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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

**FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

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

For the fiscal year ended December 31, 2004

or,

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

Commission File Number: 0-23556

NEKTAR THERAPEUTICS

(Exact name of registrant as specified in its charter)

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

150 Industrial Road
San Carlos, California 94070
(Address of principal executive offices and zip code)

650-631-3100
(Registrant's telephone number, including area code)

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

Securities registered pursuant to Section 12(g) of the Act: **Common Stock, $0.0001 par value**

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

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

The approximate aggregate market value of voting stock held by non-affiliates of the Registrant, based upon the last sale price of the Registrant's Common Stock on June 30, 2004 as reported on the NASDAQ National Market was approximately $1,655,474,516. This calculation excludes approximately 798,878 shares held by directors and executive officers of the Registrant. Exclusion of these shares should not be construed to indicate that such person controls, is controlled by or is under common control with the Registrant. This calculation does not exclude shares held by organizations whose ownership exceeds 5% of the Registrant's outstanding Common Stock as of June 30, 2004 that have represented to the Registrant that they are registered investment advisers or investment companies registered under Section 8 of the Investment Company Act of 1940. Determination of affiliate status for the purposes of this calculation is not necessarily a conclusive determination for any other purpose.

84,730,751
(Number of shares of common stock outstanding as of February 28, 2005)

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Registrant's definitive Proxy Statement to be filed for its 2005 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

NEKTAR THERAPEUTICS

2004 ANNUAL REPORT ON FORM 10-K,
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Forward-Looking Statements

This report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "1933 Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "1934 Act"). All statements other than statements of historical fact are "forward-looking statements" for purposes of this annual report, including any projections of earnings, revenues or other financial items, any statements of the plans and objectives of management for future operations, any statements concerning proposed new products or services, any statements regarding future economic conditions or performance and any statement of assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as "may," "will," "expects," "plans," "anticipates," "estimates," "potential," or "continue," or the negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, there can be no assurance that such expectations or any of the forward-looking statements will prove to be correct and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including but not limited to the risk factors set forth below and for the reasons described elsewhere in this annual report. All forward-looking statements and reasons why results may differ included in this report are made as of the date hereof and we do not intend to update any forward-looking statements except as required by law or applicable regulations.

PART I

Item 1. Business

General

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

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

Our product pipeline includes both partnered and proprietary products. We have ongoing collaborations with more than 20 biotechnology and pharmaceutical companies to provide our drug delivery technologies. Our partner product pipeline includes: six products (Neulasta®, PEGASYS®, Somavert®, PEG-INTRON®, Definity®, and Macugen®) approved by the U.S. Food and Drug Administration ("FDA"); one additional product (SprayGel™) approved in Europe that is in late stage testing in the U.S., one product (Exubera®) for which a New Drug Application ("NDA") has been filed with the FDA, two products (Exubera® and Macugen®) for which a marketing authorization application has been filed with the European Medicines Evaluation Agency ("EMEA"); two additional products (CDP 870 and CERA) in Phase III or pivotal trials; and ten products in Phase I and Phase II trials. In addition to our partnered product programs, we have four proprietary products in the early stages of development. One of these products involves an inhaled small molecule that has entered a Phase I trial and another product is in proof-of-concept human studies. The remaining two products are in preclinical testing.

We intend to continue to identify and capitalize on technologies and markets where we see opportunities to establish leadership positions.

Strategy

The key elements of our business strategy are to:

Partner with Pharmaceutical and Biotechnology Companies. We have collaborations with more than 20 pharmaceutical and biotechnology companies. We believe our partnering strategy enables us to develop a large and diversified pipeline of drug products that use our technologies.

- In a typical Nektar Pulmonary Technology collaboration, our partner will provide the active pharmaceutical ingredient (the majority of which are already approved by the FDA in another delivery form), fund development, obtain regulatory approvals, and market the resulting commercial product. We supply our technology and we may manufacture and supply the device and/or drug formulation. In consideration for our efforts, we typically receive R&D reimbursement, milestone payments, revenues from clinical drug manufacturing, as well as royalties from commercial sales of products. In addition, for products using our Pulmonary Technology, we typically receive revenues from the supply of our device for the product along with revenues for drug processing or filling once the product is commercially available.
- In a typical Nektar Advanced PEGylation Technology collaboration, we manufacture and supply the polyethylene glycol ("PEG") reagents to our partners and we may receive milestone payments, manufacturing revenues and in some cases, royalties from sales of the PEGylated commercial product.

Develop Our Own Proprietary Products Utilizing Nektar Technology and/or Know-how. We typically use our know-how and technology in combination with approved drugs to develop our own proprietary products. We

focus on identifying off-patent or near off-patent compounds that would benefit from the application of our technologies to improve the performance and/or delivery of these compounds. Our objective is to create value by advancing these molecules into clinical development and then determining the most appropriate stage to partner these based on the cost and complexity of development and the needs for commercialization. For those molecules that have complex and costly development paths and/or require significant commercial support, we may choose to seek a commercialization partner at an earlier stage. We plan to make partnering decisions for our proprietary products on a product by product basis taking into consideration both market as well as internal factors.

Overview of Nektar Technologies

Our drug delivery technology platforms are designed to improve the performance of both new and existing chemical entities whether they are small molecules or macromolecules. Improved performance typically includes one or more of the following attributes: improved efficacy, improved safety, improved convenience, or enabling the development of a drug molecule. Our three technology platforms are:

- Nektar Advanced PEGylation Technology—uses advanced PEGylation chemistry and a PEG-based delivery system to enhance the performance of most major drug classes, including macromolecules such as peptides and proteins, smaller sized molecular compounds and other drugs. Nektar Advanced PEGylation Technology is used in six products approved for use in the U.S. and in one additional product approved in Europe.
- Nektar Pulmonary Technology—uses our know-how and technology in drug formulation, powder processing, powder filling and packaging and devices to create an integrated system to reproducibly deliver therapeutics to the lung for both systemic and local lung applications. The most advanced product using this technology is Exubera® (inhaled insulin), which is under development by Pfizer Inc. (“Pfizer”) and The Sanofi-Aventis Group (“Sanofi-Aventis”) and for which a marketing authorization application has been filed with the EMEA and an NDA has been filed with the FDA in the U.S.
- Nektar Supercritical Fluid (SCF) Technology—uses a novel particle engineering process that yields consistent powder particles in terms of size, shape and morphology that can be incorporated into a number of dosage forms including tablets, capsules, and inhalation systems. We are in the process of scaling-up our SCF Technology to support later stage development and eventually provide commercial manufacturing. We believe our SCF Technology may serve as a platform technology for a diverse range of applications primarily for small molecules including such uses as taste masking and selection of stable solid state forms that can affect both the rate and extent of absorption of certain drugs.

NEKTAR ADVANCED PEGYLATION TECHNOLOGY

Nektar Advanced PEGylation Technology is designed to enhance performance of most drug classes including macromolecules, such as peptides and proteins, as well as small molecules and other drugs. PEGylation is a chemical process where PEG chains are attached to active therapeutic molecules. The advantages of Nektar Advanced PEGylation Technology include the potential to: improve drug solubility and stability; increase drug half-life; reduce immune responses to an active drug; and improve the efficacy and/or safety of a molecule in certain instances.

We use our Advanced PEGylation Technology in both our partnered and proprietary programs. In a typical partner collaboration, we derive revenue from milestone payments during research and development and may receive royalties on sales of approved products or other PEG applications. We may also receive additional revenue from manufacturing the PEG reagent used by our partners.

Nektar Advanced PEGylation Technology is used in six products approved for use in the U.S. and in one additional product approved in Europe.

Characteristics of Nektar Advanced PEGylation Technology. PEG is a neutral, water soluble, non-toxic polymer and is one of the few synthetic polymers approved for internal use by the FDA in a variety of foods, cosmetics, personal care products and pharmaceuticals.

We believe our Advanced PEGylation Technology can offer one or more of the following benefits:

- Prolonged duration of action thereby reducing the need for frequent injections by both reducing the rate of absorption from a subcutaneous injection and reducing the rate of elimination or metabolism.
- Reduced immune response to certain macromolecules which may prolong their effectiveness with repeated doses if the antibodies are neutralizing.
- Improved stability which not only contributes to the prolonged duration of activity but may facilitate the formulation of a stable liquid formulation where previously the product had to be lyophilized.
- Improved efficacy and/or safety in certain instances. Although PEGylation often reduces the potency of a drug, this loss in activity can be more than offset by an improvement in the pharmacokinetics especially for drugs in which a prolonged residence time in the body translates to improved efficacy.

Applications of Nektar Advanced PEGylation Technology. We believe our Advanced PEGylation Technology can be useful in many applications, including the following:

- ***PEG for Pharmaceutical Use*.** PEGs can be attached to different types of molecules including proteins, peptides, antibodies and oligonucleotides and may substantially enhance their therapeutic value.
- ***PEG for Medical Device Use.*** PEGs can be used in various medical device applications including their use in the formulation of gels that can act as post-surgical seals or to prevent post-surgical adhesions. Nektar PEG is currently being used by Confluent Surgical Inc. for these applications.
- ***PEG-Liposomes.*** The incorporation of PEG onto the outer coating of a type of lipid membrane (“liposomes”), increases the lifetime of a serum which can provide controlled and specific delivery of certain drugs.

NEKTAR PULMONARY TECHNOLOGY

Nektar Pulmonary Technology is designed to enable efficient and reproducible deep lung delivery of a variety of molecule types across a wide range of doses. Specifically, our development of spray-dried formulations of drug particles potentially enables efficient dispersion and reproducible delivery of both large and small molecules deep within the lung for systemic and local lung indications.

Nektar Pulmonary Technology integrates several unique technologies including customized formulation of drug compounds, dry powder processing, filling and packaging along with proprietary inhalation devices to enable efficient and consistent delivery of both macromolecule and small molecule drugs to the deep lung. For specific drug products, we typically formulate and process bulk active pharmaceutical ingredients supplied by collaborative partners into dry powders, which are packaged into individual dosing units based upon product requirements.

Dry Powder Formulations for Pulmonary Delivery. Each drug poses different formulation challenges due to differing chemical and physical characteristics and dosing requirements. As a result, optimization is required for each specific drug. We apply our know-how and technology to achieve intrinsically dispersible powders and integrate them into pulmonary delivery devices in order to provide an easy-to-use and reproducible delivery system across a wide range of conditions and patient use scenarios. In the area of macromolecules, we have developed several protein powders, which remain stable at room temperature in excess of one year. Through our work with numerous macromolecules, we are developing an extensive body of knowledge on aerosol dry powder formulations. We have filed and expect to continue to file patent applications on several of our formulations and,

through acquisitions of intellectual property, have acquired rights to certain U.S. and foreign patents and patent applications relating to stabilization of macromolecule drugs in dry powder formulations.

Powder Processing. We modify standard powder processing equipment and develop custom techniques to produce fine dry powders with particle diameters typically between one and five microns. We have scaled up powder processing to levels sufficient for producing candidate powders for late stage clinical trials. We expect that production at these levels will be sufficient to satisfy the needs of small volume commercial products. We are also in the process of further scaling up our powder processing systems in order to produce quantities sufficient for commercial production of products we believe we will need to supply in high volumes, such as Exubera®.

Powder Filling and Packaging. Powders made up of fine particles intended for inhalation typically require handling that is technically more challenging than for powders comprised of larger particles. We have developed and are internally qualifying a proprietary automated filling system suitable for use in production of clinical trial supplies and, for certain products, in production of commercial quantities. The underlying technology is intended to allow its application to a broad variety of powder types, characteristics, and a wide range of target fill masses.

Nektar Proprietary Pulmonary Inhalers. We have developed a range of devices to appropriately address most pulmonary product needs. These devices will deliver aerosols over a wide range of doses and use scenarios. We have a durable device that is targeted towards the chronic use scenario, such as Exubera® (inhaled insulin). We also have a semi-durable device that can be used for shorter durations of therapy as well as chronic use applications. In addition, certain of our powders appear to be well suited for use in metered dose inhalers. Depending on the market needs for any given product, we will select a device that best meets those needs.

To date, there are no products using our Pulmonary Technology that have been approved for use and there can be no assurance that our pulmonary technology will be approved for use or will be a successful or commercially viable technology or will work for any of its intended uses.

NEKTAR SUPERCRITICAL FLUID TECHNOLOGY

Our SCF Technology uses supercritical carbon dioxide to disperse and mix a stream of drug solution while simultaneously extracting the organic solvent resulting in a rapid formation of a drug or drug/excipient particle. This is achieved by metering the solution and the supercritical fluid into a particle formation vessel held under controlled conditions of temperature and pressure above the critical point of the supercritical fluid-solvent mixture. Particles are then recovered from the particle formation vessel. SCF Technology may offer an alternative to typical crystallization processes for many small molecules with the potential benefits of better control over particle size, form, structure, and surface characteristics.

We believe our SCF Technology may serve as a platform technology for a diverse range of applications primarily for small molecules including such uses as taste masking and selection of stable solid state forms that can affect both the rate and extent of absorption of certain drugs.

Currently, there are no approved products that use our SCF technology. There can be no assurance that our SCF Technology will be approved for use or will be a successful or commercially viable technology.

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CLINICAL PIPELINE

The following table summarizes our partnered pipeline including those in clinical development, those filed for registration and those approved. The table includes the primary indication for the product, the identity of a respective corporate partner if one has been disclosed, and the status of the program. Approval status applies to the U.S. market unless otherwise noted.

Molecule	Primary Indication	Partner	Status(1)
Neulasta® (pegfilgrastim)	Neutropenia	Amgen Inc.	Approved
PEGASYS® (peginterferon alfa-2a)	Hepatitis-C	Hoffmann-La Roche Ltd.	Approved
Somavert® (pegvisomant)	Acromegaly	Pfizer Inc.	Approved
PEG-INTRON® (peginterferon alfa-2b)	Hepatitis-C	Schering-Plough Corporation	Approved
Definity® (PEG)	Cardiac imaging	Bristol-Myers Squibb Company	Approved
Macugen® (pegaptanib sodium injection)	Age-related macular degeneration	Eyetech Pharmaceuticals, Inc	Approved in the U.S. & Filed in the EU & Canada
Macugen® (pegaptanib sodium injection)	Diabetic macular edema	Eyetech Pharmaceuticals Inc.	Phase II
Exubera® (inhaled insulin)	Diabetes	Pfizer Inc.	Filed in the U.S. and Europe
SprayGel™ adhesion barrier system (PEG-hydrogel)	Prevention of post-surgical adhesions	Confluent Surgical Inc.	Pivotal trials in U.S. Approved in Europe
CDP 870 (PEG-anti-TNF alpha antibody fragment)	Rheumatoid arthritis	UCB Pharma	Phase III
	Crohn's disease		Phase III
CERA (Continuous Erythropoiesis Receptor Activator)	Renal anemia	Hoffmann-La Roche Ltd.	Phase III
Undisclosed (PEG)	Undisclosed	Undisclosed	Phase II
CDP 791 (PEG-antibody fragment angiogenesis inhibitor)	Cancer	UCB Pharma	Phase I/II
CDP 484 (PEGylated antibody fragment targeting pro-inflammatory cytokine interleukin 1-beta)	Rheumatoid Arthritis	UCB Pharma	Phase I/II
Tobramycin inhaled powder (TIP)	Lung infection	Chiron Corporation	Phase I
Inhaled leuprolide	Endometriosis	Enzon Inc.	Phase I
MARINOL® (inhaled dronabinol)	Multiple indications	Solvay Pharmaceuticals, Inc.	Phase I
PEGylated interferon beta	Undisclosed	Serono, Inc.	Phase I
PEG-Alfacon (PEGylated interferon alfacon-1)	Hepatitis-C	InterMune, Inc.	Phase I
PEGylated-AXOKINE	Obesity	Regeneron Pharmaceuticals	Phase I
Undisclosed (PEG)	Undisclosed	Pfizer Inc.	Phase I

(1) Status definitions are as follows:
Approved—regulatory approval to market and sell product obtained in the U.S. or EU.
Phase III or Pivotal—Product in large-scale clinical trials conducted to obtain regulatory approval to market and sell a drug. Typically, these trials are initiated following encouraging Phase II trial results.
Phase II—Product in clinical trials to establish dosing and efficacy in patients.
Phase I—Product in clinical trials typically in healthy subjects to test safety.

NEKTAR PARTNER DEVELOPMENT PROGRAMS

FDA Approved Products

Neulasta® (pegfilgrastim)

We entered into a license, manufacturing and supply agreement with Amgen Inc. in July 1995 whereby we licensed to Amgen one of our PEG reagents used in the manufacture of Amgen's Neulasta® product. Neulasta® was approved by the FDA in 2002 for use in reducing the incidence of infection as manifested by febrile neutropenia, in patients with nonmyeloid malignancies receiving myelosuppressive anticancer drugs. Approval for use in similar indications for Neulasta® was granted in Europe and Australia the same year.

PEGASYS® (peginterferon alfa-2a)

We entered into a license, manufacturing and supply agreement with F. Hoffmann-La Roche Ltd. ("Roche") in February 1997, whereby we licensed to Roche one of our PEG reagents used in the manufacture of Roche's PEGASYS® (peginterferon alfa-2a) product used in the treatment of chronic hepatitis C. We share a portion of the profits on this product with Enzon Pharmaceuticals, Inc. ("Enzon"). We are also a party to a subsequent agreement with Roche executed in April 1999, related to further collaborative work on PEGASYS, a PEGylated interferon alfa-2a product.

PEG-INTRON® (peginterferon alfa-2b)

We entered into a manufacturing agreement with Schering-Plough Corporation in February 2000 whereby we provide one of our PEG reagents used in the manufacture of PEG-INTRON® (peginterferon alfa-2b) product used in the treatment of chronic hepatitis C.

Somavert® (pegvisomant)

We entered into a license, manufacturing, and supply agreement with Sensus Drug Development Corporation ("Sensus") in January 2000, whereby we provide one of our PEG reagents used in the manufacture of Somavert® (pegvisomant), a human growth hormone receptor antagonist. In March 2001, Pharmacia Corp. ("Pharmacia") acquired Sensus and in April 2003, Pfizer acquired Pharmacia. Somavert® has been approved for use in the U.S. and Europe for the treatment of certain patients with acromegaly.

Definity® (PEG)

We entered into an agreement with Dupont Pharmaceuticals, now part of Bristol Myers-Squibb Company in 1996, whereby we provide one of our PEG reagents used in the manufacture of Definity® ultrasound system designed to diagnostically visualize the heart. Definity® is the first ultrasound contrast agent in the United States that is non-blood derived.

Macugen® (pegaptanib sodium injection)

We entered into a license, manufacturing and supply agreement with Eyetech Pharmaceuticals, Inc. ("Eyetech") in February 2002 whereby we provide one of our PEG reagents used in the development and commercial manufacturing of Macugen® (pegaptanib sodium injection), a PEGylated anti-Vascular Endothelial Growth Factor aptamer currently approved in the U.S. for use in treating age related macular degeneration ("AMD") and for which an application for marketing approval has been filed with the EMEA by Eyetech and its partner, Pfizer. AMD is the leading cause of blindness among Americans over the age of 55. Nektar has received development milestone payments and will receive royalties on sales of commercialized products, as well as revenues from exclusive manufacturing of the PEG derivative. We will share a portion of Nektar revenues for this product with Enzon.

Macugen® is also in Phase II testing for the treatment of diabetic macular edema ("DME"). The FDA has granted Macugen® "fast-track" status for the treatment of DME.

Selected Products in Development

Exubera® Inhaled Insulin Program

We entered into a collaborative agreement with Pfizer in January 1995 under which we are developing with Pfizer and their collaborator Sanofi-Aventis, an inhaleable version of regular human insulin (Exubera®) that can be administered systemically using our Pulmonary Technology. We believe that Exubera® could result in greater patient compliance by eliminating some insulin injections for Type 1 and some Type 2 patients and all insulin injections for some Type 2 patients.

If Exubera® is approved for commercial use, we will have the responsibility for the commercial manufacture of a portion of the inhaleable insulin drug powders and we will have the responsibility for supplying inhalers. In addition to receiving revenues for the manufacture and supply of drug powders and inhalers, we will receive a royalty on inhaleable insulin products marketed jointly by Pfizer and Sanofi-Aventis.

In November 1998, Pfizer and Aventis announced that they entered into a worldwide agreement to manufacture insulin and to co-develop and co-promote inhaleable insulin. Under the terms of the agreement, Pfizer and Aventis have constructed a jointly owned insulin manufacturing plant in Frankfurt, Germany.

In 2004, Sanofi-Synthelabo acquired Aventis to create Sanofi-Aventis. Pfizer and Sanofi-Aventis are engaged in litigation with respect to their agreement to manufacture insulin and to co-develop and co-promote inhaleable insulin. We are not a party to this litigation. There can be no assurance that this litigation will not affect the regulatory approval process or the commercialization of Exubera®.

Insulin is a protein hormone naturally secreted by the pancreas to, in part, facilitate uptake of glucose into cells. Diabetes, the inability of the body to properly regulate blood glucose levels, is caused by insufficient production of insulin by the pancreas or resistance to the insulin produced. Over time, high blood glucose levels can lead to failure of the microvascular system, which may lead to blindness, loss of circulation, kidney failure, heart disease or stroke. Insulin, in its injectable form, is supplied by various manufacturers, including Eli Lilly and Company, Novo-Nordisk A/S and Sanofi-Aventis.

According to the World Health Organization (“WHO”), approximately 171 million people worldwide have diabetes, and that number is expected to grow to 366 million by 2030. All Type 1 diabetics, estimated at between 5% and 10% of all diabetics, require insulin therapy. Type 1 diabetics require both basal insulin in the form of long-acting insulin and multiple treatments of regular or short-acting, insulin throughout the day. Type 2 diabetics, depending on the severity of their disease, may or may not require insulin therapy. We believe that because of the inconvenience and unpleasantness of injections, many Type 2 patients who do not require insulin to survive, despite the fact that they would benefit from it, are reluctant to start insulin treatment. Further, we believe that many Type 1 and Type 2 patients take less insulin than they should because of the dislike of injections.

A ten-year study by the National Institutes of Health (“NIH”) in Type 1 diabetics demonstrated that the longer term sequela of diabetes could be significantly reduced by dosing more frequently resulting in lowering of glycosolated hemoglobin. The NIH study recommended dosing regular insulin three to four times per day, a regimen that would more closely mirror the action of naturally produced insulin in non-diabetics. Because of the risk of severe hypoglycemia, this course of treatment is not recommended for children, older adults, and people with heart disease or with a history of frequent severe hypoglycemia. In addition, many patients are reluctant to increase their number of daily doses because they find injections unpleasant and inconvenient. Similar results were demonstrated in Type 2 patients in a trial in the United Kingdom (“UK”).

Phase I and Phase IIa clinical trials with Exubera® indicated that inhaled insulin was absorbed systemically, reduced blood glucose levels and provided the same control of diabetes as injected insulin. In October 1996, Pfizer initiated a multi-site Phase IIb outpatient trial to include up to 240 diabetes patients, the results of which were announced in June 1998. In 70 Type 1 diabetics that were treated with either inhaled or conventional

injected insulin therapy for three months, blood levels of hemoglobin Alc, or ("HbAlc"), the long-term measurement of blood glucose control, were statistically equivalent. Virtually identical results were obtained in a group of Type 2 diabetics. In September 1998, Pfizer released additional Phase II data from a study of diabetics whose blood glucose was poorly controlled by oral agents alone. In that study, patients who were given Exubera® in addition to their oral medications showed marked improvement in their blood glucose control.

In June 1999, Pfizer began dosing in Phase III clinical trials. In June 2000, Pfizer reported new data on patients using inhaled insulin therapy from a Phase II continuation, or extension, study being conducted by Pfizer and Aventis. The goal of the extension study was to determine if safety and efficacy results from previously reported short-term Phase II clinical trials could be maintained in the long term. These data showed that HbAlc remained stable in patients for up to 30 months of therapy. At the time that these were compiled, 83 patients had completed 24 months of Exubera® therapy. Further data presented indicated similar results for patients who completed 30 months of therapy.

In June 2001, Pfizer reported on data released from Phase III studies showing that more Type 2 patients who were treated with Exubera® achieved the recommended blood glucose levels than patients who received only insulin injections. In addition the frequency and nature of adverse events were comparable between groups. Patients who used Exubera® developed increased insulin antibody serum binding, but there did not appear to be any related clinical significance. Additional data released from these Phase III studies suggested that Type 1 patients using inhaled insulin multiple times a day with one bedtime long acting insulin injection achieved comparable control of blood glucose to that seen in patients receiving multiple daily insulin injections. An additional Phase III study indicated that Type 2 patients who were poorly controlled on a combination of two oral diabetes therapies demonstrated improved glycemic control and greater overall satisfaction and acceptance of therapy when Exubera® was added to their treatment regimen or when it replaced oral therapies.

In December 2001, Pfizer announced that it had decided to include an increased level of controlled, long-term safety data in any potential NDA filing with the FDA with respect to Exubera®. In May and June 2002, Pfizer and Aventis released data from Phase III studies conducted with Exubera®. The data showed that Type 2 patients, who had failed to meet recommended blood glucose levels with combination oral therapy, achieved better glycemic control with Exubera® than patients who received oral agents. In addition, the study results showed that Exubera® provides glycemic control equal to insulin injections in Type 1 patients. However, the data also indicated a small relative decrease in one of the pulmonary function tests in the Exubera® treatment group. In October 2002, Pfizer and Aventis announced that they would complete additional long-term studies already underway for Exubera® to determine whether there is clinical significance to the pulmonary function data.

In June 2003, Pfizer and Aventis released Phase III data suggesting that Exubera® may provide acceptable glycemic control to significantly more subjects than rosiglitazone in Type 2 diabetes patients not optimally controlled on diet and exercise. Rosiglitazone is an oral hypoglycemic agent used to reduce the body's resistance to the action of insulin as a way of lowering blood glucose.

In March 2004, Pfizer and Aventis announced that the EMEA had accepted the filing of a marketing authorization application for Exubera®.

In June 2004, Pfizer and Aventis announced results of long-term studies held over a period of one year which showed that patients with Type 2 diabetes taking Exubera® experienced no clinically important effect on pulmonary function compared to patients on oral-agents alone.

In September 2004, Pfizer and Sanofi-Aventis announced new data from trials where the primary objective was to assess long-term pulmonary safety showing that Exubera® was effective and well-tolerated in controlling blood glucose levels over a two-year period in patients with Type 2 diabetes. The lead study investigator concluded that these data show that small pulmonary function differences between the two groups occurred early after treatment initiation, had no identified clinical relevance, and did not progress after two years of continued inhaled insulin treatment.

In March 2005, Pfizer and Sanofi-Aventis announced that a New Drug Application was accepted by the U.S. FDA for Exubera®. Pfizer and Sanofi-Aventis are seeking approval to market Exubera® in the U.S. for adult patients with type 1 and type 2 diabetes. Pfizer and Sanofi-Aventis announced at the same time that Exubera® has been studied in more than 3,500 patients, and in some of these patients for more than seven years.

There can be no assurance that the EMEA or FDA will approve Exubera® for marketing and there can be no assurance that Pfizer or Sanofi-Aventis will obtain approval to market Exubera® in any other markets. The failure to obtain regulatory approval of Exubera® in the EU, U.S. or any other markets would significantly harm our business including without limitation, our revenue and ability to invest in other areas of our business. Any eventual label claims for Exubera® will be subject to regulatory approval of the product and its labeling. Further, there can be no assurance that the current litigation between Sanofi-Aventis and Pfizer will not impact the process for regulatory approval of Exubera® or its commercialization.

If Exubera® were to be approved in the EU by the EMEA, there is no guarantee commercialization will take place in any given market due to certain other approvals that are required prior to commercialization such as reimbursement. If Exubera® were to be approved in the U.S. by the FDA, there is no guarantee that it will be placed on formularies by the various government agencies or other health care plans.

