impairments for debt securities. FSP 115-2 and 124-2 is effective for interim and annual periods ending after June 15, 2009. We adopted the provisions of FSP 115-2 and 124-2 during the quarter ended June 30, 2009, which did not have a material impact on our financial position or results of operations.



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

	<b>Estimated Fair Value at</b>	
	<b>June 30, 2009</b>	<b>December 31, 2008</b>
Cash and cash equivalents	\$ 114,992	\$ 155,584
Short-term investments (less than one year to maturity)	179,311	223,410
Total cash, cash equivalents, and available-for-sale investments	\$ 294,303	\$ 378,994

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

	<b>Estimated Fair Value at</b>	
	<b>June 30, 2009</b>	<b>December 31, 2008</b>
Cash and money market funds	\$ 106,994	\$ 145,394
Obligations of U.S. government agencies	85,574	91,667
Obligations of U.S. corporations	74,271	26,275
U.S. corporate commercial paper	22,452	115,658
Obligations of U.S. states and municipalities	5,012	
Total cash, cash equivalents, and available-for-sale investments	\$ 294,303	\$ 378,994

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we invest in liquid, high quality debt securities. Our investments in debt securities are subject to interest rate risk. To minimize the exposure due to an adverse shift in interest rates, we invest in short-term securities and maintain a weighted average maturity of one year or less. At June 30, 2009, the average portfolio duration was approximately five months and the contractual maturity of any single investment did not exceed twelve months. At December 31, 2008, the average portfolio duration was approximately two months and the contractual maturity of any single investment did not exceed twelve months.

Gross unrealized gains and losses were insignificant at June 30, 2009 and at December 31, 2008. The gross unrealized losses were primarily due to changes in interest rates on fixed income securities. Based on our available cash and our expected operating cash requirements we do not intend to sell these securities and it is not more likely than not that we will be required to sell these securities before we recover the amortized cost basis. Accordingly, we believe there are no other-than-temporary impairments on these securities and have not recorded a provision for impairment.

The following table represents the fair value hierarchy for our financial assets measured at fair value on a recurring basis as of June 30, 2009 (in thousands):

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money market funds	\$ 104,160	\$	\$	\$ 104,160
Obligations of U.S. government agencies		85,574		85,574
Obligations of U.S. corporations		74,271		74,271
U.S. corporate commercial paper		22,452		22,452
Obligations of U.S. states and municipalities		5,012		5,012
Cash equivalents and available-for-sale investments	\$ 104,160	\$ 187,309	\$	\$ 291,469
Cash				2,834

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Cash, cash equivalents, and available-for-sale investments \$ 294,303

The following table represents the fair value hierarchy for our financial assets measured at fair value on a recurring basis as of December 31, 2008 (in thousands):

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money market funds	\$ 134,686	\$	\$	\$ 134,686
U.S. corporate commercial paper		115,658		115,658
Obligations of U.S. government agencies		91,667		91,667
Obligations of U.S. corporations		26,275		26,275
Cash equivalents and available-for-sale investments	\$ 134,686	\$ 233,600	\$	\$ 368,286
Cash				10,708
Cash, cash equivalents, and available-for-sale investments				\$ 378,994

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- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

**Note 3 Inventory**

Inventory consists of the following (in thousands):

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
Raw materials	\$ 6,603	\$ 6,964
Work-in-process	618	1,743
Finished goods	2,889	612
Total	\$ 10,110	\$ 9,319

Inventory includes direct materials, direct labor, and manufacturing overhead and is computed on a first-in, first-out basis. Inventory is stated at the lower of cost or market and is net of reserves of \$4.3 million and \$5.0 million as of June 30, 2009 and December 31, 2008, respectively. Reserves are determined using specific identification plus an estimated reserve for potential defective or excess inventory based on historical experience or projected usage. Inventory is manufactured upon receipt of firm purchase orders from our licensing partners.

**Note 4 Commitments and Contingencies***Legal Matters*

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

*Indemnifications in Connection with Commercial Agreements*

As part of our collaboration agreement with our partners related to the license, development, manufacture and supply of drugs based on our proprietary technologies, 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 (with respect to our activities) and infringement of intellectual property to the extent the intellectual property is developed by us and licensed to our partners. The term of these indemnification obligations is generally perpetual any time after execution of the agreement. There is generally no limitation on the potential amount of future payments we could be required to make under these indemnification obligations.

As part of our pulmonary asset sale to Novartis that closed on December 31, 2008, we and Novartis made representations and warranties and entered into certain covenants and ancillary agreements which are supported by an indemnity obligation. In the event it were determined that we breached any of the representations and warranties or covenants and agreements made by us in the transaction documents, we could incur an indemnification liability depending on the timing, nature, and amount of any such claims.

To date we have not incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the obligated amount under these agreements is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. No liabilities have been recorded for these obligations on our Consolidated Balance Sheets as of June 30, 2009 or December 31, 2008.



**Table of Contents****Note 5 Collaborative Agreements**

On August 1, 2007, we entered into a co-development, license and co-promotion agreement with Bayer Healthcare LLC to develop a specially-formulated inhaled Amikacin (BAY41-6551). We are responsible for any future development of the nebulizer device included in the Amikacin product through the completion of Phase 3 clinical trials and scale-up for commercialization. Bayer Healthcare LLC is responsible for most future clinical development (other than \$10.0 million of Phase 3 clinical trial costs to be reimbursed by Nektar) and commercialization costs, all activities to support worldwide regulatory filings, approvals and related activities, further development of BAY41-6551 and final product packaging. We received an upfront payment of \$40.0 million and performance milestone payments of \$20.0 million, the second performance milestone of \$10.0 million will be used to reimburse Bayer for Phase 3 clinical trial costs. We recognized milestone revenue of \$1.2 million and \$2.6 million during the three month periods ended June 30, 2009 and 2008, respectively, and \$2.6 million and \$3.3 million during the six month periods ended June 30, 2009 and 2008, respectively, included in Collaboration and other revenue in our Condensed Consolidated Statement of Operations. As of June 30, 2009 and December 31, 2008, \$36.1 million and \$38.7 million, respectively, of collaborative revenue was recorded as deferred revenue in our Condensed Consolidated Balance Sheets. We are entitled to development milestones and sales milestones upon achievement of certain annual sales targets and royalties based on annual worldwide net sales of BAY41-6551.