PEG CDP 870 (PEG-anti-TNF alpha antibody fragment) Program

We entered into a license, manufacturing and supply agreement for CDP 870 (PEG-anti-TNF alpha antibody fragment) with Celltech Group plc (“Celltech”) which was executed in 2000. This agreement was subsequently assigned to Pharmacia for the rheumatoid arthritis indication. In October 2002, Pharmacia initiated Phase III clinical trials with CDP 870 for rheumatoid arthritis. In April 2003, Pfizer acquired Pharmacia and in February 2004, Pfizer reassigned rights to CDP 870 back to Celltech. In 2004, Celltech was acquired in whole by UCB Pharma, a global pharmaceutical and specialty chemical company.

In March 2004, Celltech announced preliminary Phase III CDP 870 data for rheumatoid arthritis indicating that the study met its primary endpoint.

CDP 870 is also in Phase III trials as a treatment for Crohn’s disease, a chronic digestive disorder of the intestines, sometimes referred to as inflammatory bowel disease.

Under the agreement for CDP 870, we receive milestone payments and PEG manufacturing revenues, and royalties on product sales, if the product is commercialized. We will share a portion of the royalties on this product with Enzon.

Although UCB Pharma has stated that they plan to develop CDP 870, there can be no assurance that they will continue the development of CDP 870 or that this product will be filed for approval or will be approved for use in the U.S., EU or other markets.

Nektar currently has product development collaborations with UCB Pharma for two other products, CDP 791 (PEG-antibody fragment angiogenesis inhibitor) and CDP 484 (PEGylated antibody fragment targeting pro-inflammatory cytokine interleukin 1-beta), both of which are in Phase I/II clinical trials.

SprayGel™ (PEG-hydrogel) Program

We are a party to a license, supply and manufacturing agreement with Confluent executed in August 1999, for use of our PEG-hydrogel in Confluent’s SprayGel™ adhesion barrier system. Under the terms of this arrangement, we manufacture and supply PEG components used in the SprayGel™ system and receive royalty payments on sales of commercialized products, and PEG manufacturing and supply revenues from Confluent. SprayGel™ was approved for commercial distribution in Europe, receiving product certification by European regulatory authorities in November 2001. In June 2002, Confluent initiated Phase II/III pivotal trials in the U.S. of SprayGel™.

SprayGel™ is a biodegradable, water-based, coating material designed to prevent postoperative adhesions formation. Adhesions can be responsible for severe pain and discomfort as well as small bowel obstructions and are the leading cause of infertility in women following gynecological surgery. Approximately 500,000 surgical procedures are performed annually to remove adhesions.

CERA (Continuous Erythropoiesis Receptor Activator) Program

We announced in February 2004, a collaboration with Roche whereby we had licensed a proprietary PEG (PEGylation) reagent used in the manufacture of Roche's product, Continuous Erythropoiesis Receptor Activator ("CERA"). Under the terms of the collaboration, we will receive milestone and manufacturing revenues during development and will receive royalty and manufacturing revenues following commercialization of the product. In March 2004, Roche announced that it had advanced CERA into Phase III trials.

CDP 791 and CDP 484 Programs

We entered into a licensing, manufacturing and supply agreement with Celltech for PEGylated antibody fragment products CDP 791 (PEG-antibody fragment angiogenesis inhibitor) and CDP 484 (PEGylated antibody fragment targeting pro-inflammatory cytokine interleukin 1-beta) for cancer and rheumatoid arthritis, respectively, in October 2002. In 2004, Celltech was acquired by UCB Pharma.

Under the terms of the agreement, we will provide exclusive development and manufacturing for each activated PEG for both products. In exchange, we will receive milestone payments, manufacturing revenues and royalties on sales of commercialized products.

In 2003, Celltech announced the initiation of a Phase I trial for CDP 791. To date, no Phase I results have been published for CDP 791.

In March 2004, Celltech announced they had initiated in late 2003 large placebo controlled Phase I/II trials in rheumatoid arthritis patients for CDP 484.

There can be no assurance that UCB Pharma will continue the development of CDP 791 or CDP 484 or that those products will be filed for approval or be approved for use in the U.S., EU or other markets. We currently have three product development partnerships with UCB Pharma (CDP 870, CDP 791 and CDP 484).

Tobramycin Inhaled Powder Program

In December 2001, we entered into a collaboration with Chiron Corporation to develop Tobramycin inhaled powder ("TIP"), for the treatment of *Pseudomonas aeruginosa* in cystic fibrosis patients and to explore the development of other inhaled antibiotics using our Advanced Pulmonary Technology. Chiron's existing tobramycin product, TOBI, was introduced in 1998 as the first inhaled antibiotic approved for treating Pseudomonas aeruginosa lung infections in cystic fibrosis patients.

In July 2003, Chiron initiated a Phase I trial in patients for TIP.

In October 2004, Chiron presented Phase I clinical trial data. The data presented suggest that TIP may significantly reduce the treatment burden for cystic fibrosis patients by offering a short administration time and improved portability. The Phase I trial, which included 90 patients at 15 study centers in the U.S., compared the safety, pharmacokinetics and delivery time of our dry powder TIP administered via our inhalation system to Chiron's TOBI® tobramycin solution for inhalation administered via nebulizer. Chiron also stated that it plans to initiate Phase III clinical trials for further study of TIP.

Under the terms of the tobramycin collaboration, we are responsible for the development of the formulation of inhaleable tobramycin as well as clinical and commercial manufacturing of the drug formulation and delivery

device. Chiron is responsible for the clinical development and worldwide commercialization of the drug formulation and delivery device combination. We will receive research and development funding, milestone payments, and royalty payments and manufacturing revenues once the product is commercialized.

Inhaled Leuprolide Program

In January 2002, we announced a strategic alliance with Enzon that includes an agreement making us solely responsible for licensing Enzon's PEGylation patents, an option for Enzon to license our PEGylation patents, an agreement to explore the development of non-invasive delivery of single-chain antibody products via the pulmonary route and settlement of a patent infringement litigation originally initiated by Enzon. We will have the option to license Enzon's PEGylation patents for use in our proprietary products. Enzon will receive a royalty or a share of profits on final product sales of any products that use Enzon's patented PEG technology, including branched PEG. As part of this broad alliance, we entered into a collaboration to develop up to three products using our Pulmonary Technology and/or SCF Technology. The first potential product under this collaboration may be an inhaleable formulation of leuprolide acetate to treat endometriosis. Under the terms of this collaboration, we will be responsible for the development of drug formulations for the agreed upon pharmaceutical agents as well as clinical and commercial manufacturing of the drug formulation and delivery device. Enzon will be responsible for the clinical development and worldwide commercialization of the drug formulation and delivery device combination. We may receive research and development funding and milestone payments as the program progresses through further clinical testing, and will receive royalty payments if the product is commercialized. As part of this alliance, Enzon made a $40.0 million equity investment in our convertible preferred stock.

Inhaled MARINOL® (inhaled dronabinol) Program

In February 2002, we entered into a collaboration with Unimed ("Unimed"), a wholly owned subsidiary of Solvay Pharmaceuticals, Inc., ("Solvay") to develop a Metered Dose Inhaler ("MDI") formulation of MARINOL® (dronabinol) to be used for multiple indications. MARINOL® capsules are approved in the U.S. for the treatment of anorexia associated with weight loss in patients with AIDS and for the treatment of refractory nausea and vomiting associated with cancer chemotherapy. In the second quarter of 2003, Unimed initiated a Phase I trial.

Under the terms of the collaboration, we are responsible for development of the formulation, as well as clinical and commercial manufacturing of the drug formulation delivery and device. Solvay is responsible for the clinical development and worldwide commercialization of the drug formulation and delivery device combination. We will receive research and development funding, milestone payments as the program progresses through further clinical testing, and royalty payments on product sales and manufacturing revenues if the product is commercialized.

Dental Regeneration Products

In January 2003, we announced an agreement with the Straumann Group ("Straumann") to license, manufacture and supply Nektar Advanced PEGylation Technology for the development of hydrogels for dental regeneration products. The proposed PEG-based hydrogel product will be designed for use by dentists to support tissue regeneration in dental surgery. Under the agreement, Straumann will license and source our technology and material exclusively for a proprietary formulation. We will receive milestone and manufacturing payments as well as royalties on commercialized products.

Supplemental Agreement with Alliance Pharmaceutical Corp.

In March 2002, we announced the expansion of our agreement with Alliance Pharmaceutical Corp. ("Alliance") regarding the PulmoSphere® particle and particle processing technology, aspects of which we

initially acquired from Alliance in November 1999. The PulmoSphere® technology is a particle engineering method designed to enhance the performance of drugs delivered via the lung in propellant-based metered-dose inhalers and dry powder inhalers. As a result of the supplemental agreement, we paid Alliance $5.25 million in exchange for rights beyond inhaleable applications and other considerations. In addition, we were obligated to pay Alliance future milestones and royalty payments on some products developed by us or our licensees utilizing the PulmoSphere® technology. In February 2005, we amended this agreement by agreeing to pay Alliance approximately $1.8 million in exchange for certain raw material used in our production process and the termination of all of our future royalty and payment obligations to Alliance.

Feasibility Studies

In addition to the partner collaborations mentioned above and other development programs, we have conducted and continue to conduct feasibility studies of additional drug formulations both on our own account and in cooperation with potential collaboration partners. There can be no assurance that any of our feasibility studies will be successful or result in collaborative development programs.

Collaborations Terminated in 2004

PEG CDP 860 Program

In March 2004, Celltech announced that due to their lack of progress in partnering discussions, they discontinued development of CDP 860, an antibody fragment using Nektar Advanced PEGylation Technology which was formerly in Phase II trials for cancer.

Undisclosed PEG Product

In March 2004, we ceased development of an undisclosed product in Phase II trials as a result of our partner's determination not to pursue further development.

NEKTAR PROPRIETARY PRODUCTS PROGRAMS

Approximately two years ago we began investing in our own proprietary products. Our proprietary products primarily apply our technologies to selected off-patent molecules that we believe would benefit from the application of our technologies to improve performance and/or delivery of these compounds. Our objective is to complete mid to late-stage clinical trials on these products, and then evaluate the need for a partner for late stage development efforts and/or commercialization of these products. We may also choose to partner some of our proprietary products at earlier stages of development. We believe that, when we partner these programs at a later stage, we will be able to gain a greater share of the products' economics compared to partnering the products at earlier stages.

We currently have four proprietary products in the early stages of development. One of these products, an inhaled small molecule product, has entered Phase I trials and a second inhaled product is in proof-of-concept human studies. The other two products are in preclinical studies.

We believe that there may be additional off-patent or near-term patent expiration compounds that could benefit from the application of our technologies to improve such compounds' performance and delivery.

Research and Development

Our research and development activities can be divided into research and preclinical programs, clinical development programs and commercial readiness. We estimate the costs associated with research and preclinical programs, clinical development programs, and commercial readiness over the past three years to be the following (in millions):

	Years ended December 31,		
	2004	2003	2002
Research and preclinical programs	$ 37.4	$ 29.0	$ 37.6
Clinical development programs	59.4	58.0	82.4
Commercial readiness	36.7	35.1	27.6
Total	$133.5	$122.1	$147.6

Our portfolio of projects can be broken down into two categories: 1) partnered projects and 2) proprietary products and technology development. We estimate the costs associated with partnered projects and proprietary products and technology development to be the following (in millions):

	Years ended December 31,	
	2004	2003
Partnered projects	$ 93.2	$ 92.7
Proprietary products and technology development	40.3	29.4
Total	$133.5	$122.1

The above information is not available for the year ended December 31, 2002.

Our total research and development expenditures can be disaggregated into the following significant types of expenses (in millions):

	Years ended December 31,		
	2004	2003	2002
Salaries and employee benefits	$ 59.0	$ 57.2	$ 67.3
Outside services	28.7	21.0	21.2
Supplies	18.9	16.7	22.0
Facility and equipment	19.7	16.7	18.4
Travel and entertainment	1.9	1.5	2.1
Purchased technology	—	—	5.3
Allocated overhead	4.9	7.1	8.3
Other	0.4	1.9	3.0
Total	$133.5	$122.1	$147.6

Manufacturing

With respect to products based on our Pulmonary Technology, we generally plan to formulate, manufacture and package the powders for our pulmonary delivery products and to subcontract the manufacture of our pulmonary delivery devices.

Our device for use with Exubera®, the pulmonary inhaler, is still in clinical testing. Further work is underway to enable large-scale commercial manufacturing and additional work may be required to optimize the device for regulatory approval, field reliability or other issues that may be important to its commercial success. Additional design and development work may lead to a delay in regulatory approval. Under our collaborative

agreement with Pfizer to develop Exubera®, both we and Pfizer will manufacture a portion of inhaleable insulin powders and Pfizer will be responsible for filling and packaging blisters. The terms of the supply agreement with Pfizer provide that prior to the commercialization of Exubera®, we must qualify a powder processing facility and a device manufacturer or manufacturers for Exubera®.

We have built a powder manufacturing and packaging facility in San Carlos, California capable of producing powders in quantities we believe are sufficient for clinical trials of products based on our Pulmonary Technology. This facility has been inspected and licensed by the State of California and is used to manufacture and package powders under current Good Manufacturing Practices ("cGMP"). If we are able to scale-up and validate the facility in time then we believe that the manufacturing capacity will be sufficient to meet initial anticipated commercial manufacturing requirements.

We have developed a high capacity automated filling technology, that when validated, we believe will be capable of filling blisters on a production scale for moderate and large volume products using our Pulmonary Technology. The technology has been transferred to Pfizer who will be responsible for commercial packaging and filling the bulk drug powders for Exubera®.

One of our proprietary pulmonary inhaler devices is being developed for commercial use and is being used in Phase III Exubera® trials. We have identified and have established formal supply agreements with contract manufacturers that we believe have the technical capabilities and production capacity to manufacture our pulmonary inhaler device. We believe that these contract manufacturers can successfully receive the device technology and knowledge transferred from our device development group, scale up the manufacturing process, and meet the requirements of cGMP. The contract manufacturers have completed construction of their facilities. Manufacturing scale-up and qualification, and validation efforts are underway. We are examining scale-up and validation plans to support their commercial operations.

In August 2000, we entered into a Manufacturing and Supply Agreement with our contract manufacturers to provide for the manufacturing of our pulmonary inhaler device for Exubera®. Under the terms of the Agreement, we may be obligated to reimburse the contract manufacturers for the actual unamortized and unrecovered portion of any equipment procured or facilities established and the interest accrued for their capital overlay in the event that Exubera® does not gain FDA approval to the extent that the contract manufacturers cannot re-deploy the assets. While such payments may be significant, at the present time, it is not possible to estimate the loss that will occur should Exubera® not be approved. We have also agreed to defend, indemnify and hold harmless the contract manufacturers from and against third party liability arising out of the agreement, including product liability and infringement of intellectual property. There is no limitation on the amount of potential future payments we could be required to make under these indemnification obligations. We have never incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities.

With respect to products using Nektar Advanced PEGylation Technology, we have one facility in Huntsville, Alabama for the manufacture of PEG-derivatives. We are currently increasing capacity to handle current and anticipated future demand.

With respect to products using our Nektar SCF Technology, we currently have one facility in Bradford, England for the production of dry powder material meeting the requirements of current Good Manufacturing Practices.

There can be no assurance that we or our partners will be able to successfully process drug powders, or manufacture products on our autofiller system in a timely manner or at commercially reasonable cost. Any failure or delay in further developing this technology would delay product development or inhibit commercialization of our products and would have a material adverse effect on us. Moreover, there can be no assurance that we will be able to scale-up and validate our contract manufacturers successfully, or that we will be able to maintain satisfactory contract manufacturing on commercially acceptable terms. Our dependence upon

third parties and their supply chains for the manufacture of our pulmonary inhaler device and its supply chain may adversely affect our cost of goods, our ability to develop and commercialize products on a timely and competitive basis, and the production volume of pulmonary inhaler devices.

Government Regulation

The research and development, clinical testing, manufacture and marketing of products using our technologies are subject to regulation by the FDA and by comparable regulatory agencies in other countries. These national agencies and other federal, state and local entities regulate, among other things, research and development activities and the testing (in vitro and in animals and in human clinical trials), manufacture, safety, effectiveness, labeling, storage, record keeping, approval, advertising and promotion of our products.

The process required by the FDA before a product using our technologies may be marketed in the United States depends on whether the compound has existing approval for use in other dosage forms. If the drug is a new chemical entity that has not been previously approved, the process includes the following:

- Extensive preclinical laboratory and animal testing;
- Submission of an Investigational New Drug application (“IND”);
- Adequate and well-controlled human clinical trials to establish the safety and efficacy of the drug for the intended indication; and
- Submission to the FDA for approval of an NDA, for drugs or a Biological License Application (“BLA”), for biological products.

If the drug has been previously approved, the approval process is similar, except that certain preclinical tests relating to systemic toxicity normally required for the IND and NDA application may not be necessary.

Preclinical tests include laboratory evaluation of product chemistry and animal studies to assess the potential safety and efficacy of the product and its chosen formulation. Preclinical safety tests must be conducted by laboratories that comply with FDA Good Laboratory Practices regulations. The results of the preclinical tests are submitted to the FDA as part of the IND application and are reviewed by the FDA before clinical trials can begin. Clinical trials may begin 30 days after receipt of the IND by the FDA, unless the FDA raises objections or requires clarification within that period.

Clinical trials involve the administration of the drug to healthy volunteers or patients under the supervision of a qualified, identified medical investigator according to an approved protocol. Drug products to be used in clinical trials must be manufactured according to current Good Manufacturing Practices. Clinical trials are conducted in accordance with protocols that detail the objectives of the study, the parameters to be used to monitor participant safety and efficacy or other criteria to be evaluated. Each protocol is submitted to the FDA under the original IND.

Apart from the IND submission process described above, each clinical study is conducted after written approval is obtained from an independent Institutional Review Board (“IRB”). The IRB considers, among other things, ethical factors, the potential risks to subjects participating in the trial and the possible liability to the institution where the trial(s) is/are being conducted. The IRB also approves the consent form signed by the trial participants.

Clinical trials are typically conducted in three sequential phases. In Phase I, the initial introduction of the drug into healthy human subjects, the product generally is tested for tolerability, pharmacokinetics, absorption, metabolism and excretion. Phase II involves studies in a limited patient population to:

- Determine the efficacy of the product for specific targeted indications;
- Determine dosage tolerance and optimal dosage and regimen of administration; and
- Identify possible adverse effects and safety risks.

After Phase II trials demonstrate that a product is effective and has an acceptable safety profile, Phase III trials are undertaken to evaluate the further clinical efficacy and safety of the drug/formulation within an expanded patient population at geographically dispersed clinical study sites, and in large enough trials to provide statistical proof of efficacy/tolerability. The FDA, the clinical trial sponsor, the investigators or the IRB may suspend clinical trials at any time if any one of them believes that study participants are being subjected to an unacceptable health risk.

The results of product development, preclinical studies and clinical studies are submitted to the FDA as an NDA/BLA for approval of the marketing and commercial shipment of the drug product. The FDA may deny an NDA/BLA if applicable regulatory criteria are not satisfied or may require additional clinical and/or pharmaceutical testing or requirements. Even if such data are submitted, the FDA may ultimately decide that the NDA/ BLA do not satisfy all of the criteria for approval (e.g. consistency of manufacture of the drug/formulation). Product approvals, once obtained, may be withdrawn if compliance with regulatory standards is not maintained or if safety concerns arise after the product reaches the market. The FDA may require additional post-marketing clinical testing and pharmacovigilance programs to monitor the effect of drug products that have been commercialized and has the power to prevent or limit future marketing of the product based on the results of such programs.

Each domestic drug product-manufacturing establishment must be registered with, and approved by, the FDA. Establishments handling controlled substances must in addition, be licensed by the U.S. Drug Enforcement Administration. Domestic manufacturing establishments are subject to biennial inspections by the FDA for compliance with cGMP. Facilities and drug products manufactured in the UK are also subject to European regulatory review. They are also subject to U.S., and UK federal, state and local regulations regarding workplace safety, environmental protection and hazardous and controlled substance controls, among others.

Many of the drugs we are developing are already approved for marketing by the FDA in another form and delivered by another route. We believe that when working with approved drugs, the approval process for products using our alternative drug delivery or formulation technologies may require less time and fewer tests than for new chemical entities. However, we expect that our formulations for use with any of our technologies may use excipients not currently approved for use (e.g., pulmonary delivery). Use of these excipients will require additional toxicological testing that may increase the costs of or length of time to gain regulatory approval. In addition, regulatory procedures as they relate to our products may change as regulators gain experience, and any such changes may delay or increase the cost of regulatory approvals.

For products currently under development based on our Pulmonary Technology, our pulmonary inhaler devices are considered to be part of a drug/device combination for deep lung delivery of each specific molecule. Prior to submission of an IND, the FDA will make a determination as to the most appropriate Center and Division within the FDA that will assume prime responsibility for the review of the IND and NDA/BLA. In the case of our products, the Center for Drug Evaluation and Research in consultation with the Center for Devices and Radiological Health could be involved in the review. The assessment of jurisdiction within the FDA is based upon the primary mode of action of the drug or the location of the specific expertise in one of the Centers as identified in the FDA's inter Center agreement.

To date, our partners have generally been responsible for clinical and regulatory approval procedures, but we may participate in this process by submitting to the FDA a drug master file developed and maintained by us which contains data concerning the manufacturing processes for the inhaler device or drug product. Through our internal proprietary products development efforts, we have prepared and submitted an IND application and would be responsible for additional clinical and regulatory procedures. The clinical and manufacturing development and regulatory review and approval process generally takes a number of years and requires the expenditure of substantial resources. Our ability to manufacture and sell products, whether developed by us or under collaboration agreements, ultimately depends upon the completion of satisfactory clinical trials and success in obtaining marketing approvals from the FDA and equivalent foreign health authorities.

Sales of our products outside the U.S. are subject to local regulatory requirements governing clinical trials and marketing approvals for drugs. Such requirements vary widely from country to country.

In developing the device component for our Pulmonary Technology, we have sought to develop our quality systems and design engineering function in adherence to the principles of design control for medical devices as set forth in the applicable regulatory guidance. Although hybrid drug/device products are typically reviewed as a drug, we have sought to adhere to the design control approach both as a good business practice, and because it appears that the drug and biologic centers of the FDA and other worldwide agencies are adopting this policy. In Europe, this has already taken place and delivery devices are viewed as separate entities subject to review as such under the Medical Device Directive. In the U.S., it is our intention to comply with the FDA regulations for devices.

There can be no assurance that products that we develop, including devices designed by us and built by our contract manufacturers, will be approved, or will meet approval requirements, on a timely basis, the failure of which would have a material adverse effect on us.

Patents and Proprietary Rights

We routinely apply for patents for our innovations and for improvements to our technologies. We also rely on our trade secrets and know-how to protect our technologies and our competitive position. We plan to defend our proprietary technologies from infringement, misappropriation, duplication and discovery through our issued patents and our proprietary know-how.

Our patent portfolio contains patents and patent applications that encompass each of our technologies including Nektar Advanced PEGylation, SCF and Pulmonary technologies. Our Advanced PEGylation patents and patent applications cover reactive PEG derivatives, PEG-drug conjugates, PEG-based prodrugs and PEG-drug delivery vehicles. Our SCF patents and patent applications cover compositions and apparatuses for preparing particles using our SCF Technology. Our Pulmonary Technology patents and patent applications cover our integrated systems for pulmonary delivery of both large and small molecule drugs. Although our early Advanced PEGylation Technology patent applications were filed in the United States only, we routinely file patent applications on innovations and improvements in each of these areas on a worldwide basis. Generally, the term of a new patent is twenty years from the date on which the application for the patent was filed in the United States or, in special cases, from the date an earlier related application was filed, subject to the payment of maintenance fees.

With regard to our Advanced PEGylation Technology patent portfolio, we have filed patent applications directed to activated PEG reagents having a variety of structures (branched or multi-armed PEGs, forked PEGs, linear PEGs, etc.) and reactive groups, methods of producing highly pure polymer reagents, PEG prodrugs having hydrolysable linkages, PEG-based hydrogels and alternative gel systems and PEG conjugates of certain molecules. Patents or patent applications have issued or have been published in many of these areas.

SCF Technology involves contacting an active agent solution or suspension with a supercritical fluid to precipitate active agent particles from the solution or suspension. The patents and patent applications cover both the method of forming the particles and apparatuses for carrying out the method and are not limited to the particular product made.

Our Pulmonary Technology patent portfolio relates to pharmaceutical compositions and reagents, medical devices and equipment and methods for preparation, packaging and delivery of our pharmaceutical compositions. This portfolio involves spray drying solutions and suspensions to prepare particles of various morphologies. Patents that have issued in these areas cover our pulmonary inhaler devices, formulations for pulmonary delivery and methods for preparing, packaging and using these formulations and particular active agent formulations for delivery via the respiratory tract.

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

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

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

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

Our ability to develop and commercialize our technologies will be affected by our or our partners' access to the drugs that are to be formulated. Many biopharmaceutical drugs, including some of those that are presently under development by us, are subject to issued and pending United States and foreign patent rights which may be owned by competing entities. There can be no assurance that we or our partners will be able to provide access to drug candidates for formulation or that, if such access is provided, we or our partners will not be accused of, or determined to be, infringing a third party's rights and will not be prohibited from working with the drug or be found liable for damages that may not be subject to indemnification. Any such restriction on access or liability for damages would have a material adverse effect on us.

It is our policy to require our employees and consultants, outside scientific collaborators, sponsored researchers and other advisors who receive confidential information from us to execute confidentiality agreements upon the commencement of employment or consulting relationships with us. These agreements provide that all confidential information developed or made known to the individual during the course of the

individual's relationship with us is to be kept confidential and not disclosed to third parties except in specific circumstances. The agreements provide that all inventions conceived by an employee shall be our property. There can be no assurance, however, that these agreements will provide meaningful protection or adequate remedies for our trade secrets in the event of unauthorized use or disclosure of such information.

Competition

We believe that products developed using our technologies will compete on the basis of one or more of the following parameters: efficacy, safety, reproducibility, patient convenience and cost. There is intense competition in each of our technology platforms including non-invasive delivery and less invasive delivery of peptides and proteins, and improved formulation and delivery of small molecules by the most common routes of delivery including pulmonary, oral, and injectable. In addition, a number of the products being developed using our technologies have direct and indirect competition from other companies including both drug delivery companies and pharmaceutical companies many of which are much larger and have more resources than we do.

With respect to Nektar Advanced PEGylation Technology, there are a number of companies developing alternative PEGylation technologies such as Dow Chemical Company, SunBio Corporation, Mountain View Pharmaceuticals, Inc., Neose, NOF Corporation, and Valentis, Inc., and there may be several chemical, biotechnology and pharmaceutical companies also developing PEGylation technologies. Indirect competitors to PEGylation for less invasive delivery of peptides and proteins include companies developing technologies for injectable controlled release such as liposomes, microparticles and hydrogels and molecule engineering approaches such as protein engineering, fusion proteins and protein glycosolation.

With respect to Nektar Pulmonary Technology, there are a number of companies developing dry powder inhalers, metered dose inhalers and liquid inhalers including nebulizers that could compete with us. Companies such as Alexza MDC, Alkermes, Inc., Aradigm Corporation, AeroGen, Inc., 3M, MannKind Corporation, Microdose Technologies Inc., Quadrant Technologies Limited, Skyepharma, and Vectura are all developing technologies that could compete with our pulmonary delivery systems.

In the non-invasive delivery of insulin, we have direct competition from companies such as Novo Nordisk, Alkermes, Inc., Microdose Technologies Inc., Quadrant Technologies Limited, and MannKind Corporation, all of which are working on pulmonary products and most with announced pharmaceutical partners. We also compete with companies such as Nobex Corporation, Emisphere Technologies, Inc., Coremed Corporation, and Generex Biotechnology Corporation, which are believed to be working on oral or buccal products for insulin delivery.

With respect to Nektar SCF Technology, there are a number of direct competitors developing competitive technology including CritiTech, Inc, Lavipharm Corp., Ferro Corporation, Ethypharm, Eiffel Technologies Limited, and others. Indirect competition for this technology comes from companies developing other ways of creating particles and improved dosage forms of small molecules for the most common routes of delivery.

For each of our technology platforms, we believe we have competitive advantages for certain applications and molecules. We monitor the competitive situation across our technology applications and products and may attempt to develop in-house, in-license or acquire technologies that improve or expand our technology platforms in order to remain competitive.

We are in competition with other drug delivery and drug discovery companies including molecule engineering companies, biopharmaceutical companies, as well as other organizations and individual inventors, many of which have resources much greater than ours including financial, development and commercialization capabilities. Acquisition of competing companies including drug delivery companies by larger pharmaceutical companies could also enhance our competitors' position. Accordingly, our competitors could succeed in developing competing technologies and products and gain regulatory approval faster than us or our partners. Development of newer technologies and products could also render our technology and products less or noncompetitive or obsolete.

Employees and Consultants

As of December 31, 2004 we had 662 employees, of which 524 employees were engaged in research and development, including pre-commercial operations and quality activities, and 138 employees were engaged in general administration and business development. We have 312 employees who hold advanced degrees, of which 108 are Ph.D.s. None of our employees is covered by a collective bargaining agreement, and we have experienced no work stoppages. We believe that we maintain good relations with our employees.

To complement our own expertise, we utilize specialists in regulatory affairs, pulmonary toxicology, process engineering, manufacturing, quality assurance, device design, clinical trial design, and business development. These individuals include certain of our scientific advisors as well as independent consultants. See Item 10 “Directors and Executive Officers of the Registrant”.

General Information

We were incorporated in California in 1990 and reincorporated in Delaware in 1998. We maintain our executive offices at 150 Industrial Road, San Carlos, California 94070. Our main telephone number is (650) 631-3100.

All Nektar brand and product names that we use in connection with our company and our products are trademarks or registered trademarks of Nektar Therapeutics, in the United States and other countries. This Annual Report on Form 10-K contains additional trade names, trademarks and service marks of other companies. We do not intend our use or display of other parties’ trade names, or trademarks or service marks to imply a relationship with, or endorsement or sponsorship of, us by these other parties.

Available Information

We file electronically with the Securities and Exchange Commission (“SEC”) our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and current reports on Form 8-K pursuant to Section 13(a) or 15(d) of the 1934 Act. The public may read or copy any materials we file with the SEC at the SEC’s Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information statements, and other information regarding issuers that file electronically with the SEC. The address of that site is *www.sec.gov*.

You may obtain a free copy of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and current reports on Form 8-K and amendments to those reports on the day of filing with the SEC on our website at *http://www.nektar.com*, by contacting the Investor Relations Department at our corporate offices by calling (650) 631-3100 or by sending an e-mail message to *investors@nektar.com*. The contents of our website are not part of the Annual Report on Form 10-K.

RISK FACTORS

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

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

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

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

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

- the potential inability to control whether and the extent to which our collaborative partners will devote sufficient resources to our programs or products;
- disputes which may arise in the future with respect to the ownership of rights to technology and/or intellectual property developed with collaborative partners;
- disagreements with collaborative partners which could lead to delays in or termination of the research, development or commercialization of product candidates, or result in litigation or arbitration;
- the potential for contracts with our collaborative partners to fail to provide significant protection or to be effectively enforced if one of these partners fails to perform. Collaborative partners have considerable discretion in electing whether to pursue the development of any additional products and may pursue alternative technologies or products either on their own or in collaboration with our competitors;
- the potential for collaborative partners with marketing rights to choose to devote fewer resources to the marketing of our products than they do to products of their own development;
- risks related to the ability of our collaborative partners to pay us; and
- the potential for collaborative partners to terminate their agreements with us unilaterally for any or no reason.

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

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

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

We are developing with Pfizer an inhaleable version of insulin, Exubera®, for the treatment of Type 1 and Type 2 diabetes that will be administered using our Pulmonary Technology. Exubera® is currently in extended

Phase III clinical trials. We currently depend on Pfizer as the source of a significant portion of our revenues. For both of the years ended December 31, 2004 and 2003, revenue from Pfizer accounted for 61% of our total revenue. On March 2, 2005, Pfizer and Sanofi-Aventis jointly announced that the FDA has accepted the filing of an NDA for Exubera®. In March 2004, Pfizer and Sanofi-Aventis announced that the EMEA has accepted the filing of a marketing authorization application for Exubera®. However, there can be no assurance that Exubera® will be approved for marketing and/or commercial use in the U.S. or E.U. Among the factors that may delay the approval of the NDA, the approval by the EMEA to market Exubera® in the E.U., or the commercial launch of Exubera® in the U.S. or the E.U., or that may impact a decision to proceed at all with respect to any of the foregoing, are the following:

- Pfizer is currently conducting studies to generate controlled long-term safety data with respect to Exubera®, in particular its effect on lung function, and the results of the studies may impact regulatory approvals.
- We and/or Pfizer may experience difficulties with respect to the processing of the dry powder formulation of inhaleable insulin and the filling and packaging of the inhaleable insulin powder for the large-scale commercial production of Exubera®.
- We, with our contract manufacturers, may experience difficulties with respect to the production of the pulmonary inhaler device for Exubera®, including the design, scale-up and automation of the commercial manufacture of the pulmonary inhaler device for Exubera®, and any such difficulties may delay the filing and approval of the NDA or the approval to market in the E.U. Our contract manufacturers may also experience difficulties with respect to manufacturing the device in high volumes for commercial use.
- Pfizer may elect for marketing or other reasons, to delay or not proceed with the commercial launch of Exubera®, once approved.

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

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

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

We intend to seek future collaborative relationships with pharmaceutical and biotechnology partners to fund some of our research and development expenses and to develop and commercialize potential products. Further, we anticipate that the timing of drug development programs under existing collaborative agreements with our partners will continue to affect our revenues from such agreements. We may not be able to negotiate acceptable

collaborative arrangements in the future, and any arrangements we do negotiate may not be successful. If we fail to establish additional collaborative relationships, we will be required to undertake research, development, marketing, and manufacturing of our proposed products at our own expense or discontinue or reduce these activities.

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

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

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

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

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

Except for products using our Advanced PEGylation Technology that have already been approved by the FDA or other regulatory agencies, our product candidates are still in research and development, including preclinical testing and clinical trials. Preclinical testing and clinical trials are long, expensive and uncertain processes. It may take us, or our collaborative partners, several years to complete this testing, and failure can occur at any stage in the process. Success in preclinical testing and early clinical trials does not ensure that later clinical trials will be successful. A number of companies in the pharmaceutical and biotechnology industries have suffered significant setbacks in later stage clinical trials, even after promising results in earlier trials.

Any clinical trial may fail to produce results satisfactory to us, our collaborative partners, the FDA, or other regulatory authorities. Preclinical and clinical data can be interpreted in different ways, which could delay, limit or prevent regulatory approval or commercialization. Negative or inconclusive results or adverse medical events

during a clinical trial could cause a clinical trial to be repeated or a program to be terminated. We typically rely on collaborative partners and third-party clinical investigators to conduct clinical trials of our products and, as a result, we may face additional delaying factors outside our control.

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

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

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

Our ability to efficiently attach PEG polymer chains to a drug molecule is the initial screen for determining whether drug formulations using our Advanced PEGylation Technology are commercially feasible. We would not consider a drug formulation to be a good candidate for development and commercialization using our Advanced PEGylation Technology if we could not efficiently attach a PEG polymer chain to such drug without destroying the drug’s activity.

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

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

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

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

We, or our collaborative partners, may not be able to prove that potential products using our drug delivery technologies are safe. Our products require lengthy laboratory, animal and human testing. We cannot be certain that these products, and our technology that developed these products, are safe or will not produce unacceptable adverse side effects. The safety of our formulations will vary with each drug and the ingredients used in our formulation. If any product is found not to be safe, the product will not be approved for marketing or

commercialization. In addition, even if a product is approved and commercialized, regulatory authorities could still later suspend or terminate the license to market the product if it is determined that the product does not meet safety or other standards.

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

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

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

We may not be able to provide reproducible dosing of stable formulations of drug compounds. Reproducible dosing is the ability to deliver a consistent and predictable amount of drug into the bloodstream over time both for a single patient and across patient groups. Reproducible dosing of drugs based on our Pulmonary Technology requires the development of:

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

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

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

There is a risk that we, or our partners, will not obtain regulatory approval (which in some countries includes pricing approval) for unapproved products on a timely basis, or at all. Unapproved products must undergo rigorous animal and human testing and an extensive FDA mandated or equivalent foreign authorities' review process. This process generally takes a number of years and requires the expenditure of substantial resources. The time required for completing such testing and obtaining such approvals is uncertain. The FDA and other U.S. and foreign regulatory agencies also have substantial discretion to terminate clinical trials, require additional testing, delay or withhold registration and marketing approval and mandate product withdrawals including recalls. Even though our partners have obtained regulatory approval for some of our products, these products and our manufacturing processes are subject to continued review by the FDA and other regulatory authorities. Even if we or our partners receive regulatory approval of a product, the approval may limit the indicated uses for which the product may be marketed. In addition, any marketed products and manufacturing facilities used in the manufacture of such products will be subject to continual review and periodic inspections. Later discovery from such review and inspection of previously unknown problems may result in restrictions on marketed products or on us, including withdrawal of such products from the market. The failure to obtain timely regulatory approval of products, any product marketing limitations or a product withdrawal would negatively impact our revenues and results of operations.

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

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

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

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

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

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

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

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

Nektar Advanced PEGylation Technology and Supercritical Fluid Technology

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

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

Nektar Pulmonary Technology

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

For the most part, we obtain the bulk active pharmaceutical ingredients we use to manufacture products using our technologies from sole or exclusive sources of supply. For example, with respect to our source of bulk insulin, we have entered into a collaborative agreement with Pfizer that has, in turn, entered into an agreement

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

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

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

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

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

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

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

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

We are aware of other companies engaged in developing and commercializing drug delivery and formulation technologies similar to our technologies. Some of our competitors with regard to our Pulmonary Technology include Alexza MDC, Alkermes, Inc., Aradigm Corporation, AeroGen, Inc., 3M, MannKind Corporation,

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

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

We have filed patents applications (and we plan to file additional patent applications) covering, among other things, aspects of: (a) our Pulmonary Technology (in general and as it relates to specific molecules) including, without limitation, our powder processing technology, our powder formulation technology, and our inhalation device technology; (b) our Advanced PEGylation Technology; and (c) our Supercritical Fluid Technology. As of December 31, 2004, we owned 825 issued U.S. and foreign patents that cover various aspects of our technologies, and we have a number of patent applications pending.

Access, or our partners' access, to drugs to be formulated using our various delivery technologies affects our ability to develop and commercialize our technologies. We intend generally to rely on the ability of our partners to provide access to drugs that we formulate for pulmonary and other forms of delivery. There is a risk that our partners will not be able to provide access to such drugs. This situation is complex, and as such, the ability of any one company, including us, to commercialize a particular drug is unpredictable.

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

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

On September 3, 2004, a purported securities class action complaint styled *Norman Rhodes, et al. v. Nektar Therapeutics, Ajit Gill, J. Milton Harris, and Robert B Chess*, Case No. C 04-03735 JSW, was filed in the United States District Court for the Northern District of California against Nektar Therapeutics (the "Company") and

certain of its current officers and directors. The complaint alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5. The plaintiff seeks to represent a putative class of all purchasers of the Company's securities between March 4, 2004 and August 4, 2004 (the "Class Period"). The complaint generally alleges that, during that Class Period, the Company and the individual defendants made false or misleading statements in certain press releases regarding Exubera®. The Complaint seeks unspecified monetary damages and other relief against all defendants. One motion for appointment of a lead plaintiff has been filed, and that motion is pending. The action is in a very early stage, and defendants' have not responded to the complaint.

This litigation may be costly and could prove to be time consuming and disruptive to normal business operations. There can be no assurance that we will prevail or that the cost of defending these lawsuits will be covered by our insurance policies. While it is not possible to predict accurately or to determine the eventual outcome of this litigation, an unfavorable outcome or settlement of this litigation could have a material adverse effect on our financial position, liquidity or results of operations.

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

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

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

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

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

- changes in and compliance with government regulations;
- handling and disposal of hazardous materials;
- workplace health and safety requirements;
- hiring and retaining qualified people; and
- insuring against product liability claims.

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

As of December 31, 2004, we had approximately $173.9 million in long-term convertible subordinated notes and debentures, $23.6 million in non-current capital lease obligations, and $22.3 million in other long-term debt. Our substantial long-term indebtedness, which totaled $219.8 million as of December 31, 2004, has and will continue to impact us by:

- making it more difficult to obtain additional financing; and
- constraining our ability to react quickly in an unfavorable economic climate.

Currently we are not generating positive cash flow. Delay in the approval of Exubera®, or other adverse occurrences related to our product development efforts will adversely impact our ability to meet our obligations to repay the principal amounts on our convertible subordinated notes and debentures when due. In addition, if the market price of our common stock is below the related conversion price, the holders of the related outstanding convertible subordinated notes and debentures will not likely convert such securities to equity in accordance with their existing terms. If we are unable to satisfy our debt service requirements, substantial liquidity problems could result. As of December 31, 2004 we had cash, cash equivalents and short-term investments valued at approximately $418.7 million. We expect to use a substantial portion of these assets to fund our on-going operations over the next few years. As of December 31, 2004, we had approximately $173.9 million outstanding convertible subordinated notes and debentures, all of which will mature in 2007. We may not generate sufficient cash from operations to repay our convertible subordinated notes and debentures or satisfy any other of these obligations when they become due and may have to raise additional funds from the sale of equity or debt securities or otherwise restructure our obligations in order to do so. There can be no assurance that any such financing or restructuring will be available to us on commercially acceptable terms, if at all.

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

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

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

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

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

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

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

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

We have never had a profitable year and, through December 31, 2004, we have an accumulated deficit of approximately $717.1 million. We expect to continue to incur substantial and potentially increasing losses over at least the next few years as we expand our research and development efforts, testing activities and manufacturing operations, and as we further expand our late stage clinical and early commercial production facilities. Most of our potential products are in the early stages of development. Except for the approved products incorporating our Advanced PEGylation Technology, we have generated no revenues from product sales. Our revenues to date have consisted primarily of payments under short-term research and feasibility agreements and development contracts.

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

Anti-takeover provisions in our charter documents and under Delaware law may make it more difficult to acquire us, even though such acquisitions may be beneficial to our stockholders.

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

- establishment of a classified board of directors such that not all members of the board may be elected at one time;
- lack of a provision for cumulative voting in the election of directors, which would otherwise allow less than a majority of stockholders to elect director candidates;
- the ability of our board to authorize the issuance of “blank check” preferred stock to increase the number of outstanding shares and thwart a takeover attempt;
- prohibition on stockholder action by written consent, thereby requiring all stockholder actions to be taken at a meeting of stockholders;
- establishment of advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings; and
- limitations on who may call a special meeting of stockholders.

Further, we have in place a preferred share purchase rights plan, commonly known as a “poison pill.” The provisions described above, our “poison pill” and provisions of Delaware law relating to business combinations with interested stockholders may discourage, delay or prevent a third party from acquiring us. These provisions may also discourage, delay or prevent a third party from acquiring a large portion of our securities, or initiating a tender offer or proxy contest, even if our stockholders might receive a premium for their shares in the acquisition over the then current market prices.

We expect our stock price to remain volatile.

Our stock price is volatile. In the twelve-month period ending December 31, 2004, based on closing bid prices on The NASDAQ National Market, our stock price ranged from $9.69 to $23.24. We expect our stock price to remain volatile. A variety of factors may have a significant effect on the market price of our common stock, including:

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

- announcement or termination of collaborative relationships by us or our competitors;
- fluctuations in our operating results;
- developments in patent or other proprietary rights;
- announcements of technological innovations or new therapeutic products;
- governmental regulation;
- public concern as to the safety of drug formulations developed by us or others; and
- general market conditions.

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

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

There may be potential new accounting pronouncements or regulatory rulings, which may have an impact on our future financial position and results of operations. For example, in December 2004, the FASB issued an amendment to SFAS No. 123, *Accounting For Stock-Based Compensation ("FAS 123R")*, which becomes effective for public companies in periods beginning after June 15, 2005. We will be required to implement the proposed standard no later than the quarter that begins July 1, 2005. The cumulative effect of adoption, if any, applied on a modified prospective basis, would be measured and recognized on July 1, 2005. SFAS No. 123 would eliminate the ability to account for share-based compensation transactions using Accounting Principles Board Opinion No. 25 ("APB 25"), and would instead require companies to recognize compensation expense using a fair-value based method for costs related to share-based payments including stock options and employee stock purchase plans. The adoption of SFAS No. 123R will materially impact our financial position and results of operations.

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

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

In particular, our efforts to comply with Section 404 of SOX and the related regulations regarding our required assessment of our internal controls over financial reporting and our external auditors' audit of that assessment has required, and continues to require, the commitment of significant financial and managerial resources. Our management has determined, as of the year ended December 31, 2004, that we had a material weakness in our internal control over financial reporting and that our disclosure controls and procedures were not effective. Efforts to remedy these deficiencies may require significant additional financial and managerial resources. In addition, such deficiencies may result in a loss of investor confidence and may adversely affect the price of our common stock.

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

EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth the names, ages and positions of our executive officers as of February 28, 2005:

Name	Age	Position
Robert B. Chess	48	Executive Chairman of the Board
Ajit S. Gill	56	Director, Chief Executive Officer, and President
Ajay Bansal	43	Vice President, Finance and Administration, Chief Financial Officer
John S. Patton, Ph.D.	58	Director, Founder, and Chief Scientific Officer
David Johnston, Ph.D.	54	Senior Vice President, Research and Development
Nevan C. Elam	37	General Counsel and Secretary

Robert B. Chess, has served as Executive Chairman of our board since April 1999, and as a director since May 1992. Mr. Chess served as Co-Chief Executive Officer from August 1998 to April 2000, as President from December 1991 to August 1998, and as Chief Executive Officer from May 1992 to August 1998. From September 1990 until October 1991, he was an Associate Deputy Director in the White House Office of Policy Development. In March 1987, Mr. Chess co-founded Penederm Incorporated, a topical dermatological drug delivery company, and served as its President until February 1989. Prior to co-founding Penederm, Mr. Chess held management positions at Intel Corp., a semiconductor manufacturer, and Metaphor, a computer software company (acquired by International Business Machines Corp.). Mr. Chess holds a B.S. in Engineering from the California Institute of Technology and an M.B.A. from the Harvard Business School. Mr. Chess is a director of Pharsight Corp., a software company, the Biotechnology Industry Organization, a trade organization serving and representing the emerging biotechnology industry and CoTherix, Inc., a cardiopulmonary therapeutics company.

Ajit S. Gill has served as our Chief Executive Officer since April 2000, as President since April 1999, and as a director since April 1998. From August 1998 to April 2000, Mr. Gill served as our Co-Chief Executive Officer. From October 1996 to August 1998, Mr. Gill served as our Chief Operating Officer and directed our Technical Operations organization, including research and development. From January 1993 to October 1996, Mr. Gill served as our Chief Financial Officer. Before joining us, Mr. Gill was Vice President and General Manager of Kodak's Interactive Systems Products Division. Mr. Gill has served as Vice President, Finance and Chief Financial Officer for TRW-Fujitsu and Director of Business Development for VisiCorp, a pioneer in the personal computer software market. He holds a Bachelor of Technology from the Indian Institute of Technology, an M.S. in Electrical Engineering from the University of Nebraska, and an M.B.A. from the University of Western Ontario.

Ajay Bansal has served as our Vice President of Finance and Administration and Chief Financial Officer since February 2003. From July 2002 until joining Nektar, Mr. Bansal served as Director of Operations Analysis at Capital One Financial. From August 1998 to June 2002, Mr. Bansal was at Mehta Partners LLC, a financial advisory firm and was a Partner there since January 2000. Prior to joining Mehta Partners LLC, Mr. Bansal spent more than 10 years in management roles at Novartis, a major pharmaceutical company, and in consulting at Arthur D. Little, Inc., McKinsey & Company, Inc. and ZS Associates. Mr. Bansal holds a Bachelor of Technology from the Indian Institute of Technology, an M.S. in Operations Management from Northwestern University and an M.B.A. from Northwestern University.

John S. Patton, Ph.D., our co-founder, has served as Chief Scientific Officer since November 2001 and as a director since July 1990. Dr. Patton served as Vice President, Research from December 1991 to November 2001. He served as our President from incorporation in July 1990 to December 1991. From 1985 to 1990, Dr. Patton was a Project Team Leader with Genentech, Inc., a biotechnology company, where he headed their non-invasive drug delivery activities. Dr. Patton was on the faculty of the Marine Science and Microbiology Departments at the University of Georgia from 1979 through 1985, where he was granted tenure in 1984. Dr. Patton received a B.S. in Zoology and Biochemistry from Pennsylvania State University, an M.S. from the University of Rhode Island, a Ph.D. in Biology from the University of California, San Diego and received post doctorate fellowships

from Harvard Medical School and the University of Lund, Sweden, both in biomedicine. Dr. Patton is also a director of Saegis Pharmaceuticals, Inc., and Halozyme Therapeutics, Inc., both biopharmaceutical companies.

David Johnston, Ph.D. joined Nektar in January 2004 as Senior Vice President of Research and Development. Dr. Johnston has more than 25 years of broad experience in the international pharmaceutical industry. Prior to Nektar, he was vice president and chief development officer at Control Delivery Systems Inc., a company engaged in improving traditional treatments with innovative approaches to drug delivery. Previously, he was the executive vice president and president of AAI International (now AAI Development Services), a leading company in contract pharmaceutical R&D. He was also executive vice president of drug development and chief scientific officer of Oread Inc. From 1979 to 1997, Dr. Johnston held various positions in pharmaceutical development at Sterling Winthrop/Sanofi Winthrop Inc. In his last position at Sanofi research, he was the vice president of pharmaceutical product development for Sanofi R&D in the USA and deputy group director of product development worldwide. Dr Johnston received a B.Sc. in Chemistry (1st class) and a Ph.D. from St. Andrews University, Scotland, and he completed postdoctoral studies at the Max Planck Institute for Medicinal research in Heidelberg, Germany. He has over 40 publications and has contributed to presentations in Europe and the U.S.

Nevan C. Elam has served as General Counsel and Secretary since January 17, 2005. From March 2004 to December 2004, Mr. Elam served as an advisor to E2open, Inc., a supply chain software company. From February 2002 to March 2004, Mr. Elam served as Chief Financial Officer of E2open and from October 2000 to February 2002, he was Vice President Business and Corporate Development and General Counsel of E2open. Prior to his management roles at E2open, Mr. Elam was a Partner in the corporate practice of the law firm of Wilson Sonsini Goodrich & Rosati, where he worked for eight years. Mr. Elam received his Juris Doctorate from Harvard Law School and a Bachelor of Arts from Howard University.

Item 2. Properties

We currently lease facilities in San Carlos, California and a complex in Bradford, England. We own two facilities in Huntsville, Alabama.

We currently occupy a facility in San Carlos that covers approximately 230,000 square feet and is leased pursuant to a 15-year lease agreement expiring in June 2012. This facility serves as our corporate headquarters and is used for research and development, manufacturing and administration. This manufacturing facility operates under cGMP and has been approved and licensed by the State of California to manufacture clinical supplies for use in human clinical trials.

We also occupy a second facility in San Carlos that covers approximately 215,600 square feet. The lease on an approximate 45,600 square feet expires in August 2007, while the lease on the remaining approximate 170,000 square feet expires in September 2016. This facility houses research and development and administrative offices.

We have two locations in Huntsville, Alabama related to our Advanced PEGylation Technology operations which we own. Our Church Street location is the site for the manufacture of PEG derivatives and is approximately 85,000 square feet and is owned by us. Our Discovery Drive location is approximately 50,000 square feet and is owned by us. This facility houses research and development and administrative offices.

We currently occupy a complex in Bradford, England that covers approximately 17,500 square feet, consisting of several units with varying lease terms through 2009. This facility is used for research and development, clinical research and administration related to our supercritical fluids technology.

Item 3. Legal Proceedings

On September 3, 2004, a purported securities class action complaint styled Norman Rhodes, et al. v. Nektar Therapeutics, Ajit Gill, J. Milton Harris, and Robert B Chess, Case No. C 04-03735 JSW, was filed in the United States District Court for the Northern District of California against Nektar Therapeutics (the "Company") and certain of its current officers and directors. The complaint alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5. The plaintiff seeks to represent a putative class of all purchasers of the Company's securities between March 4, 2004 and August 4, 2004 (the "Class Period"). The complaint generally alleges that, during that Class Period, the Company and the individual defendants made false or misleading statements in certain press releases regarding Exubera®. The Complaint seeks unspecified monetary damages and other relief against all defendants. One motion for appointment of a lead plaintiff has been filed, and that motion is pending. The action is in a very early stage, and defendants' have not responded to the complaint.

This litigation may be costly and could prove to be time consuming and disruptive to normal business operations. There can be no assurance that we will prevail or that the cost of defending these lawsuits will be covered by our insurance policies. While it is not possible to predict accurately or to determine the eventual outcome of this litigation, an unfavorable outcome or settlement of this litigation could have a material adverse effect on our financial position, liquidity or results of operations.

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 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, rulings, 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 on our cash and/or liquidity.

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

No matters were submitted to a vote of our security holders in the three-month period ended December 31, 2004.

PART II

Item 5. Market for Registrant's Common Stock and Related Stockholder Matters

Our Common Stock trades on the NASDAQ National Market under the symbol NKTR. The table below sets forth the high and low closing sales prices for our Common Stock (as reported on the NASDAQ National Market) during the periods indicated.

	High	Low
Year Ended December 31, 2003:		
1st Quarter	$ 9.21	$ 4.46
2nd Quarter	13.44	6.35
3rd Quarter	14.06	6.87
4th Quarter	14.94	12.65
Year Ended December 31, 2004:		
1st Quarter	$ 23.24	$ 14.30
2nd Quarter	22.83	16.33
3rd Quarter	19.81	9.69
4th Quarter	20.46	13.95

As of February 28, 2005, there were approximately 365 holders of record of our Common Stock. We have not paid any cash dividends since our inception and do not intend to pay any cash dividends in the foreseeable future.

Information regarding our equity compensation plans as of December 31, 2004 is disclosed in Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholders Matters and incorporated by reference from the definitive proxy statement for our 2005 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Form under the heading "Equity Compensation Plan Information."

Sales of Unregistered Securities

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

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

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

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

These issuances of unregistered securities were exempt from registration pursuant to Section 3(a)(9) of the Securities Act of 1933, as amended.

Item 6. Selected Consolidated Financial Data

SELECTED CONSOLIDATED FINANCIAL INFORMATION
(In thousands, except per share information)

The selected consolidated financial data set forth below should be read together with the consolidated financial statements and related notes, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the other information contained herein.