**Note 6 Stock-Based Compensation**

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

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Cost of goods sold, net of inventory change	\$ 78	\$ 91	\$ 153	\$ 121
Other cost of revenue				23
Research and development expense	822	1,141	1,484	1,110
General and administrative expense	1,466	1,547	3,054	2,609
Total stock-based compensation costs	\$ 2,366	\$ 2,779	\$ 4,691	\$ 3,863

***Aggregate Unrecognized Stock-Based Compensation Expense***

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

<b>Fiscal Year</b>	<b>As of June 30, 2009</b>
2009 (remaining 6 months)	\$ 5,021
2010	8,916
2011	7,808
2012	3,271
2013 and thereafter	1,136
	\$ 26,152

**Note 7 Net Loss Per Share**

Basic net loss per share is calculated based on the weighted-average number of common shares outstanding during the periods presented. For all periods presented in the Condensed Consolidated Statements of Operations, the net loss available to common stockholders is equal to the reported net loss. Basic and diluted net loss per share are the same due to our historical net losses and the requirement to exclude potentially dilutive securities which would have an

anti-dilutive effect on net loss per share. The weighted average of these potentially dilutive securities has been excluded from the diluted net loss per share calculation and is as follows (in thousands):

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Convertible subordinated notes	9,989	14,638	9,989	14,638
Stock options	14,604	15,064	14,945	13,590
Total	24,593	29,702	24,934	28,228

## **Table of Contents**

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

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

#### **Overview**

##### *Strategic Direction of Our Business*

We are a clinical-stage biopharmaceutical company developing a pipeline of drug candidates that utilize our PEGylation and advanced polymer conjugate technology platforms to improve the therapeutic benefits of drugs. Our proprietary product pipeline is comprised of drug candidates across a number of therapeutic areas, including oncology, pain, anti-infectives and immunology. We create our innovative product candidates by using our proprietary chemistry platform to modify the chemical structure of drugs using unique polymer conjugates. Additionally, we may utilize established pharmacologic targets to engineer a new drug candidate relying on a combination of the known properties of these targets and the attributes of our customized polymer chemistry. Our drug candidates are designed to correct deficiencies in the pharmacokinetics, half-life, oral bioavailability, metabolism or distribution of drugs to improve their therapeutic efficacy.

During 2009, we expect to continue to make substantial investments to advance our pipeline of drug candidates from early stage discovery research through clinical development. On March 2, 2009, we announced that we were terminating our Phase 2 clinical trial for Oral NKTR-118 (oral PEGylated naloxol) as a result of positive preliminary results. We also have several Phase 2 clinical trials for NKTR-102 (PEGylated irinotecan) directed at a number of different indications in the oncology therapeutic area already underway or scheduled to begin during 2009. In addition, on February 17, 2009, we announced that we had dosed the first patient in a Phase 1 clinical trial for NKTR-105 (PEGylated docetaxel) for patients with refractory solid tumors. We also have several other products in the early discovery or preclinical stage that we are preparing to move into clinical development.

Our focus on research and clinical development requires substantial investments that continue to increase as we advance each drug candidate through the development cycle. While we believe that our strategy has the potential to create significant value if one or more of our drug candidates demonstrates positive clinical results and/or receives regulatory approval in one or more major markets, drug development is an inherently uncertain process and there is a high risk of failure at every stage prior to approval and clinical results are very difficult to predict. Clinical development success and failures can have an unpredictable and disproportionate positive or negative impact on our scientific and medical prospects, financial prospects, financial condition, and market value.

We intend to decide on a product-by-product basis whether we wish to continue development into Phase 3 pivotal clinical trials and commercialize products on our own, or seek a partner, or pursue a combination of these approaches. Following completion of Phase 2 development, or earlier in the development cycle in certain circumstances, we will generally be seeking collaborations with one or more biotechnology or pharmaceutical companies to conduct Phase 3 clinical development, to be responsible for the regulatory approval process and, if such drug candidate is approved, to market and sell the drug in one or more world markets. The commercial terms of such future collaborations, if any, including, without limitation, up-front payments, development milestone payments, and royalty rates, will be critical to the future prospects of our business and financial condition. In particular, our ability to successfully conclude a new collaboration for Oral NKTR-118 on commercially favorable terms (or at all), will have a significant impact on our financial position and business prospects in 2009.

We also have a number of existing license and collaboration agreements with third parties who have licensed our proprietary technologies for drugs that have either received regulatory approval in one or more markets or drug candidates that are still in the clinical development stage. For example, the future clinical and commercial success of Bayer's Amikacin Inhale (BAY41-6551 or NKTR-061), UCB's CIMZIA, Roche's MIRCERA and Affymax's Hematide, among others, will together have a material impact on our long-term revenue prospects, as will the success of Bayer's Cipro Inhale program, in relation to which we have certain royalty rights. Because drug development and commercialization is subject to a number of risks and uncertainties, there is a risk that our future revenue from one or more of these agreements will be less than we anticipate.

##### *Key Developments and Trends in Liquidity and Capital Resources*

At June 30, 2009, we had approximately \$294.3 million in cash, cash equivalents, and short-term investments and \$241.2 million in indebtedness. We may from time to time purchase or retire convertible subordinated notes through cash purchase or exchanges for other securities of the Company in open market or privately negotiated transactions, depending on, among other factors, our levels of available cash and the price at which such convertible notes are available for purchase. We will evaluate such transactions, if any, in light of then-existing market conditions. These transactions, individually or in the aggregate, may be material to our business.



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We have financed our operations primarily through revenue from product sales and royalties and research and development contracts and public and private placements of debt and equity. To date we have incurred substantial debt as a result of our issuances of subordinated notes 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 condition and could affect our sources of short-term and long-term funding. Our ability to meet our ongoing operating expenses and repay our outstanding indebtedness is dependent upon our and our partners' ability to successfully complete clinical development of, obtain regulatory approvals for and successfully commercialize new drugs. Even if we or our partners are successful, we may require additional capital to continue to fund our operations and repay our debt obligations as they become due. There can be no assurance that additional funds, if and when required, will be available to us on favorable terms, if at all.

Our substantial investment in our preclinical and clinical research and any potential new licensing or partnership agreements, if any, will be the key drivers of our results of operations and financial position during 2009. One of our collaboration partners has a one-time license extension option exercisable in December 2009. If this partner elects to exercise this license extension option right, we will receive a cash payment of \$31.0 million in December 2009.

**Results of Operations**

*Three Months and Six Months Ended June 30, 2009 and 2008*

*Revenue (in thousands, except percentages)*

	<b>Three months ended June 30, 2009</b>	<b>Three months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
Product sales and royalties	\$ 10,525	\$ 9,010	\$ 1,515	17%
Collaboration and other	2,463	11,391	(8,928)	(78%)
Total revenue	\$ 12,988	\$ 20,401	\$ (7,413)	(36%)

	<b>Six months ended June 30, 2009</b>	<b>Six months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
Product sales and royalties	\$ 16,995	\$ 19,381	\$ (2,386)	(12%)
Collaboration and other	5,704	21,012	(15,308)	(73%)
Total revenue	\$ 22,699	\$ 40,393	\$ (17,694)	(44%)

Our revenue is derived from our collaboration agreements, under which we may receive contract research payments, milestone payments based on clinical progress, regulatory progress or net sales achievements, royalties or product sales revenue. Significant variations in the timing of receipt of cash payments and our recognition of revenue can result from the nature of significant milestone payments based on the execution of new collaboration agreements, the timing of clinical, regulatory or sales events which often result in single milestone payments and the timing and success of the commercial launch of new drugs by our collaboration partners.