	Years Ended December 31,				
	2004	2003	2002	2001	2000
Statement of Operations Data:					
Revenue:					
Contract research revenue	$ 89,185	$ 78,962	$ 76,380	$ 68,899	$ 51,629
Product sales	25,085	27,295	18,465	8,569	—
Total revenue	114,270	106,257	94,845	77,468	51,629
Total operating costs and expenses (1)	188,212	171,012	193,658	333,213	116,652
Loss from operations (1) (3)	(73,942)	(64,755)	(98,813)	(255,745)	(65,023)
Gain (Loss) on debt extinguishment	(9,258)	12,018	—	—	—
Debt conversion premium, net	—	—	—	—	(40,687)
Interest and other income (expense), net (1)	(18,849)	(12,984)	(8,655)	5,737	8,307
Benefit (provision) for income taxes	163	(169)	—	—	—
Net loss	$(101,886)	$ (65,890)	$(107,468)	$(250,008)	$ (97,403)
Basic and diluted net loss per share	$ (1.30)	$ (1.18)	$ (1.94)	$ (4.71)	$ (2.32)
Shares used in computation of basic and diluted net loss per share (2)	78,461	55,821	55,282	53,136	41,998

	Years Ended December 31,				
	2004	2003	2002	2001	2000
Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 418,740	$ 285,967	$ 293,969	$ 344,356	$ 484,841
Working capital	398,886	259,641	247,324	301,642	462,840
Total assets	744,921	616,788	606,638	667,241	629,540
Long-term debt (excluding current portion)	45,860	43,642	35,021	37,130	20,118
Convertible subordinated notes and debentures	173,949	359,988	299,149	299,149	299,149
Accumulated deficit	(717,121)	(615,235)	(549,345)	(441,877)	(191,869)
Total stockholders' equity	467,342	164,191	206,770	270,313	277,833

Note: Amounts for the year ended December 31, 2000 do not include the operations of our Nektar, UK subsidiary which was acquired in January 2001, and our Nektar, AL subsidiary which was acquired in June 2001.

(1) Certain prior year amounts reported in our Annual Report on Form 10-K for the year ended December 31, 2003, as amended, have been restated to correct for certain misapplications of GAAP. Refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and note 1 of our consolidated financial statements in Item 8 of this Annual Report on Form 10-K.

(2) Basic and diluted net loss per share is based upon the weighted average number of common shares outstanding. The shares shown above retroactively reflect a two-for-one split, effective August 22, 2000.

(3) We changed our method of accounting for goodwill and other intangible assets on January 1, 2002 in connection with the adoption of SFAS No. 142, *Goodwill and Other Intangible Assets.*

Item 7. 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 in Part I of this report under the heading "Risk Factors."

Overview

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

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

To date the revenues we have received from the sales of our products and in connection with our collaborative arrangements have been insufficient to meet our operating and other expenses. Except for sales from certain products using Nektar Advanced PEGylation Technology, we have not sold any commercial products and do not anticipate receiving significant revenue from product sales or royalties in the near future. The development of a successful product is dependent upon several factors that are outside of our control. These include, among other things, the need to obtain regulatory approval to market these products and our dependence upon our collaborative partners. As a result of these or other risks, potential products for which we have invested substantial amounts in research and development may never produce revenues or income.

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

To fund the substantial expense related to our research and development activities, we have raised significant amounts of capital through the sale of our equity and convertible debt securities. As of December 31, 2004, we had approximately $173.9 million in long-term convertible subordinated notes and debentures, $23.6 million in non-current capital lease obligations, and $22.3 million in other long-term debt. Our ability to meet the repayment obligations of this debt is dependent upon our ability to develop successful products without significant delay or expense. Even if we are successful in this regard, we will likely require additional capital to repay our debt obligations.

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

Recent Developments

In March 2005, we reported that Pfizer Inc and The Sanofi-Aventis Group announced that the United States Food and Drug Administration ("FDA") had accepted for filing a new drug application for Exubera® (inhaled insulin). Pfizer Inc and Sanofi-Aventis stated that they intended to seek approval to market Exubera® for adult patients with type 1 and type 2 diabetes and they also stated that Exubera® has been studied in more than 3,500 patients, and in some of these patients for more than seven years.

In December, 2004, we reported that Eyetech Pharmaceuticals, Inc. and Pfizer Inc. announced that FDA had approved Macugen® (pegaptanib sodium injection) for use in the treatment of neovascular (wet) age-related macular degeneration (AMD), an eye disease associated with aging that destroys central vision. This is the sixth product using our Advanced PEGylation Technology approved for use in the U.S.

In September 2004, Pfizer and Sanofi-Aventis presented new data from a trial whose primary objective was to assess long-term pulmonary safety that showed that Exubera® was effective and well tolerated in controlling blood glucose levels over a two-year period in patients with type 2 diabetes.

During 2004 and January 2005, we announced five new collaborative agreements with Pfizer, GlaxoSmithKline, Bayer, Zelos, and one undisclosed biotechnology company.

We currently have four development programs underway through our Proprietary Products Group, including one product that has entered a Phase I clinical trial, one that has entered proof-of-concept clinical testing, and two in pre-clinical testing.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") released a revision to Statement of Financial Accounting Standard ("SFAS") No. 123, *Accounting for Stock-Based Compensation* ("FAS 123R"). FAS 123R addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees, and generally would require instead that such transactions be accounted for using a fair-value-based method. We will be required to adopt FAS 123R on July 1, 2005. When we adopt the new statement, we will have to recognize substantially more compensation expense. This will have a material adverse impact on our financial position and results of operations. We are currently in the process of evaluating the effect of adopting FAS 123R.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, an amendment of APB Opinion No. 29. Statement 153 addresses the measurement of exchanges of nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS No. 153 is effective for nonmonetary asset exchanges beginning July 1, 2005. We do not believe adoption of SFAS No. 153 will have a material effect on our consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*. Also in December 2004, the FASB issued FASB Staff Position No. FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the*

American Jobs Creations Act of 2004. We do not expect the adoption of these new tax accounting standards to have a material impact on our consolidated financial position, results of operations, or cash flows.

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

In June 2004, the FASB Emerging Issues Task Force ("EITF") issued EITF 02-14, *Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock*. EITF 02-14 addresses whether the equity method of accounting applies when an investor does not have an investment in voting common stock of an investee but exercises significant influence through other means. The accounting provisions of EITF 02-14 are effective for reporting periods beginning after September 15, 2004. We do not expect the adoption of EITF 02-14 to have a material impact on our consolidated financials position, results of operations, or cash flows.

In March 2004, the EITF reached a consensus on EITF 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. EITF 03-01 provides guidance regarding disclosures about unrealized losses on available-for-sale debt and equity securities accounted for under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities.* In September 2004, the EITF delayed the effective date for the measurement and recognition guidance; however the disclosure requirements remain effective for annual periods ending after June 15, 2004 (see note 2). We have complied with the disclosure requirements of EITF 03-01, and we will evaluate the impact of the measurement and recognition provisions of EITF 03-01 once final guidance is issued.

Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States. It requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management has discussed the development, selection, and disclosure of each of the following critical accounting estimates with the audit committee.

Stock Based Compensation

In December 2004, the Financial Accounting Standards Board released a revision to SFAS No. 123, *Accounting for Stock-Based Compensation* ("FAS 123R"). FAS 123R addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees, and generally would require instead that such transactions be accounted for using a fair-value-based method. We will be required to adopt FAS 123R on July 1, 2005. When we adopt the new statement, we will have to recognize substantially more compensation expense. This would have a material adverse impact on our financial position and results of operations. We are currently in the process of evaluating the effect of adopting FAS 123R.

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

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

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

	2004	2003	2002
Risk-free interest rate	3.3%	2.8%	3.8%
Dividend yield	0.0%	0.0%	0.0%
Volatility Factor	0.707	0.744	0.743
Weighted average expected life	5 years	5 years	5 years

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

The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation (in thousands, except per share information):

	Years Ended December 31,		
	2004	2003	2002
Net loss, as reported	$(101,886)	$(65,890)	$(107,468)
Add: stock-based employee compensation included in reported net loss	1,423	878	644
Deduct: total stock-based employee compensation expense determined under fair value methods for all awards	(31,185)	(34,300)	(35,605)
Pro forma net loss	$(131,648)	$(99,312)	$(142,429)
Net loss per share			
Basic and diluted, as reported	$ (1.30)	$ (1.18)	$ (1.94)
Basic and diluted, pro forma	$ (1.68)	$ (1.78)	$ (2.58)

Cash, Cash Equivalents and Investments

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

Short-term investments consist of federal and municipal government securities, corporate bonds, and commercial paper with A1, F1, or P1 short-term ratings and A or better long-term ratings with remaining maturities at date of purchase of greater than 90 days and less than two years.

At December 31, 2004, all short-term investments are designated as available-for-sale and are carried at fair value, with unrealized gains and losses reported in stockholders' equity as accumulated other comprehensive income (loss). Short-term investments are adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities, if any, are included in other income (expense). The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest income.

Impairment of Goodwill, Intangible Assets, and Other Long-Lived Assets

Goodwill is tested for impairment at least annually, or on an interim basis if an event occurs or circumstances change that would more-likely-than-not reduce the fair value below our carrying value. We performed our annual impairment test and determined that on a consolidated basis, the undiscounted cash flow from our long-range forecast exceeds the carrying amount of our goodwill. The carrying value of goodwill is $130.1 million as of December 31, 2004 and 2003.

Goodwill will be tested for impairment using a two-step approach. The first step is to compare our fair value to our net asset value, including goodwill. If the fair value is greater than our net asset value, goodwill is not considered impaired and the second step is not required. If the fair value is less than our net asset value, the second step of the impairment test measures the amount of the impairment loss, if any. The second step of the impairment test is to compare the implied fair value of goodwill to its carrying amount. If the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized equal to that excess. The implied fair value of goodwill is calculated in the same manner that goodwill is calculated in a business combination, whereby the fair value is allocated to all of the assets and liabilities (including any unrecognized intangible assets) as if they had been acquired in a business combination and the fair value was the purchase price. The excess "purchase price" over the amounts assigned to assets and liabilities would be the implied fair value of goodwill.

The impairment tests for goodwill are performed at the corporate entity level, which we have identified to be our only reporting unit. In the future, we may determine that impairment tests should be performed at a level below the reporting unit level, depending on whether certain criteria are met.

In accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*, we perform a test for recoverability of our intangible and other long-lived assets whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. An impairment loss would be recognized only if the carrying amount of an intangible or long-lived asset exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposal of the asset. To date, there have been no events or changes in circumstances that would indicate that the carrying value of such assets may not be recoverable, and therefore we have determined that there has been no impairment on our intangible and other long-lived assets, including capitalized assets related to Exubera®.

In assessing the recoverability of our intangibles and long-lived assets, we have concluded that there is no impairment in the carrying value of these assets as of December 31, 2004. If this assessment changes in the future, we may be required to record impairment charges for these assets. The carrying value of our purchased intangibles as of December 31, 2004 and 2003 is $6.5 million and $11.0 million, respectively. These assets are scheduled to be fully amortized by December 2006. The carrying value of our other long-lived assets as of December 31, 2004 and 2003 is $153.8 million and $156.7 million, respectively.

Judgments Impacting Fixed Asset Capitalization for Exubera®

In accordance with SFAS 2, *Accounting for Research and Development Costs*, we have expensed certain amounts paid for plant design, engineering, and validation costs for the automated assembly line equipment that will be used in connection with the manufacture of the inhaler device for Exubera® because such costs have no alternative future use. The total amount expensed was $1.7 million, $6.6 million, and $7.3 million, for the years ended December 31, 2004, 2003, and 2002, respectively. As of December 31, 2004, the capitalized net book value of the automated assembly line equipment located at our contract manufactures' sites totals $25.2 million. These assets are intended to be used in connection with the manufacture of the inhaler device for Exubera®. The total amount capitalized amounted to $0.2 million, $1.4 million, and $4.6 million for the years ended December 31, 2004, 2003, and 2002, respectively. These amounts have been capitalized based upon our determination that the related assets have alternative future use and therefore have separate economic or realizable value.

Inventory Reserves

We perform quality control reviews of our raw materials and finished goods. We record inventory reserves based upon specific identification of potentially defective raw material and finished goods batches. In addition, we record an inspection reserve based on a historical estimate of finished goods that ultimately fail quality control. We generally do not maintain inventory reserves based on obsolescence or risk of competition because the shelf life of our products is long. However, if our current assumptions about demand or obsolescence were to change, additional inventory reserves may be needed, which could negatively impact our product gross margins. Our inventory reserves were $3.2 million and $1.6 million as of December 31, 2004 and 2003, respectively. This represented 23% and 16% of gross inventory as of December 31, 2004 and 2003, respectively.

Revenue Recognition

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

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

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

Contract revenue from collaborative research and feasibility agreements is recorded when earned based on the performance requirements of the contract. Advance payments for research and development revenue received in excess of amounts earned are classified as deferred revenue until earned. Revenue from collaborative research

and feasibility arrangements are recognized as the related costs are incurred. Amounts received under these arrangements are generally non-refundable if the research effort is unsuccessful.

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

Product sales are derived primarily from cost-plus manufacturing and supply contracts for our PEG Reagents with individual customers in our industry. Sales terms for specific PEG Reagents are negotiated in advance. Revenues related to our product sales are recorded in accordance with the terms of the contracts. No provisions for potential product returns have been made to date because we have not experienced any significant returns from our customers.

Restatement

Certain prior year amounts reported in our Annual Report on Form 10-K for the year ended December 31, 2003, as amended, have been restated to correct for misapplications of generally accepted accounting principles in the U.S. ("GAAP"). Also, certain amounts reported in our Quarterly Reports on Form 10-Q during the years 2004 and 2003 have been restated to correct for these misapplications of our accounting policies related to GAAP (refer to footnote 15 in Item 8 of this Annual Report on Form 10-K). These reclassifications did not result in any change to our cash position, revenue, or net loss for the years ended December 31, 2003 and December 31, 2002 or for any quarterly period during the years ended December 31, 2004 or 2003.

The specific misapplications of GAAP that lead to this conclusion are as follows:

- We have reclassified approximately $9.4 million and $9.8 million for the years ended December 31, 2003 and 2002, respectively, from research and development expenses to general and administrative expenses. This reclassification included legal expenses related to our intellectual property portfolio and a portion of finance, information systems, and human resource expenses that were not clearly related to research and development and are required to be classified outside research and development expenses under Statement Financial Accounting Standards No. 2, *Accounting for Research and Development Costs*.
- We reclassified approximately $1.4 million and $1.3 million for the years ended December 31, 2003 and 2002, respectively, from general and administrative expenses to interest expense. This reclassification was made to record the amortization of debt issuance costs to interest expense as required under Accounting Principles Board No. 21, *Interest on Receivables and Payables* and EITF 86-15 *Increasing-Rate Debt*.

Material Weakness and Remediation

In connection with management's assessment of its internal control over financial reporting as of December 31, 2004, we have concluded that we have a material weakness in our financial statement close process, including insufficient review of the following:

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

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

This material weakness impacts our ability to report financial information in conformity with GAAP, which could affect all significant financial statement accounts and has resulted in (i) a restatement of the 2002 and 2003 consolidated financial statements to reflect reclassifications of certain amounts between research and development expense, general and administrative expense, and interest expense; (ii) a restatement of all four quarters of 2003 and the first three quarters of 2004 to reflect reclassifications of certain amounts between research and development expense, general and administrative expense and interest expense; and (iii) the prior restatement of the 2003 consolidated financial statements to reduce the gain on debt extinguishment.

In 2004, we began implementation of new processes and controls and hired additional personnel with technical accounting expertise to improve our financial statement close process. We intend to continue to improve our financial statement close process in 2005 including the remediation of the material weakness discussed above by identifying, recruiting, and training personnel with the appropriate accounting skills. In addition, we plan to further enhance our technical accounting review process for non-routine and complex transactions by:

- identifying and defining non-routine and complex transactions on a regular basis, and
- researching, identifying, analyzing, documenting, and reviewing applicable accounting principles.

Our efforts to comply with Section 404 of SOX and the related regulations regarding our required assessment of our internal controls over financial reporting and the audit of that assessment by our registered public accounting firm has required, and continues to require, the commitment of significant financial and managerial resources. Our internal control systems are designed to provide reasonable assurance to management and our board of directors that our internal control over financial reporting is adequate, but there can be no guarantee that such controls will be effective. The continuing uncertainty that we will meet or continue to meet the requirements of these laws, regulations, and standards, may negatively impact our business operations and financial position.

Results of Operations

Years Ended December 31, 2004, 2003 and 2002

Revenue (in thousands except percentages)

	2004	2003	2002	Increase/ (Decrease) 2004 vs 2003	Increase/ (Decrease) 2003 vs 2002	Percentage Increase/ (Decrease) 2004 vs 2003	Percentage Increase/ (Decrease) 2003 vs 2002
Contract Revenue	$ 89,185	$ 78,962	$76,380	$ 10,223	$ 2,582	13%	3%
Product Revenue	$ 25,085	$ 27,295	$18,465	$ (2,210)	$ 8,830	(8)%	48%
Total Revenue	$114,270	$106,257	$94,845	$ 8,013	$ 11,412	8%	12%

Total revenue was $114.3 million for the year ended December 31, 2004 compared to $106.3 million and $94.8 million for the years ended December 31, 2003 and 2002, respectively. Total revenue increased 8% in 2004 compared to 2003 and increased 12% in 2003 compared to 2002.

Contract research revenue included reimbursed research and development expenses as well as the amortization of deferred up-front signing and milestone payments received from our collaborative partners. Contract revenues are expected to fluctuate from year to year, and future contract revenue cannot be predicted accurately. The level of contract revenues depends in part upon the continuation of existing collaborations, signing of new collaborations, and achievement of milestones under current and future agreements.

Contract research revenue was $89.2 million for the year ended December 31, 2004 compared to $79.0 million and $76.4 million for the years ended December 31, 2003 and 2002, respectively. The increase in contract research revenue for the year ended December 31, 2004, as compared to the year ended December 31,

2003 was due primarily to an $8.9 million increase in contract research revenue from Pfizer related to the Exubera® collaboration and a $2.0 million payment received from Aventis-Behring related to the termination of their collaboration with us.

Product revenue was $25.1 million for the year ended December 31, 2004 compared to $27.3 million and $18.5 million for the years ended December 31, 2003 and 2002, respectively. Product sales accounted for 22% of revenues for the year ended December 31, 2004, as compared to 26% and 19% of revenues for the years ended December 31, 2003 and 2002, respectively. The decrease in product revenue for the year ended December 31, 2004 as compared to the year ended December 31, 2003 was due primarily to lower demand. This resulted in lower sales of the following commercially approved products: Neulasta®, Somavert®, and PEGASYS®. These reductions in sales volume were partially offset by an increase in revenue related to CDP 870 for Phase III clinical supplies.

The increase in contract research revenue for the year ended December 31, 2003, as compared to the year ended December 31, 2002 was due primarily to increased activities under our existing collaboration agreements with Chiron Corporation and Solvay Pharmaceuticals, Inc.

The increase in product revenue for the year ended December 31, 2003 as compared to the year ended December 31, 2002 was primarily due to higher sales of Neulasta®, Somavert®, and PEGASYS®.

Future product sales are dependent upon regulatory approval of new products for sale and adoption of current products in the market.

Pfizer represented 61% of our revenue for the year ended December 31, 2004, 61% for the year ended December 31, 2003, and 59% for the year ended December 31, 2002. No other single customer represented 10% or more of our total revenues for any of the three years ended December 31, 2004, 2003, or 2002.

Cost of goods sold (in thousands except percentages)

2004	2003	2002	Increase/ (Decrease) 2004 vs 2003	Increase/ (Decrease) 2003 vs 2002
$ 19,798	$14,678	$7,020	$ 5,120	$ 7,658

Cost of goods sold for the year ended December 31, 2004 was $19.8 million resulting in a gross margin from product sales of 21%. Cost of goods sold for the year ended December 31, 2003 was $14.7 million resulting in a gross margin of 46%. Cost of goods sold for the year ended December 31, 2002 was $7.0 million resulting in a gross margin from product sales of 62%.

The decrease in product gross margin for the year ended December 31, 2004 compared to December 31, 2003 was primarily due to the following:

- Production problems encountered during the second and third quarter of 2004 resulted in a temporary shut down of part of our manufacturing operations. This resulted in lower overhead absorption. The excess overhead not absorbed was expensed to cost of goods sold. As of December 31, 2004, we are confident that the manufacturing problems are being satisfactorily addressed.
- As of January 1, 2004, we refined our methodology to allocate additional operating expenses which resulted in more overhead being allocated to production.
- Inventory reserves increased $1.6 million during the year ended December 31, 2004 from $1.6 million at December 31, 2003 to $3.2 million at December 31, 2004. The reserve represented 23% and 16% of gross inventory as of December 31, 2004 and 2003, respectively. This increase in the percentage of inventory reserved was due to a larger general reserve for defective batches.

The decrease in product gross margin for the year ended December 31, 2003 compared to December 31, 2002 was primarily due to changes in product mix and an increase to inventory reserves of from $0.4 million to $1.6 million. The increase was due to the establishment of a reserve for specifically identified failed batches.

Research and development (in thousands except percentages)

2004	2003 (restated)	2002 (restated)	Increase/ (Decrease) 2004 vs 2003	Increase/ (Decrease) 2003 vs 2002	Percentage Increase/ (Decrease) 2004 vs 2003	Percentage Increase/ (Decrease) 2003 vs 2002
$133,523	$ 122,149	$ 147,627	$ 11,374	$ (25,478)	9%	(17)%

We expense all research and development costs as they are incurred. Research and development expenses were $133.5 million for the year ended December 31, 2004, as compared to $122.1 million and $147.6 million for the years ended December 31, 2003 and 2002, respectively. The 9% increase in research and development expense for the year ended December 31, 2004 as compared to the year ended December 31, 2003 was primarily attributable to increased spending relating to commercial readiness of Exubera® as well as increased internally funded development spending.

We expect research and development spending to increase over the next few years as we continue to fund development of our technologies, and because of increased spending associated with the development of internally funded proprietary products. While we believe our proprietary products strategy may result in improved economics for any products ultimately developed and approved, it will require us to invest significant funds in developing these products without reimbursement from a collaborative partner.

The 17% decrease in research and development expense for the year ended December 31, 2003 as compared to the year ended December 31, 2002 was primarily attributable a deferral of certain research and development efforts into fiscal year 2004, as well as a workforce reduction completed in December 2002.

We have reclassified approximately $9.4 million and $9.8 million for the years ended December 31, 2003 and 2002, respectively, from research and development expenses to general and administrative expenses. This reclassification included legal expenses related to our intellectual property portfolio and a portion of finance, information systems, and human resource expenses that were not clearly related to research and development and are required to be classified outside of research and development expenses under Statement Financial Accounting Standards No. 2, *Accounting for Research and Development Costs*. The reclassification did not result in any change to our cash position, total operating expenses, or results of operations for the years ended December 31, 2003 or 2002.

The following table summarizes our partner development programs for products approved for use and those in clinical trials. The table includes the primary indication for the particular drug or product, the identity of a respective corporate partner if it has been disclosed, and the present stage of clinical development or approval in the United States, unless otherwise noted.

Molecule	Primary Indication	Partner	Status(1)
Neulasta® (pegfilgrastim)	Neutropenia	Amgen Inc.	Approved
PEGASYS® (peginterferon alfa-2a)	Hepatitis-C	Hoffmann La-Roche Ltd.	Approved
Somavert® (pegvisomant)	Acromegaly	Pfizer Inc.	Approved
PEG-INTRON® (peginterferon alfa-2b)	Hepatitis-C	Schering-Plough Corporation	Approved
Definity® (PEG)	Cardiac imaging	Bristol-Myers Squibb Company	Approved
Macugen® (pegaptanib sodium injection)	Age-related macular degeneration	Eyetech Pharmaceuticals, Inc.	Approved in the US & Filed in the EU & Canada
Macugen® (pegaptanib sodium injection)	Diabetic macular edema	Eyetech Pharmaceuticals Inc.	Phase II
Exubera® (inhaled insulin)	Diabetes	Pfizer Inc.	Filed in the U.S. and Europe
SprayGel™ adhesion barrier system (PEG-hydrogel)	Prevention of post-surgical adhesions	Confluent Surgical, Inc.	Pivotal trials in U.S. Approved in Europe
CDP 870 (PEG-anti-TNF alpha antibody fragment)	Rheumatoid arthritis	UCB Pharma	Phase III
	Crohn's disease		Phase III
CERA (Continuous Erythropoiesis Receptor Activator)	Renal anemia	Hoffmann La-Roche Ltd.	Phase III
Undisclosed (PEG)	Undisclosed	Undisclosed	Phase II
CDP 791 (PEG-antibody fragment angiogenesis inhibitor)	Cancer	UCB Pharma	Phase I/II
CDP 484 (PEGylated antibody fragment targeting pro-inflammatory cytokine interleukin 1-beta)	Rheumatoid Arthritis	UCB Pharma	Phase I/II
Tobramycin inhaled powder (TIP)	Lung infection	Chiron Corporation	Phase I
Inhaled leuprolide	Endometriosis	Enzon, Inc.	Phase I
MARINOL® (inhaled dronabinol)	Multiple indications	Solvay Pharmaceuticals, Inc.	Phase I
PEGylated interferon beta	Undisclosed	Serono, Inc.	Phase I
PEG-Alfacon (PEGylated interferon alfacon-1)	Hepatitis-C	InterMune, Inc.	Phase I
PEGylated-AXOKINE	Obesity	Regeneron Pharmaceuticals	Phase I
Undisclosed (PEG)	Undisclosed	Pfizer Inc.	Phase I

(1) Status definitions are as follows:
Approved—regulatory approval to market and sell product obtained in the U.S. or EU.
Phase III or Pivotal—Product in large-scale clinical trials conducted to obtain regulatory approval to market and sell a drug. Typically, these trials are initiated following encouraging Phase II trial results.
Phase II—Product in clinical trials to establish dosing and efficacy in patients.
Phase I—Product in clinical trials typically in healthy subjects to test safety.

Our product pipeline includes both partnered and proprietary products. We have ongoing collaborations with more than 20 biotechnology and pharmaceutical companies to provide our drug delivery technologies. Our partner product pipeline includes: six products (Neulasta®, PEGASYS®, Somavert®, PEG-INTRON®, Definity®, and Macugen®) approved by the U.S. Food and Drug Administration ("FDA"); one additional product (SprayGel™) approved in Europe that is in late stage testing in the U.S., two products (Exubera® and Macugen®) for which a marketing authorization application has been filed with the European Medicines Evaluation Agency ("EMEA"); two additional products (CDP 870 and CERA) in Phase III or pivotal trials; and ten products in Phase I and Phase II trials. In addition to our partnered product programs, we have four proprietary products in the early stages of development. One of these products involves an inhaled small molecule that has entered Phase I and another product is in proof-of-concept human studies. The remaining two products are in preclinical testing.

The length of time that a project is in a given phase varies substantially according to factors relating to the trial, such as the type and intended use of the end product, the trial design, the ability to enroll suitable patients. Generally, for partnered projects, advancement from one phase to the next and the related costs to do so is dependent upon factors that are primarily controlled by our partners.

Our research and development activities can be divided into research and preclinical programs, clinical development programs and commercial readiness. We estimate the costs associated with research and preclinical programs, clinical development programs, and commercial readiness over the past three years to be the following (in millions):

	Years ended December 31,		
	2004	2003	2002
Research and preclinical programs	$ 37.4	$ 29.0	$ 37.6
Clinical development programs	59.4	58.0	82.4
Commercial readiness	36.7	35.1	27.6
Total	$133.5	$122.1	$147.6

Our portfolio of projects can be broken down into two categories: 1) partnered projects and 2) proprietary products and technology development. We estimate the costs associated with partnered projects and proprietary products and technology development to be the following (in millions):

	Years ended December 31,	
	2004	2003
Partnered projects	$ 93.2	$ 92.7
Proprietary products and technology development	40.3	29.4
Total	$ 133.5	$ 122.1

The above information is not available for the year ended December 31, 2002.

Our total research and development expenditures can be disaggregated into the following significant types of expenses (in millions):

	Years ended December 31,		
	2004	2003	2002
Salaries and employee benefits	$ 59.0	$ 57.2	$ 67.3
Outside services	28.7	21.0	21.2
Supplies	18.9	16.7	22.0
Facility and equipment	19.7	16.7	18.4
Travel and entertainment	1.9	1.5	2.1
Purchased technology	—	—	5.3
Allocated overhead	4.9	7.1	8.3
Other	0.4	1.9	3.0
Total	$133.5	$122.1	$147.6

General and administrative (in thousands except percentages)

2004	2003 (restated)	2002 (restated)	Increase/ (Decrease) 2004 vs 2003	Increase/ (Decrease) 2003 vs 2002	Percentage Increase/ (Decrease) 2004 vs 2003	Percentage Increase/ (Decrease) 2003 vs 2002
$30,967	$29,966	$34,504	$ 1,001	$ (4,538)	3%	(13)%

General and administrative expenses were $31.0 million for the year ended December 31, 2004 as compared to $30.0 million and $34.5 million for the years ended December 31, 2003 and 2002, respectively.

General and administrative spending during the year ended December 31, 2004 was comparable to spending during the year ended December 31, 2003.

We expect general and administrative spending to increase over the next few years to support increased activities in most areas of our operations.

The 13% decrease in general and administrative expenses for the year ended December 31, 2003 as compared to December 31, 2002 was primarily due to the lack of marketing expenditures which we had incurred throughout 2002 related to our name change in January 2003, as well as a workforce reduction completed in December 2002.

We have reclassified approximately $9.4 million and $9.8 million for the years ended December 31, 2003 and 2002, respectively, from research and development expenses to general and administrative expenses. This reclassification included legal expenses related to our intellectual property portfolio and a portion of finance, information systems, and human resource expenses that were not clearly related to research and development and are required to be classified outside of research and development expenses under Statement Financial Accounting Standards No. 2, *Accounting for Research and Development Costs*. The reclassification did not result in any change to our cash position, total operating expenses, or results of operations for the years ended December 31, 2003 or 2002.

In addition, we reclassified approximately $1.4 million and $1.3 million for the years ended December 31, 2003 and 2002, respectively, from general and administrative expenses to interest expense. This reclassification was made to record the amortization of debt issuance costs to interest expense as required under Accounting Principles Board No. 21, *Interest on Receivables and Payables* and EITF 86-15 *Increasing-Rate Debt*.

Amortization of other intangible assets (in thousands except percentages)

2004	2003	2002	Increase/ (Decrease) 2004 vs 2003	Increase/ (Decrease) 2003 vs 2002	Percentage Increase/ (Decrease) 2004 vs 2003	Percentage Increase/ (Decrease) 2003 vs 2002
$3,924	$4,219	$4,507	$ (295)	$ (288)	(7)%	(6)%

Acquired technology and other intangible assets include proprietary technology, intellectual property, and supplier and customer relationships acquired from third parties or in business combinations. We periodically evaluate whether changes have occurred that would require revision of the remaining estimated useful lives of these assets or otherwise render the assets unrecoverable. If such an event occurred, we would determine whether the other intangibles are impaired. To date, no such impairment losses have been recorded.

The components of our other intangible assets as of December 31, 2004, are as follows (in thousands except useful life):

	Useful Life in Years	Gross Carrying Amount	Accumulated Amortization	Net
Core technology	5	$ 8,100	$ 5,670	$2,430
Developed product technology	5	2,900	2,030	870
Intellectual property	5-7	7,301	5,500	1,801
Supplier and customer relations	5	5,140	3,785	1,355
Total		$23,441	$ 16,985	$6,456

Amortization expense related to other intangible assets totaled $4.5 million for each of the years ended December 31, 2004, 2003, and 2002 ($0.6 million and $0.3 million was recorded to cost of sales for the years ended December 31, 2004 and 2003, respectively). The following table shows expected future amortization expense for other intangible assets until they are fully amortized (in thousands):

Years Ending December 31,	
2005	$4,507
2006	1,949
Thereafter	—
Total	$6,456

Gain (Loss) on debt extinguishment (in thousands except percentages)

2004	2003	2002	Increase/ (Decrease) 2004 vs 2003	Increase/ (Decrease) 2003 vs 2002	Percentage Increase/ (Decrease) 2004 vs 2003	Percentage Increase/ (Decrease) 2003 vs 2002
$(9,258)	$12,018	$ —	$ (21,276)	$ 12,018	(177)%	—

During the year ended December 31, 2004, we recognized a loss on debt extinguishment in connection with two privately negotiated transactions to convert our outstanding convertible subordinated notes into shares of our common stock. In January 2004, certain holders of our outstanding 3.5% convertible subordinated notes due October 2007 completed an exchange and cancellation of $9.0 million in aggregate principal amount of the notes for the issuance of 0.6 million shares of our common stock in a privately negotiated transaction. In February 2004, certain holders of our outstanding 3% convertible subordinated notes due June 2010 converted approximately $36.0 million in aggregate principal amount of such notes for approximately 3.2 million shares of our common stock and a cash payment of approximately $3.1 million in the aggregate in privately negotiated transactions. As a result of these transactions, we recognized losses on debt extinguishment of approximately $7.8 million and $1.5 million, respectively, in accordance with SFAS No. 84, *Induced Conversions of Convertible Debt.*

For the year ended December 31, 2003, gain on debt extinguishment totaled $12.0 million. Gain on debt extinguishment included a $4.3 million gain from the repurchase of $20.5 million of 3.5% convertible subordinated notes due October 2007 for $16.2 million during the second quarter of 2003. Gain on debt extinguishment also included a $7.7 million gain from the exchange of $87.9 million of 3.5% convertible subordinated notes due October 2007 for the issuance of $59.3 million of newly issued 3% convertible subordinated notes due June 2010.

Other income (expense) (in thousands except percentages)

2004	2003	2002	Increase/ (Decrease) 2004 vs 2003	Increase/ (Decrease) 2003 vs 2002	Percentage Increase/ (Decrease) 2004 vs 2003	Percentage Increase/ (Decrease) 2003 vs 2002
$296	$983	$(996)	$ (687)	$ 1,979	(70)%	199%

Other income/expense, net, was $0.3 million income for the year ended December 31, 2004, as compared to $1.0 million income and $1.0 million expense for the years ended December 31, 2003 and 2002, respectively. Our equity investment in Alliance was determined to be fully impaired and a loss of $0.8 million was recorded in the year ended December 31, 2002.

Interest income (in thousands except percentages)

2004	2003	2002	Increase/ (Decrease) 2004 vs 2003	Increase/ (Decrease) 2003 vs 2002	Percentage Increase/ (Decrease) 2004 vs 2003	Percentage Increase/ (Decrease) 2003 vs 2002
$6,602	$5,360	$10,222	$ 1,242	$ (4,862)	23%	(48)%

Interest income was $6.6 million for the year ended December 31, 2004 as compared to $5.4 million and $10.2 million for the years ended December 31, 2003 and 2002. The $1.2 million increase in interest income for the year ended December 31, 2004 as compared to December 31, 2003 was primarily due to higher average cash, cash equivalents, and short-term investment balances in 2004 compared to 2003.

The $4.9 million decrease in interest income for the year ended December 31, 2003 as compared to December 31, 2002 was primarily due to lower prevailing interest rates during 2003 compared to 2002 as well as lower average cash and short-term investment balances during 2003 compared to 2002.

Interest expense (in thousands except percentages)

2004	2003 (restated)	2002 (restated)	Increase/ (Decrease) 2004 vs 2003	Increase/ (Decrease) 2003 vs 2002	Percentage Increase/ (Decrease) 2004 vs 2003	Percentage Increase/ (Decrease) 2003 vs 2002
$25,747	$19,327	$17,881	$ 6,420	$ 1,446	33%	8%

Interest expense was $25.7 million for the year ended December 31, 2004 as compared to $19.3 million and $17.9 million for the years ended December 31, 2003 and 2002. The $6.4 million increase in interest expense for the year ended December 31, 2004 as compared to December 31, 2003 primarily relates to approximately $12.7 million in “make-whole” payments made to certain holders of our outstanding 3.0% convertible subordinated notes due June 2010 in connection with the conversion of $169.3 million in aggregate principal amount of the notes held by such holders for the issuance of approximately 14.9 million shares of our common stock following our call for the redemption of such notes during the three-month period ended March 31, 2004. This was partially offset by a decrease in interest expense due to the lower average balance of convertible subordinated notes outstanding during the year ended December 31, 2004 as compared to the year ended December 31, 2003.

The $1.4 million increase in interest expense for the year ended December 31, 2003 as compared to December 31, 2002 primarily relates to the increase in principal amount of outstanding convertible subordinated notes resulting from our issuance in June and July 2003 of $110.0 million due June 2010. This expense was offset by the decrease in the interest payable on notes exchanged in certain privately negotiated transactions, and a reduction in the principal amount of outstanding notes resulting from such exchanges and repurchases of outstanding notes.

We reclassified approximately $1.4 million and $1.3 million for the years ended December 31, 2003 and 2002, respectively, from general and administrative expenses to interest expense. This reclassification was made to record the amortization of debt issuance costs to interest expense which is the proper accounting under Accounting Principles Board No. 21, *Interest on Receivables and Payables* and EITF 86-15 *Increasing-Rate Debt*. Debt issuance costs associated with our outstanding convertible subordinated debentures, are recorded as other assets on our balance sheet, and are amortized to interest expense ratably over the term of the related debt.

Benefit (Provision) for income taxes (in thousands except percentages)

2004	2003	2002	Increase/ (Decrease) To Provision 2004 vs 2003	Increase/ (Decrease) To Provision 2003 vs 2002	Percentage Increase/ (Decrease) 2004 vs 2003	Percentage Increase/ (Decrease) 2003 vs 2002
$163	$(169)	$ —	$ (332)	$ 169	(196)%	—

We recorded a benefit for income taxes of $0.2 million for the year ended December 31, 2004; a provision of $0.2 million for the year ended December 31, 2003; and nil for the year ended December 31, 2002. The benefit (provision) relate entirely to state taxes on our Alabama subsidiary. For our Alabama subsidiary, we have recorded a deferred tax asset of $0.8 million, and a benefit of $0.4 million related to employee stock option exercises, which has been credited to additional paid in capital.

We have also recorded a deferred tax asset related to our operations outside of Alabama of $219.5 million, which has been fully reserved due to the lack of earnings history for these operations. A portion of the valuation allowance of approximately $31.2 million relates to a benefit for employee stock option exercises which will be credited to additional paid in capital when realized.

We account for federal income taxes under SFAS No. 109, *Accounting for Income Taxes*. Under SFAS No. 109, the liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax reporting bases of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Because of our lack of earnings history, the net deferred tax assets for our operations outside of Alabama have been fully offset by a valuation allowance.

Restructurings

In December 2003, we recorded a total charge of approximately $2.0 million related to a workforce reduction of 35 employees, which represented approximately 5% of our base employees. The reduction affected all business locations. The $2.0 million charge included $1.1 million in severance compensation, $0.1 million in health benefits, $0.2 million in out placement services, and $0.6 million of non-cash expenses related to stock compensation. Approximately $1.6 million of this amount was included in research and development costs and approximately $0.3 million was included in general and administrative costs. The liability as of December 31, 2003 was $0.3 million.

In December 2002, we recorded a charge of approximately $2.6 million related to a workforce reduction of 73 employees, which represented approximately 10% of our employees. The reduction affected all business functions and job classes mainly at our San Carlos facility. The $2.6 million charge included $1.7 million in severance compensation, $0.5 million in health benefits, $0.3 million in out placement services, and $0.1 million of non-cash expenses related to stock compensation. Approximately $2.1 million of this amount was included in research and development costs and approximately $0.5 million was included in general and administrative costs. During December 2002, $1.0 million was paid out associated with severance and other employee benefits. At December 31, 2002, we had a remaining accrual of $1.6 million of which $1.4 million was paid out in the first quarter of 2003. The excess $0.2 million was reversed during the second quarter of 2003.

In September 2002 we incurred restructuring charges associated with the disposal of a purchased technology. In connection with this disposal we incurred a total charge of approximately $2.6 million comprised of $1.2 million in salaries, $0.5 million as a reserve for fixed assets, $0.3 million as a reserve for other assets, and $0.6 million for outside services. All of these charges were expensed to research and development. The liability as of December 31, 2004, 2003, and 2002 was $0.2 million and $0.7 million, and $2.5 million, respectively.

Liquidity and Capital Resources

We have financed our operations primarily through public and private placements of our debt and equity securities, revenue from development contracts, product sales and short-term research and feasibility agreements, financing of equipment acquisitions and tenant improvements, and interest income earned on our investments of cash. We do not utilize off-balance sheet financing arrangements as a source of liquidity or financing. At December 31, 2004 we had cash, cash equivalents and short-term investments of approximately $418.7 million.

	Year Ended December 31,		
	2004	2003	2002
	(in millions, except current ratio)		
Cash, cash equivalents and short-term investments	$ 418.7	$ 286.0	$ 294.0
Cash provided by/(used in)			
Operating activities	$ (78.1)	$ (76.2)	$ (75.0)
Investing activities	$ (88.9)	$ 4.1	$ 40.3
Financing activities	$ 207.4	$ 101.3	$ 38.7
Capital expenditures (included in investing activities above)	$ (24.2)	$ (18.7)	$ (16.3)

Our operations used cash of $78.1 million for the year ended December 31, 2004 as compared to $76.2 million and $75.0 million for the years ended December 31, 2003 and 2002, respectively. For the year ended December 31, 2004, the $78.1 million cash used in operations primarily reflected the loss of $101.9 million partially offset by a loss on debt extinguishment of $9.3 million and depreciation and amortization of $18.0 million. For the year ended December 31, 2003, the $76.2 million cash used in operations primarily reflected the net loss of $65.9 million, the non-cash gain on debt extinguishment of $12.0 million and depreciation and amortization expense of $18.2 million. For the year ended December 31, 2002, the $75.0 million of cash used in operations primarily reflects the net loss of $107.5 million, partially offset by depreciation and amortization of $18.4 million, and an increase to deferred revenue of $6.0 million.

Cash flows used by investing activities were $88.9 million for the year ended December 31, 2004 as compared to $4.1 million cash provided and $40.3 million cash provided by investing activities for the years ended December 31, 2003 and 2002, respectively. Cash flows used or provided for investing activities for the year ended December 31, 2004, 2003, and 2002 were driven primarily by the purchase, sale, and maturity of investment securities. These cash proceeds were either reinvested or used in operations. We purchased property and equipment of approximately $24.2 million, $18.7 million, and $16.3 million during the years ended December 31, 2004, 2003 and 2002, respectively. The increase in purchased property and equipment in 2004 as compared to 2003 primarily reflects the cost of improvements made to our Huntsville, AL facility as well as capital expenditures made in preparation for a potential commercial launch of Exubera®.

Cash flows provided by financing activities were $207.4 million for the year ended December 31, 2004, compared to $101.3 million and $38.7 million of the years ended December 31, 2003 and 2002, respectively. Cash flow provided by financing activities in the year ended December 31, 2004 was primarily due to the sale of 9.5 million shares of our common stock in March 2004 at a price of $20.71 per common share for proceeds of approximately $196.4 million, net of issuance costs; cash received from employee exercises of stock options of approximately $13.7 million; a loan received from Pfizer of approximately $4.4 million; partially offset by repayment of bank loans and capital lease obligations of $8.0 million. Cash flows provided by financing activities in the year ended December 31, 2003 was primarily due to the issuance of $106.1 million of 3% convertible subordinated notes due 2010. Cash flow provided by financing activities in the year ended December 31, 2002 was primarily due to the issuance of $40.0 million of convertible preferred stock.

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

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

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

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

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

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

As a result of the transactions related to convertible subordinated debt during the year ended December 31, 2004, our total contractual obligation with regard to convertible subordinated debt has decreased from $360.0 million at December 31, 2003 to $173.9 million at December 31, 2004. All of our outstanding convertible subordinated debt as of December 31, 2004 will mature in 2007.

Given our current cash requirements, we forecast that we will have sufficient cash to meet our net operating expense requirements for at least the next two years. We plan to continue to invest in our growth and the need for cash will be dependent upon the timing of these investments. Our capital needs will depend on many factors, including continued progress in our research and development arrangements, progress with preclinical and clinical trials of our proprietary and partnered products, the time and costs involved in obtaining regulatory approvals, the costs of developing and scaling up each manufacturing operation of our technologies, the timing and cost of our clinical and commercial production facilities, the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims, the need to acquire licenses to new technologies, and the status of competitive products. The entire outstanding balance of convertible subordinated debt as of December 31, 2004 of $173.9 million will mature in 2007. We are not likely to be able to satisfy this entire obligation through cash flow generated by our operations. To satisfy our long-term needs, we intend to seek additional funding, as necessary, from corporate partners and from the sale of securities. Because we are an early stage biotechnology company, we do not qualify to issue investment grade debt or have access to certain credit facilities. As a result, any financing we undertake will likely involve the issuance of equity, convertible debt instruments or high-yield debt to fund our working capital. To date we have been primarily dependent upon equity and convertible debt financings for capital and have incurred substantial debt as a result of our issuances of subordinated notes and debentures that are convertible into our common stock. Our substantial debt, the market price of our securities, and the general economic climate, among other factors, could have material consequences for our financial position and could affect our sources of short-term and long-term funding. There can be no assurance that additional funds, if and when required, will be available to us on favorable terms, if at all.

The following is a summary of our contractual obligations as of December 31, 2004 (in thousands):

		Payment Due By Period			
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
San Carlos real estate capital lease including interest	$ 54,762	$ 5,855	$ 11,214	$ 8,051	$ 29,642
San Carlos tenant improvement loan	1,706	121	1,585	—	—
Interest payable	17,483	7,009	10,474	—	—
Operating leases	18,905	2,652	5,181	4,999	6,073
Principal amount of convertible subordinated notes and debentures	173,949	—	173,949	—	—
Purchase obligations (1)	23,072	23,072	—	—	—
Other obligations (2)	17	17	—	—	—
Total	$ 289,894	$ 38,726	$ 202,403	$ 13,050	$ 35,715

Note: The above table does not include certain commitments and contingencies which are discussed in detail in footnote 9 to the audited financial statements for the year ended December 31, 2004. The above table also does not include $9.2 million non-interest bearing loan from Pfizer, which is contingently payable upon commercial launch of Exubera® (see note 8).

(1) Substantially all of this amount had been ordered on definitive purchase orders as of December 31, 2004, but could be canceled by us at any time. If canceled, we could be charged restocking and/or cancellation fees up to 25%.

(2) Consists of certain equipment capital leases.

Item 7A. Quantitative and Qualitative Disclosures of Market Risk

Interest Rate Risk

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 highly liquid and 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.

A hypothetical 50 basis point increase in interest rates would result in an approximate $1.2 million decrease, less than 1%, in the fair value of our available-for-sale securities at December 31, 2004. This potential change is based on sensitivity analyses performed on our investment securities at December 31, 2004. Actual results may differ materially. The same hypothetical 50 basis point increase in interest rates would have resulted in an approximate $0.9 million decrease, less than 3%, in the fair value of our available-for-sale securities at December 31, 2003.

Foreign Currency Risk

Our operations include research and development, manufacturing, and sales activities in the U.S. and Europe. As a result, our financial results could be significantly affected by factors such as changes in foreign currency exchange rates or economic conditions in the foreign markets in which we have exposure. Our operating results are exposed to changes in exchange rates between the U.S. dollar and various foreign currencies, most significantly the British Pound.

To limit our economic exposure to foreign currency exchange rate fluctuations with respect to British Pounds, we periodically purchase British Pounds on the spot market and hold in a U.S. bank account. At December 31, 2004, we held British Pounds valued at approximately $8.4 million in a U.S. bank account, using the exchange rate as of period end. This amount is included in cash on our balance sheet. During the year ended

December 31, 2004, an immaterial amount of losses resulting from revaluing British Pounds at the current exchange rate were included in other income (expense). As part of our risk management strategy, we may decide to use derivative instruments, including forwards, foreign currency swaps and options to hedge certain foreign currency and interest rate exposures, however, to date we have not entered into any such derivative instruments. We do not use derivative contracts for speculative purposes.

A hypothetical 10% increase in the U.S. dollar relative to the British Pound as of December 31, 2004, would have resulted in an additional $0.7 million of foreign exchange loss on the British Pounds held in our account in the U.S. for the year ended December 31, 2004. We did not hold British Pounds in a U.S. bank account during the year ended December 31, 2003.

Interest Rate Risk on our Convertible Subordinated Notes

Increases in the interest rates and fluctuations in our stock price could affect the fair market value of our convertible subordinated notes and debentures, which pay a fixed rate of interest. As of December 31, 2004, we had approximately $173.9 million in outstanding convertible subordinated notes and debentures with a fair value of $171.3 million.

A hypothetical 50 basis point increase in interest rates would result in an approximate $1.8 million decrease and a $4.0 million decrease in the fair value of our convertible subordinated debentures as of December 31, 2004 and 2003, respectively.

Item 8. Consolidated Financial Statements and Supplementary Data

NEKTAR THERAPEUTICS

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Nektar Therapeutics

We have audited the accompanying consolidated balance sheets of Nektar Therapeutics as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the index at 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Nektar Therapeutics at December 31, 2004 and 2003, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As described in Note 1, the Company has restated its 2003 and 2002 consolidated financial statements.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Nektar Therapeutics' internal control over financial reporting as of December 31, 2004, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 11, 2005, expressed an unqualified opinion on management's assessment of the effectiveness of internal control over financial reporting and an adverse opinion on the effectiveness of internal control over financial reporting.

/S/ ERNST & YOUNG LLP

Palo Alto, California
March 11, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Nektar Therapeutics

We have audited management's assessment, included in the accompanying "Management's Report on Internal Control Over Financial Reporting," that Nektar Therapeutics (the "Company") did not maintain effective internal control over financial reporting as of December 31, 2004, because of the effect of a material weakness in the Company's financial statement close process, including insufficient review related to the application of its accounting policies and the presentation of disclosures in the notes to the financial statements, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Nektar Therapeutics' management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment. The Company has a material weakness in its financial statement close process, including insufficient review related to the application of its accounting policies and the presentation of disclosures in the notes to the financial statements. The material weakness arises from staff with inadequate proficiency to apply the Company's accounting policies in accordance with U.S. generally accepted accounting principles ("GAAP"). This material weakness impacts the Company's ability to report financial information in conformity with U.S. GAAP, which could affect all significant financial statement accounts and has resulted in (i) a restatement of the 2002 and 2003 consolidated financial statements to reflect reclassifications of certain amounts between research and development expense, general and administrative expense, and interest expense; (ii) a restatement of the quarterly unaudited consolidated financial statements for each of the three quarters through September 30, 2004

and for each of the four quarters in 2003, to reflect the reclassification of expenses discussed in (i) above; and (iii) the prior restatement of the 2003 consolidated financial statements to reduce the gain on debt extinguishment. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 financial statements, and this report does not affect our report dated March 11, 2005 on those financial statements.

In our opinion, management's assessment that Nektar Therapeutics did not maintain effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Nektar Therapeutics has not maintained effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria.

/S/ ERNST & YOUNG LLP

Palo Alto, California
March 11, 2005

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

As Nektar's Chief Executive Officer and Chief Financial Officer, we are responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our internal control system was designed to provide reasonable assurance to management and our board of directors regarding the reliability of financial reporting and preparation of published financial statements in accordance with generally accepted accounting principles.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is a more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, we have assessed the effectiveness of our internal control over financial reporting as of December 31, 2004, and as a result of this assessment, we have concluded that we have a material weakness in our financial statement close process, including insufficient review of the following:

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

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

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

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

In making our assessment of internal control over financial reporting, we used the criteria issued in the report Internal Control-Integrated Framework by the Committee of Sponsoring Organizations of the Treadway Commission. Because of the material weakness described above, our management has concluded that our internal control over financial reporting was not effective as of December 31, 2004 based on these criteria.

Our independent registered public accounting firm has issued an attestation report on management's assessment of our internal control over financial reporting which is included elsewhere herein.

NEKTAR THERAPEUTICS

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

	December 31,	
	2004	2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 104,414	$ 64,050
Short-term investments	314,326	221,917
Trade accounts receivable, net of allowance for doubtful accounts of $43 and $702 at December 31, 2004 and 2003, respectively	12,842	6,153
Inventory, net	10,691	8,559
Other current assets	12,266	5,819
Total current assets	454,539	306,498
Restricted investments	—	12,442
Property and equipment, net	151,247	149,388
Goodwill	130,120	130,120
Other intangible assets, net	6,456	10,963
Deposits and other assets	2,559	7,377
Total assets	$ 744,921	$ 616,788
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade accounts payable	$ 7,141	$ 8,074
Other accrued expenses	15,065	15,999
Short-term debt	15	288
Interest payable	2,010	2,436
Capital lease obligations—current	1,532	1,341
Deferred revenue	29,890	18,719
Total current liabilities	55,653	46,857
Convertible subordinated notes and debentures	173,949	359,988
Capital lease obligations—noncurrent	23,568	31,686
Other long-term liabilities	22,292	11,956
Accrued rent	2,117	2,110
Commitments and contingencies		
Stockholders' equity:		
Preferred Stock, 10,000 shares authorized		
Series A, $0.0001 par value: 3,100 shares designated; no shares issued or outstanding at December 31, 2004 and December 31, 2003.	—	—
Convertible Series B, $0.0001 par value: 40 shares designated; 20 and 40 shares issued and outstanding at December 31, 2004 and December 31, 2003, respectively; liquidation preference of $19,945 and $40,000 at December 31, 2004 and December 31, 2003, respectively.	—	—
Common stock, $0.0001 par value; 300,000 authorized; 84,572 and 56,197 shares issued and outstanding at December 31, 2004 and December 31, 2003, respectively.	8	6
Capital in excess of par value	1,187,575	778,500
Deferred compensation	(2,764)	(38)
Accumulated other comprehensive income/(loss)	(356)	958
Accumulated deficit	(717,121)	(615,235)
Total stockholders' equity	467,342	164,191
Total liabilities and stockholders' equity	$ 744,921	$ 616,788

See accompanying notes.

NEKTAR THERAPEUTICS

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share information)

	Years Ended December 31,		
	2004	2003	2002
Revenue:			
Contract research revenue	$ 89,185	$ 78,962	$ 76,380
Product sales	25,085	27,295	18,465
Total revenue	114,270	106,257	94,845
Operating costs and expenses:			
Cost of goods sold	19,798	14,678	7,020
Research and development (as restated for 2003 and 2002)	133,523	122,149	147,627
General and administrative (as restated for 2003 and 2002)	30,967	29,966	34,504
Amortization of other intangible assets	3,924	4,219	4,507
Total operating costs and expenses	188,212	171,012	193,658
Loss from operations (as restated for 2003 and 2002)	(73,942)	(64,755)	(98,813)
Gain/(loss) on debt extinguishment	(9,258)	12,018	—
Other income/(expense), net	296	983	(996)
Interest income	6,602	5,360	10,222
Interest expense (as restated for 2003 and 2002)	(25,747)	(19,327)	(17,881)
Loss before benefit/(provision) for income taxes	(102,049)	(65,721)	(107,468)
Benefit/(provision) for income taxes	163	(169)	—
Net loss	$(101,886)	$ (65,890)	$(107,468)
Basic and diluted net loss per share	$ (1.30)	$ (1.18)	$ (1.94)
Shares used in computing basic and diluted net loss per share	78,461	55,821	55,282

See accompanying notes.