The decrease in total revenue for the three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008, was primarily attributable to the termination of our Tobramycin Inhalation Powder (TIP) collaboration agreement with Novartis Vaccines and Diagnostics Inc. and the assignment of our Cipro Inhale collaboration agreement with Bayer Schering Pharma AG to Novartis. Pursuant to the terms of the transaction in which we assigned this collaboration agreement to Novartis, we maintain the right to receive certain potential royalties in the future based on net product sales if Cipro Inhale receives regulatory approval and is successfully

commercialized.

The timing of our product sales depends upon our collaboration partners' requirements and we do not expect to recognize our revenue ratably each quarter in 2009. One of our collaboration partners has a one-time license extension option exercisable in December 2009. If this partner elects to exercise this license extension option right, we will receive a cash payment of \$31.0 million in December 2009.

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

The decrease in product sales and royalties for the six months ended June 30, 2009 compared to the six months ended June 30, 2008 is attributable to lower product sales volumes to our collaboration partners. The increase in product sales and royalties for the three months ended June 30, 2009 compared to the three months ended June 30, 2008 resulted from changes in the timing of shipments.

*Collaboration and other*

Collaboration and other revenue includes reimbursed research and development expenses, amortization of deferred up-front signing and milestone payments received from our collaboration partners, and intellectual property license fee revenue. Collaboration revenue fluctuates from year to year, and therefore future collaboration revenue cannot be predicted accurately. The level of collaboration and other revenues depends in part upon the continuation of existing collaborations, the stage of program development, and the achievement of milestones.

The decrease in Collaboration and other revenue for the three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 is attributable to the termination of our TIP collaboration agreement and the assignment of the Cipro Inhale collaboration agreement that each accounted for approximately \$6.9 million and \$13.5 million of Collaboration and other revenue, respectively. We do not expect to recognize any revenue related to these two agreements in 2009.

The timing and future success of our product development programs are subject to a number of risks and uncertainties. See Part II, Item 1A Risk Factors for discussion of the risks associated with our partnered research and development programs.

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

	<b>Three months ended June 30, 2009</b>	<b>Three months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
Cost of goods sold	\$ 10,231	\$ 5,444	\$ 4,787	88%
Product gross margin	\$ 294	\$ 3,566	\$ (3,272)	(92%)
Product gross margin %	3%	40%		

	<b>Six months ended June 30, 2009</b>	<b>Six months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
Cost of goods sold	\$ 15,330	\$ 12,671	\$ 2,659	(21%)
Product gross margin	\$ 1,665	\$ 6,710	\$ (5,045)	(75%)
Product gross margin %	10%	35%		

For the three months ended June 30, 2009 compared to the three months ended June 30, 2008, the decrease in product gross margin percentage is attributable to a shift in product mix and decreased manufacturing volume; the decreased manufacturing volume resulted in increased unabsorbed manufacturing overhead recognized as Cost of goods sold.

For the six months ended June 30, 2009 compared to the six months ended June 30, 2008, Cost of goods sold increased despite a decrease in Product sales; lower production volumes during 2009 resulted in increased unabsorbed manufacturing overhead costs. The lower product gross margin percentage is also attributable to a shift in the product mix and a \$2.1 million success fee that became due to one of our former consulting firms as the final payment due under the agreement recognized during the first quarter of 2009.

As a result of the fixed cost base associated with our manufacturing activities, we expect product gross margin to fluctuate period to period depending on the level of manufacturing orders from our customers.



**Table of Contents***Other Cost of Revenue (in thousands, except percentages)*

	<b>Three months ended June 30, 2009</b>	<b>Three months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
Other cost of revenue	\$	\$ 1,487	\$ (1,487)	n/a

	<b>Six months ended June 30, 2009</b>	<b>Six months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
Other cost of revenue	\$	\$ 6,821	\$ (6,821)	n/a

Other cost of revenue for the three months and six months ended June 30, 2008 includes the costs of maintaining our Exubera manufacturing capacity after the termination of the Pfizer agreements on November 9, 2007 through the termination of our inhaled insulin programs in April 2008.

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

	<b>Three months ended June 30, 2009</b>	<b>Three months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
Research and development expense	\$ 24,150	\$ 33,500	\$ (9,350)	(28%)

	<b>Six months ended June 30, 2009</b>	<b>Six months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
Research and development expense	\$ 48,040	\$ 70,873	\$ (22,833)	(32%)

Research and development expenses consist primarily of personnel costs, including salaries, benefits, and stock-based compensation, clinical studies performed by contract research organizations (CROs), materials and supplies, licenses and fees, and overhead allocations consisting of various support and facilities related costs.

The decrease in Research and development expense for the three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008, is primarily attributable to the completion of the sale of certain assets related to our pulmonary business, associated property, and intellectual property to Novartis on December 31, 2008 (referred to as the Novartis Pulmonary Asset Sale) and the workforce reduction executed in February 2008. As part of the Novartis Pulmonary Asset Sale, we transferred approximately 140 of our personnel dedicated to our pulmonary operations and our San Carlos research and manufacturing facility to Novartis. In addition, we ceased research activities on the TIP research and development program, the Cipro Inhale program and certain other proprietary pulmonary development programs. For the three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008, personnel costs decreased by approximately \$4.5 million and \$13.9 million, respectively, and facilities costs decreased by approximately \$4.4 million and \$8.2 million, respectively.

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

	<b>Three months ended June 30, 2009</b>	<b>Three months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
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General and administrative expense	\$	9,087	\$	13,328	\$	(4,241)	(32%)
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		<b>Six months ended June 30, 2009</b>	<b>Six months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
General and administrative expense	\$	20,107	\$ 25,275	\$ (5,168)	(20%)

General and administrative expense is associated with administrative staffing, business development and marketing. For the three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008, personnel costs decreased by approximately \$1.3 million and \$2.4 million, respectively, due to headcount reductions, marketing costs decreased by approximately \$0.6 million and \$1.0 million, respectively, professional outside service costs decreased by approximately \$0.7 million and \$1.0 million, respectively, and patent fees decreased by \$0.3 million and \$0.5 million, respectively, due to the transfer of pulmonary specific intellectual property as part of the Novartis Pulmonary Asset Sale. Additionally, for the three months ended June 30, 2009 compared to the three months ended June 30, 2008, stock-based compensation expense decreased by \$0.2 million.

**Table of Contents***Interest Income and Interest Expense (in thousands, except percentages)*

	<b>Three months ended June 30, 2009</b>	<b>Three months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
Interest Income	\$ 950	\$ 3,190	\$ (2,240)	(70%)
Interest Expense	\$ (2,948)	\$ (3,929)	\$ (981)	(25%)

	<b>Six months ended June 30, 2009</b>	<b>Six months ended June 30, 2008</b>	<b>Increase / (Decrease) 2009 vs. 2008</b>	<b>Percentage Increase / (Decrease) 2009 vs. 2008</b>
Interest Income	\$ 2,600	\$ 8,203	\$ (5,603)	(68%)
Interest Expense	\$ (6,285)	\$ (7,847)	\$ (1,562)	(20%)

The decrease in interest income for the three months and six months ended June 30, 2009, compared to the three months and six months ended June 30, 2008, was primarily attributable to lower interest rates and a lower average balance of our cash, cash equivalents, and short-term investments. The decrease in interest expense for the three months and six months ended June 30, 2009, compared to the three months and six months ended June 30, 2008, was primarily attributable to a lower average balance of convertible subordinated notes outstanding. We repurchased \$100.0 million of our 3.25% convertible subordinated notes in the fourth quarter of 2008.