NEKTAR THERAPEUTICS

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(in thousands)

	Preferred Shares		Common Shares		Capital In Excess of Par Value	Deferred Compensation	Accumulated Other Comprehensive Income/(Loss)	Accumulated Deficit	Total Stockholders' Equity
	Shares	Par Value	Shares	Par Value					
Balance at January 1, 2002	—	—	55,094	$ 5	$ 712,039	$ (923)	$ 1,069	$ (441,877)	$ 270,313
Common stock issued upon exercise of stock options	—	—	197	1	440	—	—	—	441
Preferred stock issued as part of Enzon Settlement	40	—	—	—	40,000	—	—	—	40,000
Stock based compensation related to consultants	—	—	—	—	306	—	—	—	306
Stock based compensation related to employee severance	—	—	—	—	95	—	—	—	95
Shares issued for retirement plans	—	—	121	—	960	—	—	—	960
Shares issued for services rendered	—	—	141	—	975	—	—	—	975
Reversal of deferred compensation due to terminations	—	—	—	—	(135)	135	—	—	—
Amortization of deferred compensation	—	—	—	—	—	549	—	—	549
Other comprehensive income/(loss)	—	—	—	—	—	—	599	—	599
Net loss	—	—	—	—	—	—	—	(107,468)	(107,468)
Comprehensive loss	—	—	—	—	—	—	—	—	(106,869)
Balance at December 31, 2002	40	—	55,553	6	754,680	(239)	1,668	(549,345)	206,770
Common stock issued upon exercise of stock options	—	—	362	—	1,959	—	—	—	1,959
Premium associated with newly issued convertible subordinated notes	—	—	—	—	19,208	—	—	—	19,208
Stock based compensation related to consultants	—	—	—	—	178	—	—	—	178
Stock based compensation related to employee severance	—	—	—	—	677	—	—	—	677
Shares issued for employee stock purchase plan	—	—	140	—	595	—	—	—	595
Shares issued for retirement plans	—	—	142	—	1,203	—	—	—	1,203
Amortization of deferred compensation	—	—	—	—	—	201	—	—	201
Other comprehensive income/(loss)	—	—	—	—	—	—	(710)	—	(710)
Net loss	—	—	—	—	—	—	—	(65,890)	(65,890)
Comprehensive loss									(66,600)
Balance at December 31, 2003	40	—	56,197	6	778,500	(38)	958	(615,235)	164,191
Common stock issued upon exercise of stock options	—	—	1,817	—	13,665	—	—	—	13,665
Common stock issued to public, net of issuance costs of $3,088	—	—	9,500	1	196,411	—	—	—	196,412
Conversion of convertible subordinate notes net of issuance costs of $2,315	—	—	15,974	1	191,281	—	—	—	191,282
Conversion of preferred stock to common stock	(20)	—	880	—	—	—	—		—
Stock based compensation related to consultants	—	—	—	—	678	—	—	—	678
Stock based compensation related to employee severance	—	—	—	—	247	—	—	—	247
Shares issued for employee stock purchase plan	—	—	126	—	1,285	—	—	—	1,285
Shares issued for retirement plans	—	—	66	—	1,158	—	—	—	1,158
Shares issued for exercise of warrants	—	—	12	—	—	—	—	—	—
Tax benefit related to employee stock option exercises					448				448
Amortization of deferred compensation	—	—	—	—	3,902	(2,726)	—	—	1,176
Other comprehensive income/(loss)	—	—	—	—	—	—	(1,314)	—	(1,314)
Net loss	—	—	—	—	—	—	—	(101,886)	(101,886)
Comprehensive loss									(103,200)
Balance at December 31, 2004	20	—	84,572	$ 8	$1,187,575	$ (2,764)	$ (356)	$ (717,121)	$ 467,342

See accompanying notes.

NEKTAR THERAPEUTICS

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Years ended December 31,		
	2004	2003	2002
Cash flows used in operating activities:			
Net loss	$ (101,886)	$ (65,890)	$ (107,468)
Adjustments to reconcile net loss to net cash used in operating activities:			
Increase/(decrease) in allowance for doubtful accounts	(659)	69	633
Increase in inventory reserve	1,553	1,613	—
Loss/(Gain) on debt extinguishment	9,258	(12,018)	—
Depreciation	12,557	12,279	12,645
Amortization of other intangible assets	4,507	4,507	4,507
Amortization of debt issuance costs	947	1,430	1,268
Amortization of deferred compensation	1,176	201	549
Issuance of common stock for retirement plans	1,158	1,203	960
Stock-based compensation for employee severence	247	677	95
Stock-based compensation for services rendered	678	178	1,281
Tax benefit related to employee stock option exercises	448	—	—
Gain on sale of assets	(531)	(92)	—
Loss on disposal of assets	69	—	—
Loss on impairment of marketable equity securities	—	—	721
Changes in assets and liabilities:			
Increase in trade accounts receivable	(6,032)	(1,852)	(495)
Increase in inventories	(3,685)	(3,863)	(3,108)
Decrease (increase) in other assets	(4,399)	1,708	4,695
Increase (decrease) in accounts payable	(683)	(581)	970
Increase (decrease) in accrued expenses	(2,520)	(11,361)	3,591
Decrease in interest payable	(426)	(1,326)	(826)
Increase/(decrease) in deferred revenue	11,341	(3,367)	5,974
Increase (decrease) in other liabilities	(1,260)	284	(967)
Net cash used in operating activities	(78,142)	(76,201)	(74,975)
Cash flows from investing activities:			
Purchases of short-term investments	(400,468)	(228,521)	(280,650)
Sales of short-term investments	18,842	56,762	117,804
Maturities of short-term investments	285,020	206,927	216,007
Purchase of restricted investments	(28)	(14,492)	—
Maturities of restricted investments	12,470	2,050	—
Acquisition of Shearwater, net of cash acquired and purchase price adjustments	—	—	3,443
Disposal of property and equipment	—	92	39
Proceeds from the sale of interest in partnership, net	22,450	—	—
Purchase of building, net	(2,953)	—	—
Purchases of property and equipment	(24,241)	(18,746)	(16,327)
Net cash provided by/(used in) investing activities	(88,908)	4,072	40,316
Cash flows from financing activities:			
Proceeds from loan and capital lease financing	4,399	12,363	1,146
Payments of loan and capital lease obligations	(7,971)	(3,537)	(2,863)
Issuance of convertible subordinated debentures, net of issuance costs	—	106,100	—
Repurchase of convertible subordinated debentures	(376)	(16,180)	—
Issuance of preferred stock	—	—	40,000
Issuance of common stock, net of issuance costs	196,412	—	—
Issuance of common stock related to employee stock purchase plan	1,285	595	—
Issuance of common stock related to employee stock exercises	13,665	1,959	441
Net cash provided by financing activities	207,414	101,300	38,724
Net increase/(decrease) in cash and cash equivalents	40,364	29,171	4,065
Cash and cash equivalents at beginning of period	64,050	34,879	30,814
Cash and cash equivalents at end of period	$ 104,414	$ 64,050	$ 34,879

See accompanying notes

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2004

Note 1—Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation

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

Our business is to advance therapeutics through improved drug delivery. We have three drug delivery technology platforms that are designed to improve the performance of molecules and drug delivery. The platforms are: Nektar Advanced PEGylation Technology, Nektar Pulmonary Technology and Nektar Supercritical Fluid ("SCF") Technology.

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

Restatement

Certain prior year amounts reported in our Annual Report on Form 10-K for the year ended December 31, 2003, as amended, have been restated to correct for misapplications of our accounting policies related to generally accepted accounting principles in the U.S. ("GAAP"). Also, certain amounts reported in our Quarterly Reports on Form 10-Q during the years 2004 and 2003 have been restated to correct for these misapplications of GAAP (see note 15). These reclassifications did not result in any change to our cash position, revenue, or net loss for the years ended December 31, 2003 or December 31, 2002 or for any quarterly period during the years ended December 31, 2004 or 2003.

The specific misapplications of GAAP that lead to this conclusion are as follows:

- We have reclassified approximately $9.4 million and $9.8 million for the years ended December 31, 2003 and 2002, respectively, from research and development expenses to general and administrative expenses. This reclassification included legal expenses related to our intellectual property portfolio and a portion of finance, information systems, and human resource expenses that were not clearly related to research and development and are required to be classified outside of research and development expenses under Statement Financial Accounting Standards No. 2, *Accounting for Research and Development Costs*.
- We reclassified approximately $1.4 million and $1.3 million for the years ended December 31, 2003 and 2002, respectively, from general and administrative expenses to interest expense. This reclassification was made to record the amortization of debt issuance costs to interest expense as required under Accounting Principles Board No. 21, *Interest on Receivables and Payables* and EITF 86-15 *Increasing-Rate Debt.*

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Principles of Consolidation

Our consolidated financial statements include the financial position and results of operations and cash flows of our wholly-owned subsidiaries: Nektar Therapeutics AL, Corporation ("Nektar AL"), formerly Shearwater Corporation; Nektar Therapeutics UK, Ltd. ("Nektar UK"), formerly Bradford Particle Design Ltd; and Inhale Therapeutic Systems Deutschland GmbH ("Inhale Germany"). As of December 31, 2003 our consolidated financial statements also included the financial statements of Inhale 201 Industrial Road, L.P., a real estate partnership in San Carlos, California and Shearwater Polymers, LLC, a real estate partnership in Alabama. As of September 30, 2004, these real estate partnerships were dissolved and are no longer included in our consolidated financial statements (see note 13). All intercompany accounts and transactions have been eliminated in consolidation.

Our consolidated financial statements are denominated in U.S. dollars. Accordingly, changes in exchange rates between the applicable foreign currency and the U.S. dollar will affect the translation of each foreign subsidiary's financial results into U.S. dollars for purposes of reporting our consolidated financial results. The process by which each foreign subsidiary's financial results are translated into U.S. dollars is as follows: income statement accounts are translated at average exchange rates for the period; balance sheet asset and liability accounts are translated at end of period exchange rates; and equity accounts are translated at historical exchange rates. Translation of the balance sheet in this manner results in an accumulated other comprehensive gain (loss) in the stockholders' equity section. To date, such cumulative translation adjustments have not been material to our consolidated financial position.

Significant Concentrations

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

Our customers are primarily pharmaceutical and biotechnology companies that are located in the U.S. and Europe. Our account receivable balance contains trade receivables from product sales and collaborative research agreements. At December 31, 2004, four different customers represented 25%, 23%, 16%, and 10% of our accounts receivable, respectively, and at December 31, 2003 one customer represented 63% of our accounts receivable. We provide for a general allowance for doubtful accounts by reserving for specifically identified doubtful accounts plus a percentage of past due amounts. We have not experienced significant credit losses from our accounts receivable or collaborative research agreements, and none is currently expected. We perform a regular review of our customer's payment history and associate credit risks and do not require collateral from our customers.

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

We are dependent on Pfizer as the source of a significant proportion of our revenue. Contract research revenue from Pfizer represented 61%, 61% and 59% of our revenue for the years ended December 31, 2004,

2003 and 2002. Deferred revenue from Pfizer represented 76%, 89%, and 72% of deferred revenue as of December 31, 2004, 2003, and 2002, respectively. The termination of this collaboration arrangement could have a material adverse effect on our financial position and results of operations. No other single customer represented 10% or more of our total revenues for any of the three years ended December 31, 2004, 2003, or 2002.

Should the Pfizer collaboration be discontinued prior to the launch of Exubera®, we will need to find alternative funding sources to replace the collaboration revenue and will need to reassess the realizability of assets capitalized. Additionally, we may have contingent payments to our contract manufacturers to reimburse them for their capital outlay to the extent that they cannot re-deploy their assets and may incur additional liabilities. At the present time, it is not possible to estimate the loss that will occur as a result of these obligations should Exubera® not be approved.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") released a revision to Statement of Financial Accounting Standard ("SFAS") No. 123, *Accounting for Stock-Based Compensation* ("FAS 123R"). FAS 123R addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees, and generally would require instead that such transactions be accounted for using a fair-value-based method. We will be required to adopt FAS 123R on July 1, 2005. When we adopt the new statement, we will have to recognize substantially more compensation expense. This would have a material adverse impact on our financial position and results of operations. We are currently in the process of evaluating the effect of adopting FAS 123R.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, an amendment of APB Opinion No. 29. SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS No. 153 is effective for nonmonetary asset exchanges beginning July 1, 2005. We do not believe adoption of SFAS No. 153 will have a material effect on our consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*. Also in December 2004, the FASB issued FASB Staff Position No. FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act of 2004*. We do not expect the adoption of these new tax provisions to have a material impact on our consolidated financial position, results of operations, or cash flows.

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

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

In June 2004, the FASB Emerging Issues Task Force ("EITF") issued EITF 02-14, *Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock*. EITF 02-14 addresses whether the equity method of accounting applies when an investor does not have an investment in voting common stock of an investee but exercises significant influence through other means. The accounting provisions of EITF 02-14 are effective for reporting periods beginning after September 15, 2004. We do not expect the adoption of EITF 02-14 to have a material impact on our consolidated financials position, results of operations, or cash flows.

In March 2004, the EITF reached a consensus on EITF 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. EITF 03-01 provides guidance regarding disclosures about unrealized losses on available-for-sale debt and equity securities accounted for under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. In September 2004, the EITF delayed the effective date for the measurement and recognition guidance; however the disclosure requirements remain effective for annual periods ending after June 15, 2004 (see note 2). We have complied with the disclosure requirements of EITF 03-01, and we will evaluate the impact of the measurement and recognition provisions of EITF 03-01 once final guidance is issued.

Cash, Cash Equivalents and Investments

We consider all highly liquid investments with a maturity at the date of purchase of three months or less to be cash equivalents. Cash and cash equivalents include demand deposits held in banks, interest bearing money market funds, commercial paper, federal and municipal government securities, and repurchase agreements. Short-term investments consist of federal and municipal government securities, corporate bonds, and commercial paper with A1, F1, or P1 short-term ratings and A or better long-term ratings with remaining maturities at date of purchase of greater than 90 days and less than two years.

At December 31, 2004, all short-term investments are designated as available-for-sale and are carried at fair value, with unrealized gains and losses reported in stockholders' equity as accumulated other comprehensive income (loss). Short-term investments are adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities, if any, are included in other income (expense). The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest income.

Inventories

Inventories consist primarily of raw materials, work-in-process and finished goods of Nektar AL. Inventories are stated at the lower of cost (first-in, first-out method) or market. Cost is computed using standard cost, which approximates actual costs on a first-in, first-out basis. Inventories are reflected net of a reserve of $3.2 million and $1.6 million as of December 31, 2004 and 2003, respectively. Reserves are determined using specific identification plus an estimated reserve against finished goods for potential defective or excess inventory based on historical experience. The following is a breakdown of net inventory (in thousands):

	December 31,	
	2004	2003
Raw material	$ 4,848	$4,552
Work-in-process	4,552	3,598
Finished goods	1,291	409
Total	$10,691	$8,559

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Property and Equipment

Property and equipment are stated at cost. Major improvements are capitalized, while maintenance and repairs are expensed when incurred. Laboratory and other equipment are depreciated using the straight-line method generally over estimated useful lives of three to seven years. Leasehold improvements and buildings are depreciated using the straight-line method over the shorter of the estimated useful life or the remaining term of the lease. Buildings are depreciated using the straight-line over the estimated useful life of twenty years.

Certain amounts have been expensed for plant design, engineering and validation costs based on our evaluation that it is unclear whether such costs are ultimately recoverable. These amounts may become fully recoverable only if and when Exubera® is approved by the appropriate regulatory agencies and commercial production commences (see note 3).

Goodwill

Goodwill is tested for impairment at least annually or on an interim basis if an event occurs or circumstances change that would more-likely-than-not reduce the fair value below our carrying value. We performed our annual impairment test and determined that on a consolidated basis, the undiscounted cash flow from our long-range forecast exceeds the carrying amount of our goodwill.

Goodwill will be tested for impairment using a two-step approach. The first step is to compare our fair value to our net asset value, including goodwill. If the fair value is greater than our net asset value, goodwill is not considered impaired and the second step is not required. If the fair value is less than our net asset value, the second step of the impairment test measures the amount of the impairment loss, if any. The second step of the impairment test is to compare the implied fair value of goodwill to its carrying amount. If the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized equal to that excess. The implied fair value of goodwill is calculated in the same manner that goodwill is calculated in a business combination, whereby the fair value is allocated to all of the assets and liabilities (including any unrecognized intangible assets) as if they had been acquired in a business combination and the fair value was the purchase price. The excess “purchase price” over the amounts assigned to assets and liabilities would be the implied fair value of goodwill.

The impairment tests for goodwill are performed at the corporate entity level, which we have identified to be our only reporting unit. In the future, we may determine that impairment tests should be performed at a level below the reporting unit level, depending on whether certain criteria are met.

Other Intangible Assets

Acquired technology and other intangible assets with definite useful lives are amortized on a straight-line basis over their estimated useful lives, which we currently estimate to be a period of five to seven years. Acquired technology and other intangible assets are tested for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impaired, asset values are adjusted to fair value. Acquired technology and other intangible assets include proprietary technology, intellectual property, and supplier and customer relationships acquired from third parties or in business combinations.

We periodically evaluate whether changes have occurred that would require revision of the remaining estimated useful lives of these assets or otherwise render the assets unrecoverable. If such an event occurred, we would determine whether the other intangibles are impaired. To date, no such impairment losses have been recorded.

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Derivative Instruments

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

During 2003 and part of 2004, we had a bank loan which had been secured by one of our Nektar AL facilities in Alabama. This loan originally had a variable rate of interest tied to the LIBOR index. In November 2003, we entered into an interest rate swap agreement to limit our exposure to fluctuations in U.S. interest rates. The interest rate swap agreement effectively converts a portion of our debt to a fixed rate basis, thus reducing the impact of interest rate changes on future interest expense. The swap is designated a cash flow hedge. Under the terms of our swap arrangement, we paid an initial effective interest rate of 5.17%. This rate was variable on a monthly basis based on changes in the LIBOR index, but only to a maximum of 7.05%.

This swap had been accounted for as a derivative subject to SFAS No. 133, *Accounting for Derivatives and Hedging Activity.* Because there is still potential variability in our effective interest rate, this specific swap arrangement was not an effective hedge. Accordingly, we recorded the fair value of this derivative at December 31, 2003 by recording a liability and corresponding interest expense of $0.2 million. The fair value is adjusted to market value on a quarterly basis, with an increase in interest rates generally resulting in a reduction in the liability and a decrease to interest expense, and a decrease in interest rates generally resulting in an increase to the liability and an increase in interest expense. The fair value of the swap was included in other long-term liabilities on our balance sheet as of December 31, 2003.

In September 2004, we retired the bank loan after paying the remaining principal balance of $5.6 million. We also retired the interest rate swap agreement by paying $0.3 million to the lender, representing the fair value of this instrument on that date which was equal to the swap liability recorded on our books. This amount was charged to interest expense.

To limit our exposure to foreign currency exchange rate fluctuations with respect to British Pounds, we have periodically purchased British Pounds on the spot market and hold in a U.S. bank account. At December 31, 2004, we held British Pounds valued at approximately $8.4 million in a U.S. bank account, using the exchange rate as of period end. Such amount is included in cash on our balance sheet. During the year ended December 31, 2004, an immaterial amount of losses resulting from revaluing British Pounds at the current exchange rate were included in other income/(expense).

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Comprehensive Gain (Loss)

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

	For the Years Ended December 31,		
	2004	2003	2002
Net loss	$(101,886)	$(65,890)	$(107,468)
Changes in net unrealized losses on available for sale securities	(2,129)	(975)	(195)
Net unrealized losses (gains) reclassified into earnings	23	(48)	241
Net change in cumulative translation adjustment	792	313	553
Comprehensive loss	$(103,200)	$(66,600)	$(106,869)

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

	December 31,	
	2004	2003
Unrealized gains (losses) on available-for-sale securities	$(1,856)	$250
Foreign currency translation adjustment	1,500	708
Total accumulated other comprehensive income	$ (356)	$958

Stock-Based Compensation

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

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

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

	December 31,		
	2004	2003	2002
Risk-free interest rate	3.3%	2.8%	3.8%
Dividend yield	0.0%	0.0%	0.0%
Volatility Factor	0.707	0.744	0.743
Weighted average expected life	5 years	5 years	5 years

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

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

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

	Years Ended December 31,		
	2004	2003	2002
Net loss, as reported	$(101,886)	$(65,890)	$(107,468)
Add: stock-based employee compensation included in reported net loss	1,423	878	644
Deduct: total stock-based employee compensation expense determined under fair value methods for all awards	(31,185)	(34,300)	(35,605)
Pro forma net loss	$(131,648)	$(99,312)	$(142,429)
Net loss per share			
Basic and diluted, as reported	$ (1.30)	$ (1.18)	$ (1.94)
Basic and diluted, pro forma	$ (1.68)	$ (1.78)	$ (2.58)

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

Revenue Recognition

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

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

We enter into collaborative research and development arrangements with pharmaceutical and biotechnology partners that may involve multiple deliverables. For multiple-deliverable arrangements entered into after July 1, 2003 judgment is required in the areas of separability of units of accounting and the fair value of individual elements. The principles and guidance outlined in EITF No. 00-21 provide a framework to (a) determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, and (b) determine how the arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. Our arrangements may contain the following elements: collaborative research, milestones, manufacturing and supply, royalties and license fees. For each separate unit of accounting we have objective and

reliable evidence of fair value using available internal evidence for the undelivered item(s) and our arrangements generally do not contain a general right of return relative to the delivered item. In accordance with the guidance in EITF No. 00-21, the Company uses the residual method to allocate the arrangement consideration when it does not have fair value of a delivered item(s). Under the residual method, the amount of consideration allocated to the delivered item equals the total arrangement consideration less the aggregate fair value of the undelivered items.

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

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

Product sales are derived primarily from cost-plus manufacturing and supply contracts for our PEG Reagents with individual customers in our industry. Sales terms for specific PEG Reagents are negotiated in advance. Revenues related to our product sales are recorded in accordance with the terms of the contracts. No provisions for potential product returns have been made to date because we have not experienced any significant returns from our customers.

Research and Development

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

Segment Reporting

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

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Our research revenue is derived primarily from clients in the pharmaceutical and biotechnology industries. Revenue from Pfizer represented 61%, 61% and 59% of our revenue for the years ended December 31, 2004, 2003, and 2002, respectively. Deferred revenue from Pfizer represented 76%, 89%, and 72% of deferred revenue as of December 31, 2004, 2003, and 2002, respectively. Product sales relate to sale of our manufactured Advanced PEGylation Technology products by Nektar AL.

Our accounts receivable balance contains trade receivables from product sales and collaborative research agreements. On December 31, 2004, four different customers represented 25%, 23%, 16%, and 10% of our accounts receivable, respectively. On December 31, 2003, one customer represented 63% of accounts receivable.

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

	Years ended December 31,	
	2004	2003
Contract research revenue		
United States	$ 87,962	$ 77,496
United Kingdom	380	418
Other European countries	839	827
All other countries	4	221
Total contract research revenue	$ 89,185	$ 78,962
Product sales		
United States	$ 12,893	$ 15,837
United Kingdom	3,758	2,121
Other European countries	6,629	8,139
All other countries	1,805	1,198
Total product sales	$ 25,085	$ 27,295

The net book value of our other long-lived assets is from the following geographic areas (in thousands):

	Years ended December 31,	
	2004	2003
United States	$ 220,714	$ 228,937
United Kingdom	69,509	68,728
Other European Countries	159	183
Total	$ 290,382	$ 297,848

Net Loss Per Share

Basic net loss per share is calculated based on the weighted-average number of common shares outstanding during the periods presented, less the weighted-average shares outstanding which are subject to the Company's right of repurchase.

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

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

	Years ended December 31,		
	2004	2003	2002
Numerator:			
Net loss	$(101,886)	$(65,890)	$(107,468)
Denominator:			
Weighted average number of common shares outstanding	78,461	55,821	55,282
Net loss per share—basic and diluted	$ (1.30)	$ (1.18)	$ (1.94)

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

	Years Ended December 31,		
	2004	2003	2002
Warrants	36	56	56
Options and restricted stock units	13,976	14,953	14,742
Convertible preferred stock	875	1,755	1,755
Convertible debentures and notes	3,831	19,106	6,644
Total	18,718	35,870	23,197

Income Taxes

We account for income taxes under SFAS No. 109, *Accounting for Income Taxes*. Under SFAS No. 109, the liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax reporting bases of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Because of our lack of earnings history, the net deferred tax assets for our operations outside of Alabama have been fully offset by a valuation allowance.

Note 2—Financial Instruments

As of December 31, 2004 and 2003, we held a portfolio exclusively of debt securities. Certain of these securities have a fair value less than their amortized cost. In accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and EITF 03-01, we have recorded the difference between the amortized cost and fair value as a component of accumulated other comprehensive income. Management has concluded that no impairment should be recognized related to these investments because the unrealized losses incurred to date are not considered other than temporary. Management has reached this conclusion based upon its intention to generally hold all debt investments to maturity at which point they are redeemed at full par value, a

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

history of actually holding the majority of our investments to maturity, and our strategy of aligning of the maturity of our debt investments to meet our cash flow needs. Therefore, we will, in most cases, have the ability to hold all of our debt investments to maturity.

We determine the fair value amounts by using available market information. At December 31, 2004 and 2003, the average portfolio duration was approximately one year, and the contractual maturity of any single investment did not exceed twenty-four months at December 31, 2004 and 2003. The gross unrealized gains on available for sale securities at December 31, 2004 and 2003 amounted to approximately nil and $0.4 million, respectively. The gross unrealized losses on available for sale securities at December 31, 2004 and 2003 amounted to approximately $1.9 million and approximately $0.1 million, respectively. As of December 31, 2004, there were 21 securities that had been in a loss position for twelve months or more and which had a fair value $31.4 million and an unrealized loss of $84,000. As of December 31, 2003, there were no securities that had been in a loss position for twelve months or more.

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and Available-for-Sale Securities				
Obligations of U.S. government agencies	$164,883	$ 1	$ (923)	$163,961
Obligations of U.S. state and local government agencies	66,500	—	—	66,500
U.S. corporate obligations	154,114	—	(918)	153,196
Non U.S. corporate obligations	4,033	—	(16)	4,017
Repurchase agreements	14,200	—	—	14,200
Cash	16,866	—	—	16,866
Total Cash and Available-for-Sale Securities	$420,596	$ 1	$ (1,857)	$418,740
Amounts included in cash and cash equivalents	$104,414	$ —	$ —	$104,414
Amounts included in short-term investments (less than one year to maturity)	212,586	—	(916)	211,670
Amounts included in short-term investments (one to two years to maturity)	103,596	1	(941)	102,656
Total Cash and Available-for-Sale Securities	$420,596	$ 1	$ (1,857)	$418,740

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

The following is a summary of operating cash, held-to-maturity, and available-for-sale securities as of December 31, 2003 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-Maturity Securities				
U.S. treasury securities	$ 12,442	$ —	$ —	$ 12,442
Cash and Available-for-Sale Securities				
Obligations of U.S. government agencies	$138,404	231	(74)	$138,561
U.S. corporate commercial paper	115,010	118	(26)	115,102
Non U.S. corporate obligations	2,343	1	(1)	2,343
Repurchase agreements	9,083	—	—	9,083
Cash	20,878	—	—	20,878
	$285,718	$ 350	$ (101)	$285,967
Total Held-to-Maturity, Cash, and Available-for-Sale Securities	$298,160	$ 350	$ (101)	$298,409
Amounts included in cash and cash equivalents	$ 64,049	$ 1	$ —	$ 64,050
Amounts included in short-term investments (less than one year to maturity)	205,610	330	(89)	205,851
Amounts included in short-term investments (one to two years to maturity)	16,059	19	(12)	16,066
Amounts included in restricted investments	12,442	—	—	12,442
Total Held-to-Maturity, Cash, and Available-for-Sale Securities	$298,160	$ 350	$ (101)	$298,409

In June, July, and October 2003, we purchased an aggregate of approximately $14.8 million face value of zero coupon U.S. treasury securities pledged for the exclusive benefit of the holders of our 3% convertible subordinated notes due June 2010. These securities were noted as restricted investments on our balance sheet and were classified as held-to-maturity. In March 2004, we converted $133.3 million of 3% convertible subordinated notes due June 2010 into 11.7 million shares of common stock. In connection with the conversion, we agreed to pay $75.00 per $1,000 of the notes to be converted, for an aggregate payment of approximately $10.0 million. This amount was paid through the sale of these held-to-maturity pledged treasury securities. As a result there were no held-to-maturity securities as of December 31, 2004. The realized gain on these held-to-maturity securities of the date of sale was approximately $26,000.

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Note 3—Property and Equipment

Property and equipment consist of the following (in thousands):

	December 31,	
	2004	2003
Laboratory and other equipment	$ 66,503	$ 53,061
Building and leasehold improvements	85,832	82,733
Land	1,055	8,067
Construction-in-progress	61,525	64,884
Property and equipment at cost	214,915	208,745
Less accumulated amortization and depreciation	(63,668)	(59,357)
Property and equipment, net	$151,247	$149,388

At December 31, 2003, building and leasehold improvements included $29.6 million related to a build-to-suit lease with a real estate partnership. This partnership was 49% owned by us and was fully consolidated into our operations. Accumulated depreciation of the building under lease was approximately $6.6 million for the year ended December 31, 2003. During the year ended December 31, 2004, we entered into a redemption agreement with respect to our interest in the partnership (see note 13). We simultaneously entered into a sale-leaseback agreement and, in accordance with FAS 98, *Accounting for Leases*, we capitalized the building by recording a capital lease asset and obligation equal to the fair market value of the leased asset of $25.5 million. Accumulated amortization of the building under lease was approximately $1.1 million for the year ended December 31, 2004. Amortization of capital leases is included in depreciation expense.

Construction-in-progress includes assets associated with the scale-up of our commercial manufacturing operations.

Depreciation expense for the years ended December 31, 2004, 2003 and 2002 was $12.6 million, $12.3 million and $12.6 million, respectively.

In accordance with SFAS 2, *Accounting for Research and Development Costs*, we have expensed certain amounts paid for plant design, engineering, and validation costs for the automated assembly line equipment that will be used in connection with the manufacture of the inhaler device for Exubera® because such costs have no alternative future use. The total amount expensed was $1.7 million, $6.6 million, and $7.3 million, for the years ended December 31, 2004, 2003, and 2002, respectively. As of December 31, 2004, the capitalized net book value of the automated assembly line equipment located at our contract manufactures' sites totals $25.2 million. These assets are intended to be used in connection with the manufacture of the inhaler device for Exubera®. The total amount capitalized amounted to $0.2 million, $1.4 million, and $4.6 million for the years ended December 31, 2004, 2003, and 2002, respectively. These amounts have been capitalized based upon our determination that the related assets have alternative future use and therefore have separate economic or realizable value.

Note 4—Significant Collaborative Research and Development and Product Agreements

We perform research and development for others pursuant to feasibility agreements and collaborative development and license agreements. Under the feasibility agreements, we are generally reimbursed for the cost of work performed. Under our development and license agreements, we may be reimbursed for a portion of our development costs and may also be entitled to milestone payments when and if certain development and/or

regulatory milestones are achieved. We may also receive royalties on sales of commercial product. All of our research and development agreements are generally cancelable by our partners without significant financial penalty to the partner. Cost associated with product agreements are recorded as costs of goods sold.

In July 2002, we announced a collaboration arrangement with Chiron Corporation for development of an inhaleable powdered version of PA2794, a proprietary Chiron antibiotic from a class commonly used to treat pulmonary infections. In October 2003, we announced that, at the request of Chiron, for strategic marketing reasons, we discontinued development of this product. We recognized nil, $3.6 million and $1.6 million in revenues for the years ended December 31, 2004, 2003 and 2002, respectively, related to this collaboration.

We entered into an agreement with Eyetech Pharmaceuticals, Inc. in February 2002 to supply our Advanced PEGylation Technology in the development and commercial manufacturing of Macugen® (pegaptanib sodium injection), a PEGylated anti-Vascular Endothelial Growth Factor aptamer currently approved for marketing approval in the U.S. and filed for approval in the EU by Eyetech and its partner, Pfizer. Macugen® is indicated for the treatment of age-related macular degeneration (“AMD”), which is the leading cause of blindness among Americans over the age of 55. Nektar received development milestone payments and will receive royalties on sales of commercialized products, as well as revenues from exclusive manufacturing of the PEG derivative. We will share a portion of the profits on this product with Enzon Pharmaceuticals, Inc. Macugen® is also in Phase II testing for the treatment of diabetic macular edema (“DME”). Under this agreement we recognized revenue of approximately $1.5 million and $0.7 million in 2004 and 2003, respectively.

In February 2002, we entered into a collaboration with Unimed Pharmaceuticals, Inc., a wholly owned subsidiary of Solvay Pharmaceuticals, Inc., to develop an MDI formulation of dronabinol (synthetic delta-9-tetrahydrocannabinol) to be used for multiple indications. Dronabinol is the active ingredient in Unimed’s MARINOL® capsules. MARINOL® capsules are approved in the U.S. for the treatment of anorexia associated with weight loss in patients with AIDS and for the treatment of refractory nausea and vomiting associated with cancer chemotherapy. In the second quarter of 2003, Unimed initiated a Phase I trial. Under the terms of the collaboration, we will be responsible for development of the formulation, as well as clinical and commercial manufacturing of the drug formulation delivery and device. Solvay will be responsible for the clinical development and worldwide commercialization of the drug formulation and delivery device combination. We will receive research and development funding, milestone payments as the program progresses through further clinical testing, and royalty payments on product sales and manufacturing revenues if the product is commercialized. Under this agreement we recognized revenue of approximately $5.5 million, $5.3 million, and $0.5 million in 2004, 2003, and 2002, respectively.

In November 2001, we entered into a collaboration with Chiron to develop a next-generation inhaleable formulation of tobramycin for the treatment of *Pseudomonas aeruginosa* in cystic fibrosis patients and to explore the development of other inhaled antibiotics using our Pulmonary Technology. We recognized $7.3 million, $5.8 million and $5.9 million in revenue for the years ended December 31, 2004, 2003, and 2002 respectively, related to this collaboration.

We entered into a license, manufacturing and supply agreement for CDP 870 (PEG-anti-TNF alpha antibody fragment) with Celltech Group plc in 2000, which was subsequently assigned to Pharmacia for the rheumatoid arthritis indication. In October 2002, Pharmacia initiated Phase III clinical trials with CDP 870. In April 2003, Pfizer acquired Pharmacia and in February 2004, Pfizer reassigned rights to CDP870 back to Celltech. In 2004, Celltech was acquired by UCB Pharma. Under the agreement, we receive milestone payments, royalties on product sales and PEG manufacturing revenues if the product is commercialized, which are partially shared with

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Enzon. Celltech is also assessing CDP 870 in Phase III studies as a treatment for Crohn's disease. Under this agreement, we recognized product revenue of approximately $8.5 million and $5.0 million for the years ended December 31, 2004 and 2003, respectively.

We entered into a manufacturing agreement with Schering-Plough Corporation in February 2000 whereby we provide one of our PEG reagents used in the manufacture of PEG-INTRON® (peginterferon alfa-2b) used in the treatment of the hepatitis C virus. Under this agreement, we recognized product revenue of approximately $0.7 million and $1.1 million for the years ended December 31, 2004 and 2003, respectively.

We entered into a license, manufacturing and supply agreement with Sensus Drug Development Corporation (which was subsequently acquired by Pfizer) in January 2000, for the PEGylation of Somavert® (pegvisomant), a human growth hormone receptor antagonist. The agreement provides us with milestone payments, rights to manufacture the PEG reagent and a share of revenues. Somavert® has been approved for marketing in the U.S. and Europe for the treatment of certain patients with acromegaly. In 2004, 2003, and 2002, Somavert® accounted for approximately $1.2 million, $4.8 million, and $3.3 million, respectively, of our product sales.

We entered into a license, supply and manufacturing agreement with Confluent Surgical, Inc. in August 1999, for use of our PEG-hydrogel in Confluent's SprayGel™ adhesion barrier systems. Under the terms of this arrangement, we manufacture and supply PEG components used in the SprayGel™ system and receive manufacturing and supply revenues from Confluent. We may also receive royalty payments on sales of commercialized products. SprayGel™ was approved for commercial distribution in Europe, receiving product certification by European regulatory authorities in November 2001. In June 2002, Confluent initiated Phase II/III pivotal trials in the U.S. of SprayGel™. Under this agreement we recognized revenue of approximately $0.3 million and $0.3 million in 2004 and 2003, respectively.

We entered into a license, manufacturing and supply agreement in February 1997 with F. Hoffmann-La Roche Ltd. whereby we license to Roche the PEG reagent used in Roche's PEGASYS® (peginterferon alfa-2b) product for the treatment of chronic hepatitis C. This agreement provides us with milestone payments, rights to manufacture the PEG reagent and a share of revenues related to the PEGASYS® product. A subsequent agreement with Roche related to further collaborative work on PEGASYS® was entered into in April 1999 to develop the PEGylated interferon alfa-2a product. In 2004, 2003, and 2002, Roche accounted for approximately $3.2 million, $4.7 million, and $3.4 million, respectively, of our product sales.

In January 1997, we entered into a collaborative agreement with Centeon (later Aventis-Behring) to develop a pulmonary formulation of alpha-1 proteinase inhibitor to treat patients with alpha-1 antitrypsin deficiency, or genetic emphysema. In January 2004, the agreement was terminated. Under this agreement, we recognized revenue of approximately $2.1 million, $0.9 million, and $3.5 million in 2004, 2003, and 2002, respectively.

We entered into a license, manufacturing and supply agreement with Amgen Inc., in July 1995, to supply one of our PEG reagents, which is utilized in the manufacture of Amgen's Neulasta®. This product is indicated for reducing the incidence of infection, as manifested by febrile neutropenia in patients with non-myeloid malignancies receiving myelosuppresive anti-cancer drugs. The FDA approved Neulasta® for marketing in the United States in late January 2002. Under this agreement, we recognized product sales revenue of approximately $5.2 million, $6.2 million, and $2.9 million in 2004, 2003, and 2002, respectively.

In January 1995, we entered into a collaborative development and license agreement with Pfizer to develop Exubera® based on our Pulmonary Technology. Under the terms of the agreement, we receive funding consisting of initial fees, contract research and development funding and progress payments. Upon execution of the agreement Pfizer purchased $5.0 million of our Common Stock. In addition, in October 1996, Pfizer purchased

an additional $5.0 million of our Common Stock. Pfizer has global commercialization rights for Exubera® while we receive royalties on sales of commercialized products. We will manufacture a portion of inhaleable insulin powder and supply pulmonary inhaler devices to Pfizer. Under this agreement we recognized revenue of approximately $64.4 million, $55.4 million, and $56.1 million in 2004, 2003, and 2002, respectively.

Note 5—Goodwill and Other Intangible Assets

In 2001 we acquired two businesses. The cost to acquire these businesses has been allocated to the assets acquired (including intangibles) and liabilities assumed according to their respective fair values, with the excess purchase price being allocated to goodwill.

Goodwill is tested for impairment at least annually or on an interim basis if an event occurs or circumstances change that would more-likely-than-not reduce the fair value below our carrying value. We performed our annual impairment test and determined that on a consolidated basis, the undiscounted cash flow from our long-range forecast exceeds the carrying amount of our goodwill. The carrying value of goodwill is $130.1 million as of December 31, 2004 and 2003.

Goodwill will be tested for impairment using a two-step approach. The first step is to compare our fair value to our net asset value, including goodwill. If the fair value is greater than our net asset value, goodwill is not considered impaired and the second step is not required. If the fair value is less than our net asset value, the second step of the impairment test measures the amount of the impairment loss, if any. The second step of the impairment test is to compare the implied fair value of goodwill to its carrying amount. If the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized equal to that excess. The implied fair value of goodwill is calculated in the same manner that goodwill is calculated in a business combination, whereby the fair value is allocated to all of the assets and liabilities (including any unrecognized intangible assets) as if they had been acquired in a business combination and the fair value was the purchase price. The excess “purchase price” over the amounts assigned to assets and liabilities would be the implied fair value of goodwill.

The impairment tests for goodwill are performed at the corporate entity level, which we have identified to be our only reporting unit. In the future, we may determine that impairment tests should be performed at a level below the reporting unit level, depending on whether certain criteria are met.

We periodically evaluate whether changes have occurred that would require revision of the remaining estimated useful lives of our other intangible assets or otherwise render the assets unrecoverable. If such an event occurred, we would determine whether the other intangibles are impaired. To date, there have been no events or changes in circumstances that would indicate that the carrying value of such assets may not be recoverable, and therefore we have determined that there has been no impairment on our intangible and other long-lived assets, including capitalized assets related to Exubera®. The components of our other intangible assets as December 31, 2004, are as follows (in thousands except useful life):

	Useful Life in Years	Gross Carrying Amount	Accumulated Amortization	Net
Core technology	5	$ 8,100	$ 5,670	$2,430
Developed product technology	5	2,900	2,030	870
Intellectual property	5-7	7,301	5,500	1,801
Supplier and customer relations	5	5,140	3,785	1,355
Total		$23,441	$ 16,985	$6,456

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December 31, 2004

Amortization expense related to other intangible assets totaled $4.5 million for each of the years ended December 31, 2004, 2003, and 2002 ($0.6 million and $0.3 million was recorded to cost of sales for the years ended December 31, 2004 and 2003, respectively). The following table shows expected future amortization expense for other intangible assets until they are fully amortized (in thousands):

Years Ending December 31,	
2005	$4,507
2006	1,949
Thereafter	—
Total	$6,456

Note 6—Deposits and Other Assets, Other Accrued Expenses and Other Long-Term Liabilities

Deposits and other assets consist of the following (in thousands):

	December 31,	
	2004	2003
Debt issuance costs, net	$2,173	$6,759
Deposits and other assets	386	618
Total deposits and other assets	$2,559	$7,377

Debt issuance costs are associated with our outstanding series of convertible subordinated debentures and notes (see note 7) and are amortized to interest expense ratably over the term of the related debt.

Other accrued expenses consist of the following (in thousands):

	December 31,	
	2004	2003
Accrued research and development expenses (other than compensation)	$ 2,789	$ 4,012
Accrued general and administrative expenses (other than compensation)	2,054	2,282
Accrued compensation	8,629	9,705
Deferred gain on sale of interest in partnership	1,593	—
Total other accrued expenses	$15,065	$15,999

Deferred gain on sale of interest in partnership is associated with our sale-leaseback transaction of one of our facilities and is being amortized over the term of the lease (see note 13).

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December 31, 2004

Other long-term liabilities consist of the following (in thousands):

	December 31,	
	2004	2003
Tenant improvement loan and equipment leases	$ 1,398	$ 7,305
Deferred gain on sale of interest in partnership	10,596	—
Loan from Pfizer	9,165	4,766
Deferred revenue	1,131	961
Minority interest in partnerships	—	(1,951)
Other	2	875
Total other long-term liabilities	$22,292	$11,956

The tenant improvement loan and equipment leases represent the long-term portion of the present value of a tenant improvement loan and certain equipment leases (see note 8). Loan from Pfizer relates to a non-interest bearing loan from Pfizer which is contingently payable upon a commercial launch of Exubera® (see note 8). Minority interest in partnership relates to our partnerships with Inhale 201 and with Shearwater LLC, both of which were dissolved during the year ended December 31, 2004 (see note 13).

Restructurings

Included in accrued expenses is the following restructuring activity:

In December 2003, we recorded a total charge of approximately $2.0 million related to a workforce reduction of 35 employees, which represented approximately 5% of our base employees. The reduction affected all business locations. The $2.0 million charge included $1.1 million in severance compensation, $0.1 million in health benefits, $0.2 million in out placement services, and $0.6 million of non-cash expenses related to stock compensation. Approximately $1.6 million of this amount was included in research and development expenses and approximately $0.3 million was included in general and administrative expenses. The liability as of December 31, 2003 was $0.3 million. The following table summarizes activity in accrued expenses for this restructuring (in thousands):

	Accrual	Utilization	Balance 12/31/03	Reversal	Utilization	Balance 12/31/04
Severance compensation	$1,120	$ (963)	$ 157	$ —	$ (157)	$ —
Health benefits	66	(4)	62	(11)	(72)	(21)
Outplacement	182	(102)	80	(13)	(45)	22
Stock compensation	600	(600)	—	—	—	—
Total	$1,968	$ (1,669)	$ 299	$ (24)	$ (274)	$ 1

In December 2002, we recorded a charge of approximately $2.6 million related to a workforce reduction of 73 employees, which represented approximately 10% of our employees. The reduction affected all business functions and job classes mainly at our San Carlos facility. The $2.6 million charge included $1.7 million in severance compensation, $0.5 million in health benefits, $0.3 million in out placement services, and $0.1 million of non-cash expenses related to stock compensation. Approximately $2.1 million of this amount was included in research and development expenses and approximately $0.5 million was included in general and administrative expenses. During December 2002, $1.0 million was paid out associated with severance and other employee

benefits. At December 31, 2002, we had a remaining accrual of $1.6 million of which $1.4 million was paid out in the first quarter of 2003. The excess $0.2 million was reversed during the second quarter of 2003. The following table summarizes activity in accrued expenses for this restructuring (in thousands):

	Balance 12/31/02	Reversal	Utilization	Balance 12/31/03
Severance compensation	$1,179	$ —	$ (1,179)	$ —
Health benefits	64	—	(64)	—
Outplacement	334	(201)	(133)	—
Stock compensation	—	—	—	—
Total	$1,577	$ (201)	$ (1,376)	$ —

In September 2002 we incurred restructuring charges associated with the disposal of a purchased technology. In connection with this disposal we incurred a total charge of approximately $2.6 million comprised of $1.2 million in salaries, $0.5 million as a reserve for fixed assets, $0.3 million as a reserve for other assets, and $0.6 million for outside services. All of these charges were expensed to research and development. The liability as of December 31, 2004, 2003, and 2002 was $0.2 million and $0.7 million, and $2.5 million, respectively. The following table summarizes activity in accrued expenses for this restructuring (in thousands):

	Balance 12/31/02	Utilization	Balance 12/31/03	Utilization	Balance 12/31/04
Severance compensation	$1,162	$ (1,162)	$ —	$ —	$ —
Fixed assets	492	(231)	261	(261)	—
Other assets	272	(75)	197	(30)	167
Outside services	549	(332)	217	(199)	18
Total	$2,475	$ (1,800)	$ 675	$ (490)	$ 185

Note 7—Convertible Subordinated Notes and Debentures

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

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

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

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

As a result of the transactions related to convertible subordinated debt during the year ended December 31, 2004, our total contractual obligation with regard to convertible subordinated debt has decreased from $360.0 million at December 31, 2003 to $173.9 million at December 31, 2004. All of our outstanding convertible subordinated debt as of December 31, 2004 will mature in 2007 when payment of principal and accrued but unpaid interest will be due in a balloon payment.

The following summarizes our outstanding convertible subordinated debt as of December 31, 2004:

Class	Maturity	Amount Outstanding	Conversion Price
5%	February 2007	$ 61.4 million	$38.36
3.5%	October 2007	$112.5 million	$50.46

The 5% debt was issued in February 2000 to certain qualified institutional buyers pursuant to an exemption under Rule 144A of the 1933 Act. Interest on the notes accrues at a rate of 5.0% per year, subject to adjustment in certain circumstances. The notes will mature in February 2007 and are convertible, at the discretion of the holder, into shares of our Common Stock at a conversion price of $38.355 per share, subject to adjustment in certain circumstances. The notes were redeemable in part or in total at any time before February 8, 2003 at an exchange premium of $137.93 per $1,000 principal amount, less any interest actually paid on the notes before the call for redemption, if the closing price of our Common Stock has exceeded 150% of the conversion price then in effect for at least 20 trading days within a period of 30 consecutive trading days. We can redeem some or all of the notes at any time after February 8, 2003, with redemption prices dependent upon the date of the redemption. Interest is payable semi-annually on August 8 and February 8. The notes are unsecured subordinated obligations, which rank junior in right of payment to all of our existing and future Senior Debt. At December 31, 2004, $61.4 million of these 5.0% convertible subordinated notes remain outstanding.

The 3.5% debt was issued in October 2000 to certain qualified institutional buyers pursuant to an exemption under Rule 144A of the 1933 Act. Interest on the notes accrues at a rate of 3.5% per year, subject to adjustment in certain circumstances. The notes will mature in October 2007 and are convertible, at the discretion of the holder, into shares of our Common Stock at a conversion price of $50.46 per share, subject to adjustment under certain circumstances. The notes were redeemable in part or in total at any time before October 17, 2003 at $1,000 per $1,000 principal amount plus a provisional redemption exchange premium, payable in cash or shares of Common Stock, of $105.00 per $1,000 principal amount, plus accrued and unpaid interest, if any, to the redemption date, if the closing price of our Common Stock has exceeded 150% of the conversion price then in effect for at least 20 trading days within a period of 30 consecutive trading days. The notes are also redeemable in part or in total at any time after October 17, 2003 at certain redemption prices dependent upon the date of redemption if the closing price of our Common Stock has exceeded 120% of the conversion price then in effect for at least 20 trading days within a period of 30 consecutive trading days. Interest is payable semi-annually on April 17 and October 17. The notes are unsecured obligations, which rank junior in right of payment to all of our existing and future senior debt. At December 31, 2004, $112.5 million of these 3.5% convertible subordinated notes remain outstanding.

Costs relating to the issuances of these notes and debentures are recorded as long-term assets and are amortized to interest expense over the term of the debt. As of December 31, 2004 and 2003, we had

approximately $173.9 million and $360.0 million in outstanding convertible subordinated notes and debentures with a fair market value of approximately $171.3 million and $406.6 million, respectively. The fair market was obtained through quoted market prices.

For the year ended December 31, 2004, we recognized a loss on debt extinguishment in connection with two privately negotiated transactions to convert our outstanding convertible subordinated notes into shares of our common stock. In January 2004, certain holders of our outstanding 3.5% convertible subordinated notes due October 2007 completed an exchange and cancellation of $9.0 million in aggregate principal amount of the notes for the issuance of 0.6 million shares of our common stock in a privately negotiated transaction. In February 2004, certain holders of our outstanding 3% convertible subordinated notes due June 2010 converted approximately $36.0 million in aggregate principal amount of such notes for approximately 3.2 million shares of our common stock and a cash payment of approximately $3.1 million in the aggregate in privately negotiated transactions. As a result of these transactions, we recognized losses on debt extinguishment of approximately $7.8 million and $1.5 million, respectively, in accordance with SFAS No. 84, Induced Conversions of Convertible Debt.

For the year ended December 31, 2003, gain on debt extinguishment totaled $12.0 million. Gain on debt extinguishment included a $4.3 million gain from the repurchase of $20.5 million of 3.5% convertible subordinated notes due October 2007 for $16.2 million during the second quarter of 2003. Gain on debt extinguishment also included a $7.7 million gain recorded in the fourth quarter of 2003 from the exchange of $87.9 million of 3.5% convertible subordinated notes due October 2007 for the issuance of $59.3 million of newly issued 3% convertible subordinated notes due June 2010.

Note 8—Debt

Tenant Improvement Loans

In November 1997, we received from the landlord of our facility in San Carlos, California, a loan of $5.0 million to fund a portion of the cost of improvements made to the facility. The loan bears interest at 9.46% per annum, and principal and interest payments are payable monthly over the ten-year loan term with a balloon payment of $4.5 million due in November 2007. In October 2002, we renegotiated the terms of this loan. As a result, we made a $1.5 million principal payment and reduced the interest rate by 1.5%. In October 2003, we made an additional $1.9 million principal payment. The loan now bears an interest rate of 7.96% per annum, and principal and interest payments are payable monthly over the original ten-year loan term with a balloon payment of $1.4 million due in November 2007.

Future non-cancelable principal payments under this tenant improvement loan as of December 31, 2004 are as follows (in thousands):

Years Ending December 31,	
2005	$ 121
2006	121
2007	1,464
Total minimum payments required	1,706
Less amount representing interest	311
Present value of future payments	1,395
Less current portion	11
Non-current portion	$1,384

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Real Estate Capital Leases

We occupy a facility in San Carlos under a capital lease for which a portion expires in August 2007, while the remainder expires in September 2016.

Under the terms of the lease our rent will increase by 2% in October of each year. The total committed future minimum lease payments under the terms of these capital lease agreements are as follows (in thousands):

Years ending December 31,	
2005	$ 5,855
2006	5,973
2007	5,242
2008	3,986
2009	4,065
2010 and thereafter	29,641
Total minimum payments required	54,762
Less amount representing interest	29,662
Present value of future payments	25,100
Less current portion	1,532
Non-current portion	$23,568

We have recorded a total liability of $25.1 million and $31.2 million relating to this lease as of December 31, 2004 and 2003, respectively, which represents the present value of future minimum payments on the lease. During the year ended December 31, 2004, we entered into a redemption agreement with respect to our interest in the partnership (see note 13). We simultaneously entered into a sale-leaseback agreement and, in accordance with FAS 98, *Accounting for Leases*, we capitalized the building by recording a capital lease asset and obligation equal to the fair market value of the leased asset of approximately $25.5 million. The interest rate on the lease is 18.0%.

Other Debt

We have recorded a long-term liability of $9.2 million and $4.8 million as of December 31, 2004 and 2003, respectively, in connection with a non-interest bearing loan from Pfizer. This loan is contingently payable only upon commercial launch of Exubera® in the United States.

Note 9—Commitments and Contingencies

Operating Leases

We lease certain facilities under arrangements expiring through June 2012. Rent expense was approximately $3.0 million, $3.2 million, and $3.9 million for the years ended December 31, 2004, 2003, and 2002, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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Future non-cancelable commitments under operating leases as of December 31, 2004 are as follows (in thousands):

Years Ending December 31,	
2005	$ 2,652
2006	2,624
2007	2,557
2008	2,537
2009	2,462
2010 and thereafter	6,073
Total minimum payments required	$18,905

Legal Matters

On September 3, 2004, a purported securities class action complaint styled *Norman Rhodes, et al. v. Nektar Therapeutics, Ajit Gill, J. Milton Harris, and Robert B Chess*, Case No. C 04-03735 JSW, was filed in the United States District Court for the Northern District of California against Nektar Therapeutics (the "Company") and certain of its current officers and directors. The complaint alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5. The plaintiff seeks to represent a putative class of all purchasers of the Company's securities between March 4, 2004 and August 4, 2004 (the "Class Period"). The complaint generally alleges that, during that Class Period, the Company and the individual defendants made false or misleading statements in certain press releases regarding Exubera®. The Complaint seeks unspecified monetary damages and other relief against all defendants. One motion for appointment of a lead plaintiff has been filed, and that motion is pending. The action is in a very early stage, and defendants' have not responded to the complaint.

This litigation may be costly and could prove to be time consuming and disruptive to normal business operations. There can be no assurance that we will prevail or that the cost of defending these lawsuits will be covered by our insurance policies. While it is not possible to predict accurately or to determine the eventual outcome of this litigation, an unfavorable outcome or settlement of this litigation could have a material adverse effect on our financial position, liquidity or results of operations.

From time to time, we may be involved in other 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 and/or liquidity.