**Liquidity and Capital Resources**

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

We had cash, cash equivalents and short-term investments in marketable securities of \$294.3 million and indebtedness of \$241.2 million, including \$215.0 million of 3.25% convertible subordinated notes due September 2012, \$21.0 million in capital lease obligations, and \$5.2 million in other liabilities as of June 30, 2009.

Due to the recent adverse developments in the credit markets, we may experience reduced liquidity with respect to some of our short-term investments. These investments are generally held to maturity, which is less than one year. However, if the need arose to liquidate such securities before maturity, we may experience losses on liquidation. At June 30, 2009, the average portfolio duration was approximately five months and the contractual maturity of any single investment did not exceed twelve months. To date we have not experienced any liquidity issues with respect to these securities, but should such issues arise, we may be required to hold some, or all, of these securities until maturity. We believe that, even allowing for potential liquidity issues with respect to these securities, our remaining cash, cash equivalents, and short-term investments will be sufficient to meet our anticipated cash needs for at least the next twelve months. Based on our available cash and our expected operating cash requirements we do not intend to sell these securities and it is not more likely than not that we will be required to sell these securities before we recover the amortized cost basis. Accordingly, we believe there are no other-than-temporary impairments on these securities and have not recorded a provision for impairment.

*Cash flows used in operating activities*

Cash flows used in operating activities for the six months ended June 30, 2009 totaled \$71.1 million that includes \$4.9 million for employee bonus payments related to services performed in 2008, \$3.5 million for our semi-annual interest payment on our convertible subordinated notes, \$2.7 million for severance payments for employees terminated in December 2008, and \$60.0 million of other net operating cash uses. Because of the nature and timing of certain cash receipts and payments, net cash utilization is not expected to be ratable over the four quarters of the year. One of our collaboration partners has a one-time license extension option exercisable in December 2009. If this partner elects to exercise this license extension option right, we will receive a cash payment of \$31.0 million in December 2009.





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For the six months ended June 30, 2008, cash used in operations includes payments to Bepak Europe Ltd. and Tech Group North America, Inc. of \$39.9 million for amounts due under our termination agreements with those companies related to the Exubera inhaler contract manufacturing agreement, all of which was recorded as an expense in 2007, \$5.0 million to maintain Exubera inhaler manufacturing capacity at Tech Group's facility, and \$5.3 million for severance, employee benefits, and outplacement services in connection with our workforce reduction plans.

### *Cash flows from investing activities*

We purchased \$8.0 million and \$10.3 million of property and equipment in the six months ended June 30, 2009 and 2008, respectively. During the six months ended June 30, 2009 we paid \$4.4 million of previously expensed transaction costs related to the Novartis Pulmonary Asset Sale, which was completed on December 31, 2008.

### *Cash flows used in financing activities*

Cash used in financing activities were not significant for the six months ended June 30, 2009 and for the six months ended June 30, 2008.

## **Contractual Obligations**

In the three-months ended June 30, 2009, there was no material change to the summary of contractual obligations included in our Annual Report on Form 10-K for the year ended December 31, 2008.

## **Off-Balance Sheet Arrangements**

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

## **Recent Accounting Pronouncements**

### *SFAS No. 168*

In June 2009, the Financial Accounting Standards Board (FASB) issued SFAS No. 168, *The FASB Accounting Standards Codification<sup>TM</sup> and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162* (SFAS 168). The statement confirmed that the *FASB Accounting Standards Codification* (the Codification) will become the single official source of authoritative U.S. GAAP (other than guidance issued by the SEC), superseding existing FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force (EITF), and related literature. After that date, only one level of authoritative U.S. GAAP will exist. All other literature will be considered non-authoritative. The Codification does not change U.S. GAAP; instead, it introduces a new structure that is organized in an easily accessible, user-friendly online research system. The Codification, which changes the referencing of financial standards, becomes effective for interim and annual periods ending on or after September 15, 2009. We will apply the Codification beginning in the third quarter of 2009. We do not expect the adoption of SFAS 168 to have any substantive impact on our Condensed Consolidated Financial Statements or related footnotes.

### *SFAS No. 165*

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This statement sets forth the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements. SFAS 165 also requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date – that is, whether that date represents the date the financial statements were issued or were available to be issued. This statement is effective for interim or annual reporting periods ending after June 15, 2009. We adopted SFAS 165 during the quarter ended June 30, 2009, which did not have a material impact on our financial position or results of operations.

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### *FASB Staff Position No. 157-4*

In April 2009, the FASB issued FASB Staff Position No. 157-4 (FSP 157-4), *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, which provides guidance on determining fair value when there is no active market or where the price inputs being used represent distressed sales. FSP 157-4 is effective for interim and annual periods ending after June 15, 2009. We adopted the provisions of FSP 157-4 during the quarter ended June 30, 2009, which did not have a material impact on our financial position or results of operations.

### *FASB Statement of Position No. 115-2 and 124-2*

In April 2009, the FASB issued FASB Staff Position No. 115-2 and 124-2 (FSP 115-2 and 124-2), *Recognition and Presentation of Other-Than-Temporary Impairments*, which provides operational guidance for determining other-than-temporary impairments for debt securities. FSP 115-2 and 124-2 is effective for interim and annual periods ending after June 15, 2009. We adopted the provisions of FSP 115-2 and 124-2 during the quarter ended June 30, 2009, which did not have a material impact on our financial position or results of operations.

### **Subsequent Events**

We evaluated subsequent events through August 5, 2009, the date on which this Quarterly Report on Form 10-Q was filed with the Securities and Exchange Commission.

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

Our market risks at June 30, 2009 have not changed significantly from those discussed in Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2008 on file with the Securities and Exchange Commission.

### **Item 4. Controls and Procedures**

#### **Disclosure Controls and Procedures**

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

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

#### **Changes in Internal Control Over Financial Reporting**

We continuously seek to improve the efficiency and effectiveness of our internal controls. This results in refinements to processes throughout the company. However, there was no change in our internal control over financial reporting that occurred in the three months ended June 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

#### **Limitations on the Effectiveness of Controls**

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

cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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**Approval of Non-Audit Services**

In the three months ended June 30, 2009, the Audit Committee of the Board of Directors approved no non-audit related services to be provided by Ernst & Young LLP, our independent registered public accounting firm.

**PART II: OTHER INFORMATION**

**Item 1. Legal Proceedings**

Reference is hereby made to our disclosures in Legal Matters under Note 4 of the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q and the information under the heading Legal Matters is incorporated by reference herein.

**Item 1A. Risk Factors**

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

**Risks Related to Our Business**

**Drug development is an inherently uncertain process and there is a high risk of failure at every stage of development and development failures can significantly harm our business.**

We have a number of proprietary product candidates and partnered product candidates in research and development ranging from the early discovery research phase through preclinical testing and clinical trials. Preclinical testing and clinical trials are long, expensive and a highly uncertain processes. It will take us, or our collaborative partners, several years to complete clinical trials. Drug development is an uncertain scientific and medical endeavor and failure can unexpectedly occur at any stage of clinical development. Typically, there is a high rate of attrition for product candidates in preclinical and clinical trials due to scientific feasibility, safety, efficacy, changing standards of medical care and other variables.

**Even with success in preclinical testing and clinical trials, the risk of clinical failure remains high prior to regulatory approval.**

A number of companies in the pharmaceutical and biotechnology industries have suffered significant unforeseen setbacks in later stage clinical trials (i.e., Phase 2 or Phase 3 trials) due to factors such as inconclusive efficacy results and adverse medical events, even after achieving positive results in earlier trials that were satisfactory both to them and to reviewing regulatory agencies. Although we recently announced positive preliminary Phase 2 clinical results for Oral NKTR-118 (oral PEGylated naloxol), there are still substantial risks associated with the future outcome of a Phase 3 clinical trial and the regulatory review process. In addition, although NKTR-102 (PEGylated irinotecan) continues in active Phase 2 clinical development, there remains a significant uncertainty that this drug candidate will eventually receive regulatory approval or be a commercial success even if approved. The risk of failure is increased for our product candidates that are based on new technologies, such as the application of our advanced polymer conjugate technology to small molecules, including without limitation Oral NKTR-118 and NKTR-102. If our PEGylation and advanced polymer conjugate technologies fail to generate new drug candidates with positive clinical trial results and approved drugs, our business, results of operations, and financial condition would be materially harmed.

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

We intend to continue to seek partnerships with pharmaceutical and biotechnology partners to fund a portion of our research and development expenses and develop and commercialize our product candidates. For example, following the recent announcement of our preliminary Phase 2 clinical results for Oral NKTR-118 (oral PEGylated naloxol), we are in the process of actively seeking a collaboration partner for this program. Our ability to successfully conclude a collaboration partnership for Oral NKTR-118 on commercially favorable terms, or at all, will have a significant impact on our business and financial position in 2009. The timing of any future partnership, as well as the terms and conditions of the partnership, will affect our ability to benefit from the relationship. If we are unable to find suitable partners or to negotiate collaborative arrangements with favorable commercial terms with respect to our existing and future product candidates or the licensing of our technology, or if any arrangements we negotiate, or have negotiated, are terminated, our business, results of operations and financial condition could suffer. While we may enter new collaboration or license agreements in 2009, we currently expect revenue to decrease in 2009 as a result of the termination of our collaboration agreements with Novartis Vaccines and Diagnostics, Inc. for Tobramycin inhalation powder (TIP) and our assignment of our rights and obligations, other than certain royalty rights, related to the Cipro Inhale program partnered with Bayer AG. Revenue from the TIP and Cipro Inhale collaboration agreements was \$4.9 million and \$2.0 million, or 24% and 10% of revenue, respectively for the three months ended June 30, 2008 and \$8.8 million and \$4.7 million, or 22% and 12% of revenue, respectively, for the six months ended June 30 2008. We will not receive any revenue related to these programs in 2009.

**The commercial potential of a drug candidate in development is difficult to predict and if the market size for a new drug is significantly smaller than we anticipated, it could significantly and negatively impact our revenue, results of operations and financial condition.**

It is very difficult to estimate the commercial potential of product candidates due to factors such as safety and efficacy compared to other available treatments, including potential generic drug alternatives with similar efficacy profiles, changing standards of care, third party payer reimbursement, patient and physician preferences and the availability of competitive alternatives that may emerge either during the long drug development process or after commercial introduction. If due to one or more of these risks the market potential for a product candidate is lower than we anticipated, it could significantly and negatively impact the commercial terms of any collaboration partnership potential for such product candidate or, if we have already entered into a collaboration for such drug candidate, the revenue potential from royalty and milestones could be significantly diminished and would negatively impact our revenue, results of operations and financial condition.

**Our revenue is exclusively derived from our collaboration agreements, which can result in significant fluctuation in our revenue from period to period, and our past revenue is therefore not necessarily indicative of our future revenue.**

Our revenue is derived from our collaboration agreements with partners, under which we may receive contract research payments, milestone payments based on clinical progress, regulatory progress or net sales achievements, royalties or manufacturing revenue. Significant variations in the timing of receipt of cash payments and our recognition of revenue can result from the nature of significant milestone payments based on the execution of new collaboration agreements, the timing of clinical, regulatory or sales events which result in single milestone payments and the timing and success of the commercial launch of new drugs by our collaboration partners. The amount of our revenue derived from collaboration agreements in any given period will depend on a number of unpredictable factors, including our ability to find and maintain suitable collaboration partners, the timing of the negotiation and conclusion of collaboration agreements with such partners, whether and when we or our partner achieve clinical and sales milestones, whether the partnership is exclusive or whether we can seek other partners, the timing of regulatory approvals and the market introduction of new drugs, as well as other factors.

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

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

design and conduct large scale clinical studies;

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

and/or

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

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Our reliance on collaboration partners poses a number of risks to our business, including risks that:

- we may be unable to control whether, and the extent to which, our partners devote sufficient resources to the development programs or commercial efforts;
- disputes may arise in the future with respect to the ownership of rights to technology or intellectual property developed with partners;
- disagreements with partners could lead to delays in, or termination of, the research, development or commercialization of product candidates or to litigation or arbitration;
- contracts with our partners may fail to provide us with significant protection, or to be effectively enforced, in the event one of our partners fails to perform;
- partners have considerable discretion in electing whether to pursue the development of any additional product candidates and may pursue alternative technologies or products either on their own or in collaboration with our competitors;
- partners with marketing rights may choose to devote fewer resources to the marketing of our partnered products than they do to products of their own development;
- the timing and level of resources that our partners dedicate to the development program will affect the timing and amount of revenue we receive;
- partners may be unable to pay us as expected; and
- partners may terminate their agreements with us unilaterally for any or no reason, in some cases with the payment of a termination fee penalty and in other cases with no termination fee penalty.

Given these risks, the success of our current and future partnerships is highly uncertain. We have entered into collaborations in the past that have been subsequently terminated, such as our collaboration with Pfizer for the development and commercialization of inhaled insulin that was terminated by Pfizer in November 2007. If other collaborations are suspended or terminated, our ability to commercialize certain other proposed product candidates could also be negatively impacted. If our collaborations fail, our product development or commercialization of product candidates could be delayed or cancelled, which would negatively impact our business, results of operations and financial condition.

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

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

Even if we or our partners receive regulatory approval of a product, the approval may limit the indicated uses for which the product may be marketed. Our partnered products that have obtained regulatory approval, and the manufacturing processes for these products, are subject to continued review and periodic inspections by the FDA and other regulatory authorities. Discovery from such review and inspection of previously unknown problems may result in restrictions on marketed products or on us, including withdrawal or recall of such products from the market, suspension of related manufacturing operations or a more restricted label. The failure to obtain timely regulatory approval of product candidates, any product marketing limitations or a product withdrawal would negatively impact our business, results of operations and financial condition.





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**We are a party to numerous collaboration agreements and other significant agreements, including in connection with the Novartis Pulmonary Asset Sale, which contain complex commercial terms that could result in disputes, litigation or indemnification liability that could adversely affect our business, results of operations and financial condition.**

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

- research and development performance and reimbursement obligations for our personnel and other resources allocated to partnered product development programs;
- clinical and commercial manufacturing agreements, some of which are priced on an actual cost basis for products supplied by us to our partners with complicated cost allocation formulas and methodologies;
- intellectual property ownership allocation between us and our partners for improvements and new inventions developed during the course of the partnership;
- royalties on end product sales based on a number of complex variables, including net sales calculations, geography, patent life and other financial metrics; and
- indemnity obligations for third-party intellectual property infringement, product liability and certain other claims.

In addition, we have also entered into complex commercial agreements with Novartis in connection with the sale of certain assets related to our pulmonary business, associated technology and intellectual property to Novartis (Novartis Pulmonary Asset Sale), which was completed on December 31, 2008. Our agreements with Novartis contain complex representations and warranties, covenants and indemnification obligations that could result in substantial future liability and harm our financial condition if we breach any of our agreements with Novartis or any third party agreements impacted by this complex transaction. In addition to the asset purchase, we entered an exclusive license agreement with Novartis Pharma pursuant to which Novartis Pharma grants back to us an exclusive, irrevocable, perpetual, royalty-free and worldwide license under certain specific patent rights and other related intellectual property rights necessary for us to satisfy certain continuing contractual obligations to third parties, including in connection with development, manufacture, sale and commercialization activities related to our partnered program for BAY41-6551 with Bayer Healthcare LLC. We also entered into a service agreement pursuant to which we have subcontracted to Novartis certain services to be performed related to our partnered program for BAY41-6551 and a transition services agreement pursuant to which Novartis and we will provide each other with specified services for limited time periods following the closing of the Novartis Pulmonary Asset Sale to facilitate the transition of the acquired assets and business from us to Novartis.

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

**If we or our partners are not able to manufacture drugs in quantities and at costs that are commercially feasible, our proprietary and partnered product candidates may experience clinical delays or constrained commercial supply which could significantly harm our business.**

If we are not able to scale-up manufacturing to meet the drug quantities required to support large clinical trials or commercial manufacturing in a timely manner or at a commercially reasonable cost, we risk delaying our clinical trials or those of our partners and may breach contractual obligations and incur associated damages and costs. In some cases, we may subcontract manufacturing or other services. For instance, we entered a service agreement with Novartis pursuant to which we subcontract to Novartis certain important services to be performed in relation to our partnered program for BAY41-6551 with Bayer Healthcare LLC. If our subcontractors do not dedicate adequate resources to our programs, we risk breach of our obligations to our partners. Building and validating large scale clinical or commercial-scale manufacturing facilities and processes, recruiting and training qualified personnel and obtaining necessary regulatory approvals is complex, expensive and time consuming. In the past we have encountered

challenges in scaling up manufacturing to meet the requirements of large scale clinical trials without making modifications to the drug formulation, which may cause significant delays in clinical development. Further, our drug and device combination products, such as BAY41-6551 and the Cipro Inhale program, require significant device design, formulation development work and manufacturing scale-up activities. As such, drug and device combinations are particularly complex, expensive, time-consuming and uncertain due to the number of variables involved in the final product design, including ease of patient/doctor use, maintenance of clinical efficacy, cost of manufacturing and other important factors. Failure to manufacture products in quantities or at costs that are commercially feasible could cause us not to meet our supply requirements, contractual obligations or other requirements for our proprietary product candidates and, as a result, would negatively impact our business, results of operations and financial condition.

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**We purchase some of the raw starting material for drugs and drug candidates from a single source or a limited number of suppliers, and the partial or complete loss of one of these suppliers could cause production delays, clinical trial delays, substantial loss of revenue and contract liability to third parties.**

We often face very limited supply of a critical raw material that can only be obtained from a single, or a limited number of, suppliers, which could cause production delays, clinical trial delays, substantial lost revenue opportunity or contract liability to third parties. For example, there are only a limited number of qualified suppliers, and in some cases single source suppliers, for the raw materials included in our PEGylation and advanced polymer conjugate drug formulations, and any interruption in supply or failure to procure such raw materials on commercially feasible terms could harm our business by delaying our clinical trials, impeding commercialization of approved drugs or increasing operating loss to the extent we cannot pass on increased costs to a manufacturing customer.

**The current crisis in global credit and financial markets could materially and adversely affect our business, results of operations and financial condition.**

Financial markets have experienced extreme disruption in recent months, including, among other things, extreme volatility in security prices, severely diminished liquidity and credit availability, rating downgrades of certain investments and declining valuations. There could be further deterioration in credit and financial markets and confidence in economic conditions. While we do not currently require access to credit markets to finance our operations, these economic developments are likely to affect our business in various ways. The current tightening of credit in financial markets may harm the ability of our partners to finance operations and they may dedicate fewer resources to our partnered product candidates, which could result in delays in the regulatory approval process and increase the estimated time to commercialization of our product candidates. Since we expect that licensing deals, comprised of a combination of upfront and contract research fees, milestones, manufacturing product sales and product royalties, will represent the majority of our revenue in 2009, such delays could harm our business, results of operations and financial condition. Further, our partners may be unable to continue to develop our partnered product candidates, and some partners may terminate our collaborations. In addition, to date all of our revenue has come from payments from partners, and it may become more difficult to collect any payments due from our partners on a timely basis, or at all. The economic crisis may also affect the ability of suppliers of starting materials to meet our capacity requirements or cause them to increase the price of starting materials. We are unable to predict the likely duration and severity of the current disruption in financial markets and adverse economic conditions in the U.S. and other countries. As a result of the worldwide economic slowdown, it is extremely difficult for us and our partners to forecast future sales levels based on historical information and trends.

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

The patent positions of pharmaceutical, medical device and biotechnology companies, such as ours, are uncertain and involve complex legal and factual issues. We own approximately 80 U.S. and approximately 335 foreign patents and a number of pending patent applications that cover various aspects of our technologies. We have filed patent applications, and plan to file additional patent applications, covering various aspects of our PEGylation and advanced polymer conjugate technologies. There can be no assurance that patents that have issued will be valid and enforceable or that patents for which we apply will issue with broad coverage, if at all. The coverage claimed in a patent application can be significantly reduced before the patent is issued and, as a consequence, our patent applications may result in patents with narrow coverage. Since publication of discoveries in scientific or patent literature often lags behind the date of such discoveries, we cannot be certain that we were the first inventor of inventions covered by our patents or patent applications. As part of the patent application process, we may have to participate in interference proceedings declared by the U.S. Patent and Trademark Office, which could result in substantial cost to us, even if the eventual outcome is favorable. Further, an issued patent may undergo further proceedings to limit its scope so as not to provide meaningful protection and any claims that have issued, or that eventually issue, may be circumvented or otherwise invalidated. Any attempt to enforce our patents or patent application rights could be time consuming and costly. An adverse outcome could subject us to significant liabilities to third parties, require disputed rights to be licensed from or to third parties or require us to cease using the technology in dispute. Even if a patent is issued and enforceable, because development and commercialization of pharmaceutical products can be subject to substantial

delays, patents may expire early and provide only a short period of protection, if any, following commercialization of related products.

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

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

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

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

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

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

In the three months and six months ended June 30, 2009, we reported net losses of \$32.1 million and \$63.9 million, respectively. If and when we achieve profitability depends upon a number of factors, including the timing and recognition of milestone payments and license fees received, the timing of revenue under collaboration agreements, the amount of investments we make in our proprietary product candidates and the regulatory approval and market success of our product candidates. We may not be able to achieve and sustain profitability.

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

- develop products utilizing our technologies, either independently or in collaboration with other pharmaceutical or biotech companies;
- receive necessary regulatory and marketing approvals;

- maintain or expand manufacturing at necessary levels;
- achieve market acceptance of our partnered products;
- receive royalties on products that have been approved, marketed or submitted for marketing approval with regulatory authorities; and
- maintain sufficient funds to finance our activities.



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

As of June 30, 2009, we had cash, cash equivalents, and short-term investments in marketable securities valued at approximately \$294.3 million and approximately \$241.2 million of indebtedness, including approximately \$215.0 million in convertible subordinated notes due September 2012, \$21.0 million in capital lease obligations, and \$5.2 million of other long-term liabilities. We expect to use a substantial portion of our cash to fund our ongoing operations over the next few years. In October and November 2008, we repurchased approximately \$100.0 million in par value of our 3.25% convertible subordinated notes for an aggregate purchase price of \$47.8 million.

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

- making it more difficult to obtain additional financing;
- constraining our ability to react quickly in an unfavorable economic climate;
- constraining our stock price; and
- constraining our ability to invest in our proprietary product development programs.

Currently, we are not generating positive cash flow. If we are unable to satisfy our debt service requirements, substantial liquidity problems could result. In relation to our convertible subordinated notes, since the market price of our common stock is significantly below the conversion price, the holders of our outstanding convertible subordinated notes are unlikely to convert the notes to common stock in accordance with the existing terms of the notes. If we do not generate sufficient cash from operations to repay principal or interest on our remaining convertible subordinated notes, or satisfy any of our other debt obligations, when due, we may have to raise additional funds from the issuance of equity or debt securities or otherwise restructure our obligations. Any such financing or restructuring may not be available to us on commercially acceptable terms, if at all.

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

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

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

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

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

We depend on independent clinical investigators, contract research organizations and other third-party service providers to conduct clinical trials for our proprietary product candidates. Though we rely heavily on these parties for successful execution of our clinical trials and are ultimately responsible for the results of their activities, many aspects of their activities are beyond our control. For example, we are responsible for ensuring that each of our clinical trials is conducted in accordance with the general investigational plan and protocols for the trial, but the independent clinical investigators may prioritize other projects over ours or communicate issues regarding our products to us in an untimely manner. Third parties may not complete activities on schedule or may not conduct our clinical trials in accordance with regulatory requirements or our stated protocols. The early termination of any of our clinical trial arrangements, the failure of third parties to comply with the regulations and requirements governing clinical trials or our reliance on results of trials that we have not directly conducted or monitored could hinder or delay the development, approval and commercialization of our product candidates and would adversely affect our business, results of operations and financial condition.

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

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

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

Our PEGylation and advanced polymer conjugate chemistry platforms and our partnered and proprietary products and product candidates compete with various pharmaceutical and biotechnology companies. Competitors of our PEGylation and polymer conjugate chemistry technologies include The Dow Chemical Company, Enzon Pharmaceuticals, Inc., SunBio Corporation, Mountain View Pharmaceuticals, Inc., Neose Technologies, Inc., and NOF Corporation. Several other chemical, biotechnology and pharmaceutical companies may also be developing PEGylation technologies or technologies that have similar impact on target drug molecules. Some of these companies license or provide the technology to other companies, while others are developing the technology for internal use.

There are several competitors for our proprietary product candidates currently in development. For BAY41-6551 (Amikacin inhale), the current standard of care includes several approved intravenous antibiotics for the treatment of either hospital-acquired pneumonia or ventilator-associated pneumonia in patients on mechanical ventilators. For Oral NKTR-118 (PEGylated naloxol), there are currently several alternative therapies used to address opioid-induced constipation (OIC) and opioid-induced bowel dysfunction (OBD), including over-the-counter laxatives and stool



softeners such as docusate sodium, senna and milk of magnesia. In addition, there are a number of companies developing potential products which are in various stages of clinical development and are being evaluated for the treatment of OIC and OBD in different patient populations, including Adolor Corporation, GlaxoSmithKline plc, Progenics Pharmaceuticals, Inc., Wyeth, Mundipharma Int. Limited, Sucampo Pharmaceuticals and Takeda Pharmaceutical Company Limited. For NKTR-102 (PEG-irinotecan), there are a number of approved therapies for the treatment of colorectal cancer, including Eloxatin, Camptosar, Avastin, Erbitux, Vectibux, Xeloda, Adrucil and Wellcovorin. In addition, there are a number of drugs in various stages of preclinical and clinical development from companies exploring cancer therapies or improved chemotherapeutic agents to potentially treat colorectal cancer, including, but not limited to, products in development from Bristol-Myers Squibb Company, Pfizer, Inc., GlaxoSmithKline plc, Antigenics, Inc., F. Hoffmann-La Roche Ltd, Novartis AG, Cell Therapeutics, Inc., Neopharm Inc., Mediatech Research Ltd, Alchemia Limited, Enzon Pharmaceuticals, Inc. and others.

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

### **We could be involved in legal proceedings and may incur substantial litigation costs and liabilities that will adversely affect our business, results of operations and financial condition.**

From time to time, third parties have asserted, and may in the future assert, that we or our partners infringe their proprietary rights. The third party often bases its assertions on a claim that its patents cover our technology. Similar assertions of infringement could be based on future patents that may issue to third parties. In certain of our agreements with our partners, we are obligated to indemnify and hold harmless our partners from intellectual property infringement, product liability and certain other claims, which could cause us to incur substantial costs if we are called upon to defend ourselves and our partners against any claims. If a third party obtains injunctive or other equitable relief against us or our partners, they could effectively prevent us, or our partners, from developing or commercializing, or deriving revenue from, certain products or product candidates in the U.S. and abroad. For instance, F. Hoffmann-La Roche Ltd, to which we license our proprietary PEGylation reagent for use in the MIRCERA product, was a party to a significant patent infringement lawsuit brought by Amgen Inc. related to Roche's proposed marketing and sale of MIRCERA to treat chemotherapy anemia in the U.S. Amgen prevailed in this lawsuit and a U.S. federal district court issued an injunction preventing Roche from marketing and selling MIRCERA in the U.S. Third-party claims could also result in the award of substantial damages to be paid by us or a settlement resulting in significant payments to be made by us. For instance, a settlement might require us to enter a license agreement under which we pay substantial royalties to a third party, diminishing our future economic returns from the related product. In 2006, we entered into a litigation settlement related to an intellectual property dispute with the University of Alabama in Huntsville pursuant to which we paid \$11.0 million and agreed to pay an additional \$10.0 million in equal \$1.0 million installments over ten years ending with the last payment due on July 1, 2016. We cannot predict with certainty the eventual outcome of any pending or future litigation. Costs associated with such litigation, substantial damage claims, indemnification claims or royalties paid for licenses from third parties could have a material adverse effect on our business, results of operations and financial condition.

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

The manufacture, clinical testing, marketing and sale of medical products involve inherent product liability risks. If product liability costs exceed our product liability insurance coverage, we may incur substantial liabilities that could have a severe negative impact on our financial position. Whether or not we are ultimately successful in any product liability litigation, such litigation would consume substantial amounts of our financial and managerial resources and might result in adverse publicity, all of which would impair our business. Additionally, 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.

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

Our business strategy requires us to manage our business to provide for the continued development and potential commercialization of our proprietary and partnered product candidates. Our strategy also calls for us to undertake increased research and development activities and to manage an increasing number of relationships with partners and other third parties, while simultaneously managing the expenses generated by these activities. If we are unable to manage effectively our current operations and any growth we may experience, our business, financial condition and results of operations may be adversely affected. If we are unable to effectively manage our expenses, we may find it necessary to reduce our personnel-related costs through further reductions in our workforce, which could harm our

operations, employee morale and impair our ability to retain and recruit talent. Furthermore, if adequate funds are not available, we may be required to obtain funds through arrangements with partners or other sources that may require us to relinquish rights to certain of our technologies or products that we would not otherwise relinquish.

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

Our success largely depends on the continued services of our executive officers and other key personnel. The loss of one or more members of our management team or other key employees could seriously harm our business, operating results and financial condition. The relationships that our key managers have cultivated within our industry make us particularly dependent upon their continued employment with us. We are also dependent on the continued services of our technical personnel because of the highly technical nature of our products and the regulatory approval process. Because our executive officers and key employees are not obligated to provide us with continued services, they could terminate their employment with us at any time without penalty. We do not have any post-employment noncompetition agreements with any of our employees and do not maintain key person life insurance policies on any of our executive officers or key employees.

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

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

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

Our corporate headquarters, including a substantial portion of our research and development operations, are located in the San Francisco Bay Area, a region known for seismic activity and a potential terrorist target. In addition, we own facilities for the manufacture of products using our PEGylation and advanced polymer conjugate technologies in Huntsville, Alabama and lease offices in Hyderabad, India. There are no backup facilities for our manufacturing operations located in Huntsville, Alabama. In the event of an earthquake or other natural disaster or terrorist event in any of these locations, our ability to manufacture and supply materials for drug candidates in development and our ability to meet our manufacturing obligations to our customers would be significantly disrupted and our business, results of operations and financial condition would be harmed. Our collaborative partners may also be subject to catastrophic events, such as hurricanes and tornadoes, any of which could harm our business, results of operations and financial condition. We have not undertaken a systematic analysis of the potential consequences to our business, results of operations and financial condition from a major earthquake or other catastrophic event, such as a fire, sustained loss of power, terrorist activity or other disaster, and do not have a recovery plan for such disasters. In addition, our insurance coverage may not be sufficient to compensate us for actual losses from any interruption of our business that may occur.

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

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

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

lack of a provision for cumulative voting in the election of directors, which would otherwise allow less than a majority of stockholders to elect director candidates;  
the ability of our board to authorize the issuance of blank check preferred stock to increase the number of outstanding shares and thwart a takeover attempt;

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prohibition on stockholder action by written consent, thereby requiring all stockholder actions to be taken at a meeting of stockholders;  
 establishment of advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings; and  
 limitations on who may call a special meeting of stockholders.

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

## ***Risks Related to Our Securities***

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

Our stock price is volatile. During the three months ended June 30, 2009, based on closing bid prices on the NASDAQ Global Select Market, our stock price ranged from \$5.02 to \$6.94 per share. We expect our stock price to remain volatile. In addition, as our convertible senior notes are convertible into shares of our common stock, volatility or depressed prices of our common stock could have a similar effect on the trading price of our notes. Also, interest rate fluctuations can affect the price of our convertible senior notes. A variety of factors may have a significant effect on the market price of our common stock or notes, including:

- announcements of data from, or material developments in, our clinical trials or those of our competitors, including delays in clinical development, approval or launch;
- announcements by collaboration partners as to their plans or expectations related to products using our technologies;
- announcements or terminations of collaboration agreements by us or our competitors;
- fluctuations in our results of operations;
- developments in patent or other proprietary rights, including intellectual property litigation or entering into intellectual property license agreements and the costs associated with those arrangements;
- announcements of technological innovations or new therapeutic products that may compete with our approved products or products under development;
- announcements of changes in governmental regulation affecting us or our competitors;
- hedging activities by purchasers of our convertible senior notes;
- litigation brought against us or third parties to whom we have indemnification obligations;
- public concern as to the safety of drug formulations developed by us or others; and

general market conditions.

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**Our stockholders may be diluted, and the price of our common stock may decrease, as a result of the exercise of outstanding stock options and warrants or the future issuances of securities.**

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

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

None, including no purchases of any class of our equity securities by us or any affiliate pursuant to any publicly announced repurchase plan in the three months ended June 30, 2009.

**Item 3. Defaults Upon Senior Securities**

None.

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

A. The annual meeting of the stockholders was held on June 11, 2009.

B. The following matters were voted upon at the annual meeting:

1. To elect the following directors to hold office until the 2012 annual meeting of stockholders:

<b>Nominee</b>	<b>For</b>	<b>Abstain</b>
Robert B. Chess	79,359,564	1,022,501
Susan Wang	79,816,122	565,943
Roy A. Whitfield	78,952,354	1,429,711

In addition to the directors elected above, Michael A. Brown, Christopher A. Kuebler, Joseph J. Krivulka, Lutz Lingnau, and Howard W. Robin continued to serve as directors after the annual meeting.

2. To ratify the appointment, by the audit committee of the board of directors, of Ernst & Young LLP as the independent registered public accounting firm for the fiscal year ending December 31, 2009.

<b>For</b>	<b>Against</b>	<b>Abstain</b>
79,625,028	563,288	194,630

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

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

<b>Exhibit Number</b>	<b>Description of Documents</b>
31.1(1)	Certification of Nektar Therapeutics principal executive officer required by Rule 13a-14(a) or Rule 15d-14(a).
31.2(1)	Certification of Nektar Therapeutics principal financial officer required by Rule 13a-14(a) or Rule 15d-14(a).
32.1(1)*	Section 1350 Certifications.

(1) Filed herewith.

\* Exhibit 32.1 is being furnished and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall such exhibit be deemed to be incorporated by reference in any registration statement or other document filed under the Securities Act of 1933, as amended, or the Securities Exchange Act, except as otherwise stated



in such filing.

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**SIGNATURES**

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

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

Date: August 5, 2009

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

Date: August 5, 2009

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