Workers Compensation

Pursuant to the terms of our worker's compensation insurance policy, we are subject to self-fund all claims up to $250,000 per occurrence subject to a maximum of $739,250 for the term of the insurance policy, November 1, 2004 – October 31, 2005. Historically, we have not been obligated to make significant payments for these obligations, and no significant liabilities have been recorded for these obligations on our balance sheet as of December 31, 2004 or 2003.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Royalties

We have certain royalty commitments associated with the shipment and licensing of certain products. Royalty expense was approximately $2.0 million, $3.1 million, and $1.2 million for the years ended December 31, 2004, 2003, and 2002, respectively. The overall maximum amount of the obligations is based upon sales of the applicable product and cannot be reasonably estimated.

Director and Officer Indemnifications

As permitted under Delaware law, and as set forth in our Certificate of Incorporation and our Bylaws, we indemnify our directors, executive officers, other officers, employees, and other agents for certain events or occurrences that arose while in such capacity. The maximum potential amount of future payments we could be required to make under this indemnification is unlimited; however, we have insurance policies that may limit our exposure and may enable us to recover a portion of any future amounts paid. Assuming the applicability of coverage, the willingness of the insurer to assume coverage, and subject to certain retention, loss limits and other policy provisions, we believe any obligations under this indemnification are not material, other than an initial $500,000 per incident retention deductible per our insurance policy. However, no assurances can be given that the covering insurers will not attempt to dispute the validity, applicability, or amount of coverage without expensive litigation against these insurers, in which case we may incur substantial liabilities as a result of these indemnification obligations. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on our balance sheet as of December 31, 2004 or 2003.

Indemnification Underwriters and Initial purchasers of our Securities

In connection with our sale of equity and convertible debt securities from, we have agreed to defend, indemnify and hold harmless our underwriters or initial purchasers, as applicable, as well as certain related parties from and against certain liabilities, including liabilities under the Securities Act of 1933, as amended. The term of these indemnification obligations is generally perpetual. There is no limitation on the potential amount of future payments we could be required to make under these indemnification obligations. We have never incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations are triggered, however, we may incur substantial liabilities. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on our balance sheet as of December 31, 2004 or 2003.

Strategic Alliance—Enzon

In January 2002, we announced a broad strategic alliance with Enzon Pharmaceuticals, Inc. that included a collaboration to develop up to three products using our Pulmonary Technology and/or Supercritical Fluids Technology. Under the terms of the agreement, we are responsible for the development of drug formulations for the agreed upon pharmaceutical agents. We are required to self-fund a portion of these costs. As of December 31, 2004, we are required to fund up to an incremental $3.0 million in the coming years without reimbursement for research and development expenses. To date these costs, amounting to $14.0 million, have been included in our research and development expenses. After our funding requirement has been met, Enzon will have an option to license the products and if they exercise this option, they will be required to provide research and development funding as well as milestone payments should the products progress through clinical testing.

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December 31, 2004

Manufacturing and Supply Agreement with Contract Manufacturers

In August 2000, we entered into a Manufacturing and Supply Agreement with our contract manufacturers to provide for the manufacturing of our pulmonary inhaler device for Exubera®. Under the terms of the Agreement, we may be obligated to reimburse the contract manufacturers for the actual unamortized and unrecovered portion of any equipment procured or facilities established and the interest accrued for their capital overlay in the event that Exubera® does not gain FDA approval to the extent that the contract manufacturers cannot re-deploy the assets. While such payments may be significant, at the present time, it is not possible to estimate the loss that will occur should Exubera® not be approved. We have also agreed to defend, indemnify and hold harmless the contract manufacturers from and against third party liability arising out of the agreement, including product liability and infringement of intellectual property. There is no limitation on the potential amount of future payments we could be required to make under these indemnification obligations. We have never incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on our balance sheet as of December 31, 2004 or 2003.

Security Agreement with Pfizer, Inc.

In connection with the Collaboration, Development and License Agreement ("CDLA") dated January 18, 1995 that we entered into with Pfizer for the development of the Exubera® product, we entered into a Security Agreement pursuant to which our obligations under the CDLA and certain Manufacturing and Supply Agreements related to the manufacture and supply of powdered insulin and pulmonary inhaler devices for the delivery of powdered insulin, are secured. Our default under any of these agreements triggers Pfizer's rights with respect to property relating solely to, or used or which will be used solely in connection with, the development, manufacture, use and sale of Exubera® including proceeds from the sale or other disposition of the property. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on our balance sheet as of December 31, 2004 or 2003.

Collaboration Agreements for Pulmonary Products

As part of our collaboration agreements with our partners for the development, manufacture and supply of products based on our Pulmonary Technology, we generally agree to defend, indemnify and hold harmless our partners from and against third party liabilities arising out of the agreement, including product liability and infringement of intellectual property. The term of these indemnification obligations is generally perpetual any time after execution of the agreement. There is no limitation on the potential amount of future payments we could be required to make under these indemnification obligations. We have never incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on our balance sheet as of December 31, 2004 or 2003.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

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

As part of our license, manufacturing and supply agreements with our partners for the development and/or manufacture and supply of PEG reagents based on our Advanced PEGylation Technology, we generally agree to defend, indemnify and hold harmless our partners from and against third party liabilities arising out of the agreement, including product liability and infringement of intellectual property. The term of these indemnification obligations is generally perpetual any time after execution of the agreement. There is no limitation on the potential amount of future payments we could be required to make under these indemnification obligations. We have never incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on our balance sheet as of December 31, 2004 or 2003.

Lease Restoration

We have several leases for our facilities in multiple locations. In the event that we do not exercise our option to extend the term of the lease, we guarantee certain costs to restore the property to certain conditions in place at the time of lease. We believe the estimated fair value of this guarantee is minimal. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on our balance sheet as of December 31, 2004 or 2003.

Note 10—Stockholders' Equity

Preferred Stock

We have authorized 10,000,000 shares of Preferred Stock, each share having a par value of $0.0001. Three million one hundred thousand (3,100,000) shares of Preferred Stock are designated Series A Junior Participating Preferred Stock (the "Series A Preferred Stock") and forty thousand (40,000) shares of Preferred Stock are designated as Series B Convertible Preferred Stock (the "Series B Preferred Stock").

Series A Preferred Stock

On June 1, 2001 the Board of Directors approved the adoption of a Share Purchase Rights Plan (the "Plan"). Terms of the Plan provide for a dividend distribution of one preferred share purchase right (a "Right") for each outstanding share of our Common Stock (the "Common Shares"). The Rights have certain anti-takeover effects and will cause substantial dilution to a person or group that attempts to acquire the Company on terms not approved by our Board of Directors. The dividend distribution was payable on June 22, 2001 (the "Record Date") to the stockholders of record on that date. Each Right entitles the registered holder to purchase from us one one-hundredth of a share of Series A Preferred Stock at a price of $225.00 per one one-hundredth of a share of Series A Preferred Stock (the "Purchase Price"), subject to adjustment. Each one one-hundredth of a share of Series A Preferred Stock has designations and powers, preferences and rights, and the qualifications, limitations and restrictions which make its value approximately equal to the value of a Common Share.

The Rights are not exercisable until the Distribution Date (as defined in the Certificate of Designation for the Series A Preferred Stock). The Rights will expire on June 1, 2011, unless the Rights are earlier redeemed or exchanged by us. Each share of Series A Preferred Stock will be entitled to a minimum preferential quarterly

dividend payment of $1.00 but will be entitled to an aggregate dividend of 100 times the dividend declared per Common Share. In the event of liquidation, the holders of the Series A Preferred Stock would be entitled to a minimum preferential liquidation payment of $100 per share, but would be entitled to receive an aggregate payment equal to 100 times the payment made per Common Share. Each share of Series A Preferred Stock will have 100 votes, voting together with the Common Shares. Finally, in the event of any merger, consolidation or other transaction in which Common Shares are exchanged, each share of Series A Preferred Stock will be entitled to receive 100 times the amount of consideration received per Common Share. Because of the nature of the Series A Preferred Stock dividend and liquidation rights, the value of one one-hundredth of a share of Series A Preferred Stock should approximate the value of one Common Share. The Series A Preferred Stock ranks junior to the Series B Preferred Stock and would rank junior to any other series of preferred stock. Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder, including, without limitation, the right to vote or to receive dividends.

Series B Convertible Preferred Stock

In connection with a strategic alliance with Enzon Pharmaceuticals, Inc., we entered into a Preferred Stock Purchase Agreement pursuant to which we sold to Enzon and Enzon purchased from us 40,000 shares of non-voting Series B Preferred Stock at a purchase price of one thousand dollars ($1,000) per share for an aggregate purchase price of $40.0 million. A Certificate of Designation filed with the Secretary of State of Delaware sets forth the rights, privileges and preferences of the Series B Preferred Stock. Pursuant to the Certificate of Designation, the Series B Preferred Stock does not have voting rights. The Series B Preferred Stock is convertible, in whole or in part, into that number of shares of our Common Stock (the “Conversion Shares”) equal to the quotient of $1,000 per share divided by the Conversion Price. The “Conversion Price” was initially $22.79 per share or 125% of the Closing Price and at no time can the Preferred Stock convert into shares of Common Stock at a discount to the Closing Price. The “Closing Price” equals $18.23 per share and was based upon the average of our closing bid prices as listed on the Nasdaq National Market for the twenty (20) trading days preceding the date of the closing of the transaction.

The Series B Preferred Stock is convertible at the option of the holder. In accordance with the rights, privileges, and preferences of the Series B Preferred Stock pursuant to the certificate of designation, on January 7, 2005 the Conversion Price was adjusted to be equal to $19.49 per share based on the average of the closing bid prices of our common stock as quoted on the Nasdaq National Market for the 20 trading days preceding January 7, 2005.

To the extent not previously converted, the Series B Preferred Stock will automatically convert into shares of our Common Stock, based on the then effective Conversion Price, upon the earliest of (i) the fourth anniversary of the Original Issue Date (January 7, 2006); (ii) immediately prior to an Asset Transfer or Acquisition (as defined in the Certificate of Designation); or (iii) with the consent of the holders of a majority of the then outstanding Series B Preferred Stock immediately prior to a liquidation, dissolution or winding up of Nektar. In the event of an automatic conversion pursuant to an asset transfer, acquisition or liquidation, the adjustment mechanism described above will be applied immediately prior to the automatic conversion.

In the event of our liquidation, dissolution or winding down, either voluntary or involuntary, following the payment of any distributions due the holders of any class of capital stock or series of preferred stock that ranks senior to the Series B Preferred Stock, the holders of the Series B Preferred Stock shall be entitled to receive, prior and in preference to any distribution of any of our assets or surplus funds to the holders of our Common Stock or any class of capital stock or series of preferred stock that does not rank senior to or on parity with the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Series B Preferred Stock, an amount per share (as adjusted for any combinations, consolidations, stock distributions or stock dividends with respect to the Series B Preferred Stock) equal to up to $1,000.

During the year ended December 31, 2004, Enzon converted an aggregate 20,055 shares of Series B Convertible Preferred Stock into an aggregate 880,085 shares of our common stock. As of December 31, 2004 there were 19,945 shares of Series B Convertible Preferred Stock outstanding.

Issuance of Common Stock

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

Employee Stock Purchase Plan

In February 1994**,** our Board of Directors adopted the Employee Stock Purchase Plan (the "Purchase Plan"). Under the Purchase Plan, 300,000 shares of Common Stock have been reserved for purchase by our employees pursuant to section 423(b) of the Internal Revenue Code of 1986. In May 2002, we amended and restated the Purchase Plan to increase the number of shares of Common Stock authorized for issuance under the Purchase Plan from a total of 300,000 shares to a total of 800,000 shares. Our stockholders approved this amendment in June 2002. As of December 31, 2004, 265,492 of Common Stock have been issued under the Purchase Plan.

The terms of the Employee Stock Purchase Plan provide eligible employees with the opportunity to acquire an ownership interest in Nektar through participation in a program of periodic payroll deductions for the purchase of our common stock. Employees must make an election to enroll or re-enroll in the plan on a semi-annual basis. Stock is purchased at 85% of the lower of the closing price on the first day of the enrollment period or the last day of the enrollment period.

Stock Option Plans

The following table summarizes information, as of December 31, 2004, with respect to shares of our Common Stock that may be issued under our existing equity compensation plans:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) (1)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for issuance under equity compensation plans (excluding securities reflected in column(a)) (c)
Equity compensation plans approved by security holders	4,759,466	$ 16.70	2,124,235(2)
Equity compensation plans not approved by security holders	8,806,833	$ 18.64	2,354,449
Total	13,566,299	$ 17.96	4,478,684

(1) Does not include options to purchase 39,105 shares assumed in connection with the acquisition of Bradford Particle Design Ltd (with a weighted-average exercise price of $7.74 per share) and options to purchase 163,999 shares we assumed in connection with the acquisition of Shearwater Corporation (with a weighted-average exercise price of $0.03 per share).

(2) Includes 534,508 shares of common stock available for future issuance under our Employee Stock Purchase Plan as of December 31, 2004. Eligible participants purchased an aggregate amount of 125,617 shares and 139,875 shares under the Employee Stock Purchase Plan in fiscal year 2004 and 2003, respectively.

2000 Equity Incentive Plan

Our 1994 Equity Incentive Plan was adopted by the Board of Directors on February 10, 1994 and was amended and restated in its entirety and renamed the "2000 Equity Incentive Plan" on April 19, 2000. The purpose of the 2000 Equity Incentive Plan is to attract and retain qualified personnel, to provide additional incentives to our employees, officers, consultants and employee directors and to promote the success of our business. Pursuant to the 2000 Equity Incentive Plan, we may grant or issue incentive stock options to employees and officers and non-qualified stock options, rights to acquire restricted stock and stock bonuses to consultants, employees, officers and employee directors. Options granted to non-employees are recorded at fair value based on the fair value measurement criteria of FAS 123.

The maximum term of a stock option under the 2000 Equity Incentive Plan is ten years, but if the optionee at the time of grant has voting power of more than 10% of our outstanding capital stock, the maximum term of an incentive stock option is five years. The exercise price of incentive stock options granted under the 2000 Equity Incentive Plan must be at least equal to 100% (or 110% with respect to holders of more than 10% of the voting power of our outstanding capital stock) of the fair market value of the stock subject to the option on the date of the grant. The exercise price of non-qualified stock options, and the purchase price of rights to acquire restricted stock, granted under the 2000 Equity Incentive Plan are determined by the Board of Directors.

The Board may amend the 2000 Equity Incentive Plan at any time, although certain amendments would require stockholder approval. The 2000 Equity Incentive Plan will terminate on February 9, 2010 unless earlier terminated by the Board. In 2004, we amended and restated the 2000 Equity Incentive Plan to increase the number of shares of Common Stock authorized for issuance under the Purchase Plan from a total of 10,350,000 shares to a total of 11,250,000 shares. Our stockholders approved this amendment on June 17, 2004.

Non-Employee Directors' Stock Option Plan

On February 10, 1994, our Board of Directors adopted the Non-Employee Directors' Stock Option Plan under which options to purchase up to 400,000 shares of our Common Stock at the then fair market value may be granted to our non-employee directors. There are no remaining options available for grant under this plan as of December 31, 2004.

2000 Non-Officer Equity Incentive Plan

Our 1998 Non-Officer Equity Incentive Plan was adopted by the Board of Directors on August 18, 1998 and was amended and restated in its entirety and renamed the "2000 Non-officer Equity Incentive Plan" on June 6, 2000 (the "2000 Plan"). The purpose of the 2000 Plan is to attract and retain qualified personnel, to provide additional incentives to employees and consultants and to promote the success of our business. Pursuant to the 2000 plan, we may grant or issue non-qualified stock options, rights to acquire restricted stock and stock bonuses to employees and consultants who are neither Officers nor Directors of Nektar.

The maximum term of a stock option under the 2000 Plan is ten years. The exercise price of stock options, and the purchase price of restricted stock granted under the 2000 Plan are determined by the Board of Directors.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

On January 25, 2002, we offered to certain employees (officers and directors were excluded) the ability to exchange certain options ("Eligible Options") to purchase shares of our Common Stock granted prior to July 24, 2001 with exercise prices greater than or equal to $25.00 per share for replacement options to purchase shares of our Common Stock to be granted under the 2000 Plan. We conducted the exchange with respect to the Eligible Options on a one-for-two (1:2) basis. If an employee accepted this offer with respect to any Eligible Option, such employee also was obligated to exchange all options to acquire our Common Stock granted to such employee on or after July 24, 2001 (the "Mandatory Exchange Options"). We conducted the exchange with respect to Mandatory Exchange Options on a one-for-one (1:1) basis. A total of 90 employees participated in the exchange offer, exchanging 1,217,500 Eligible Options and 78,170 Mandatory Exchange Options to purchase shares of our Common Stock. We issued Replacement Options to purchase 686,920 shares of Common Stock on August 26, 2002 at an exercise price equal to the closing price of our Common Stock as reported on the NASDAQ National Market on the last market trading day prior to the date of grant ($7.31).

A summary of activity under the 2000 Equity Incentive Plan, the Non-Employee Directors' Stock Option Plan and the 2000 Non-Officer Equity Incentive Plan is as follows (in thousands, except for per share information):

	Options Outstanding		
	Number of Shares	Exercise Price Per Share	Weighted-Average Exercise Price Per Share
Balance at January 1, 2002	14,672	$0.005-61.63	$ 20.96
Options granted	3,232	4.13-18.55	8.93
Options exercised	(198)	0.005-14.13	2.23
Options expired	(715)	0.03-61.63	26.84
Options canceled	(2,249)	0.01-61.63	27.03
Balance at December 31, 2002	14,742	0.005-61.63	17.20
Options granted	1,631	4.46-14.63	8.75
Options exercised	(362)	0.005-14.63	5.42
Options expired	(343)	0.11-46.06	18.21
Options canceled	(715)	4.31-57.03	16.04
Balance at December 31, 2003	14,953	0.005-61.63	16.57
Options granted	1,393	10.10-22.49	17.33
Options exercised	(1,817)	0.005-19.25	7.52
Options expired	(228)	5.06-56.38	31.46
Options canceled	(532)	0.005-56.38	16.33
Balance at December 31, 2004	13,769	$0.005-61.63	$ 17.71

At December 31, 2004, 2003, and 2002, options were exercisable to purchase 9.2 million, 9.2 million, and 7.5 million shares at weighted-average exercise prices of $18.49, $16.52, and $15.76 per share, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Weighted average fair value of options granted during the years ended December 31, 2004, 2003 and 2002, was $10.45, $5.44, and $5.56, respectively. The following table provides information regarding our stock option plans as of December 31, 2004 (in thousands, except per share information):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life (in years)	Number	Weighted-Average Exercise Price Per Share
$ 0.01-0.01	104	$ 0.01	4.5	104	$ 0.01
0.01-0.01	1	0.01	0.4	1	0.01
0.03-0.03	164	0.03	6.4	164	0.03
3.13-4.62	137	4.27	1.2	124	4.25
4.76-7.13	1,088	5.76	6.7	514	5.77
7.15-10.68	2,196	8.18	6.5	1,151	8.25
10.93-16.28	4,017	13.88	5.5	3,111	14.02
16.40-23.96	2,489	20.65	6.7	1,330	21.56
25.00-37.47	3,034	29.21	5.5	2,295	29.28
37.63-56.38	538	43.20	5.3	414	42.87
60.88-61.63	1	61.25	5.2	1	61.25
$ 0.01-61.63	13,769	$ 17.71	5.9	9,209	$ 18.49

Warrants

In November 2000, we issued warrants to certain consultants to purchase an additional 6,000 shares of common stock. These warrants bear an exercise price of $45.88 per share and expire after six years.

In September 2000, we issued warrants to purchase 10,000 shares of common stock to the landlord of one of our facilities in connection with the signing of a capital lease on that facility. These warrants bear an exercise price of $45.88 per share and expire after six years. These warrants were accounted for as equity in accordance with EITF 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*.

The warrants issued in 2000 were valued using a Black-Scholes option valuation model with the following weighted-average assumptions: a risk free interest rate of 6.4%; a dividend yield of 0.0%; a volatility factor of ..688; and a weighted average expected life of ten years.

In November 1996, we issued warrants to purchase a total of 40,000 shares of common stock in connection with a tenant improvement loan for one of our facilities. These warrants bear an exercise price of $6.56 per share and expire after ten years. These warrants were accounted for as equity in accordance with EITF 96-18. These warrants allow for net share settlement at the option of the warrant holder. In November 2004, one of the warrants representing 20,000 shares of common stock was exercised in the form of a net share settlement for 11,775 shares of common stock.

The warrants issued in 1996 were valued using a Black-Scholes option valuation model with the following weighted-average assumptions: a risk free interest rate of 6.4%; a dividend yield of 0.0%; a volatility factor of .620; and a weighted average expected life of ten years.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

We recognized approximately $0.1 million of expense related to warrants for the year ended December 31, 2004.

At December 31, 2004, we had warrants outstanding to purchase a total of 36,000 shares of our common stock. No warrants were issued during the years ended December 31, 2004 and 2003.

Stock issued to non-employees

Options granted to consultants are recorded according the fair value method over the vesting period. For the year ended December 31, 2004, 2003, and 2002, we have recorded compensation costs of $0.7 million, $0.2 million, and $1.3 million, respectively.

These options were valued using a Black-Scholes option valuation model with the following weighted-average assumptions:

	2004	2003	2002
Risk-free interest rate	1.1%-4.7%	3.2%-4.6%	3.5%-5.5%
Dividend yield	0.0%	0.0%	0.0%
Volatility Factor	0.707	0.688	0.772
Weighted average expected life	4.2 years	8.4 years	8.3 years

Deferred Compensation

During the three-month period ended March 31, 2004, we issued restricted stock unit awards totaling 206,666 shares of our common stock to certain officers. The restricted stock unit awards are settled by delivery of shares of our common stock on or shortly after the date the awards vest. The restricted stock unit awards become fully vested over a period of 34 months. In connection with these restricted stock unit awards, we recorded deferred compensation of $3.9 million, which represents the fair value of these shares using a risk free interest rate of 3.0%, a volatility factor of 68%, and a weighted average expected life of three years. We are ratably expensing the deferred compensation on a monthly basis over the vesting term of 34 months. For the year ended December 31, 2004, we recognized expense related to these restricted stock grants of approximately $1.2 million.

Time Accelerated Restricted Stock Award Plan (“TARSAP”)

During the year ended December 31, 2004, we issued options for 111,000 shares of stock out of our 2000 Non-Officer Equity Incentive Plan to certain employees. The options have an exercise price equal to fair market value on the date of grant. These options become 100% vested upon the earlier of: 1) approval of Exubera® by the FDA or 2) five years from the date of grant.

401(k) Plan

We sponsor a 401(k) retirement plan whereby eligible employees may elect to contribute up to the lesser of 60% of their annual compensation or the statutorily prescribed annual limit allowable under Internal Revenue Service regulations. The 401(k) plan permits us to make matching contributions on behalf of all participants. Currently, we match the lesser of 75% of year to date participant contributions or 3% of eligible wages. The match vests ratably over the first three years of employment, such that after three years of employment, all matching is fully vested. The matching contribution is in the form of shares of our common stock.

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

We issued approximately 66,000 shares, 142,000 shares, and 121,000 shares of our common stock valued at approximately $1.2 million, $1.2 million, and $1.0 million in connection with the match in 2004, 2003, and 2002 respectively. During part of 2004, shares reserved for issuance related to matching contributions that had been previously been approved by our Board of Directors became fully depleted. During this time, we purchased approximately 14,000 shares on the open market on behalf of employees for a total cost of $0.2 million. This amount was recorded as compensation expense. During the year ended December 31, 2004, our Board of Directors approved an additional 300,000 shares to be reserved for issuance related to matching contributions. A total of 271,263 shares were reserved for issuance related to matching contributions as of December 31, 2004.

Reserved Shares

At December 31, 2004, we have reserved shares of Common Stock for issuance as follows (in thousands):

Warrants to purchase Common Stock	36
Employee purchase plan	534
Convertible preferred stock	875
Convertible subordinated notes and debentures	3,831
Stock options	3,737
Shares reserved for retirement plans	271
Total	9,284

Note 11—Income Taxes

For financial reporting purposes, “Loss before provision for income taxes,” includes the following components (in thousands):

	2004	2003	2002
Domestic	$ (95,999)	$(58,983)	$ (99,884)
Foreign	(6,050)	(6,738)	(7,584)
Total	$(102,049)	$(65,721)	$(107,468)

As of December 31, 2004, we had a net operating loss carryforward for federal income tax purposes of approximately $417.4 million, which expires beginning in the year 2006. We had a California state net operating loss carryforward of approximately $126.6 million, which expires beginning in 2005. We had a foreign net operating loss carryforward of approximately $19.3 million, which has an unlimited carryforward period. We do not have any net operating losses for Alabama state tax purposes which would reduce the amount of tax to be paid to Alabama. However, the amount of the current Alabama state tax liability of $0.6 million, will be reduced by $0.4 million related to the exercise of employee stock options which was credited to equity.

Utilization of the federal and state net operating loss and credit carryforwards may be subject to a substantial annual limitation due to the “change in ownership” provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

The benefit (provision) for income taxes consists of the following (in thousands):

	2004	2003	2002
Current:			
Federal	$ —	$ —	$ —
State	(665)	(169)	—
Foreign	—	—	—
Total Current	(665)	(169)	—
Deferred:			
Federal	—	—	—
State	828	—	—
Foreign	—	—	—
Total Deferred	828	—	—
Benefit/(provision) for income taxes	$ 163	$(169)	$ —

Income tax expense benefit (provision) related to continuing operations differ from the amounts computed by applying the statutory income tax rate of 34% to pretax loss as follows (in thousands):

	2004	2003	2002
U.S. federal benefit/(taxes)			
At statutory rate	$ 34,697	$ 22,345	$ 36,539
State taxes	163	(169)	—
Net operating losses not benefited	(33,000)	(20,674)	(34,039)
Investment impairment and non-deductible amortization	(1,532)	(1,434)	(2,209)
Other	(165)	(237)	(291)
Total	$ 163	$ (169)	$ —

Deferred income taxes reflect the net tax effects of loss and credit carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of our deferred tax assets for federal and state income taxes are as follows (in thousands):

	December 31,	
	2004	2003
Deferred tax assets:		
Net operating loss carryforwards	$ 154,200	$ 125,300
Research and other credits	16,900	11,600
Capitalized research expenses	9,200	15,300
Deferred revenue	11,900	7,900
Depreciation	5,400	5,100
Other	22,700	16,600
Total deferred tax assets	220,300	181,800
Valuation allowance for deferred tax assets	(219,472)	(181,800)
Net deferred tax assets	$ 828	$ —

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December 31, 2004

Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Because of our lack of earnings history, the net deferred tax assets related to our non Alabama operations have been fully offset by a valuation allowance. The valuation allowance increased by $37.7 million and $28.2 million during the years ended December 31, 2004 and 2003, respectively. The valuation allowance includes approximately $31.2 million of benefit related to employee stock option exercises which will be credited to additional paid in capital when realized.

We have recorded a deferred tax asset related to our Alabama subsidiary of $0.8 million, and a reduction of our tax liability of $0.4 million related to employee stock option exercises which has been credited to additional paid in capital.

We also have federal research credits of approximately $10.9 million, which expire beginning in the year 2006 and state tax research credits of approximately $10.7 million which have no expiration date.

Note 12—Statement of Cash Flows Data

	Years Ended December 31,		
	2004	2003	2002
Supplemental disclosure of cash flows information (in thousands):			
Cash paid for interest	$ 25,226	$ 19,223	$ 17,439
Cash paid for income taxes	$ 238	$ —	$ —
Supplemental schedule of non-cash investing and financing activities (in thousands):			
Net reduction in convertible subordinated notes due to exchange of 3.5% notes for 3% notes	$ —	$ 28,700	$ —
Conversion of debt into common stock	$ 186,029	$ —	$ —
Deferred compensation related to the issuance of stock options	$ 3,902	$ —	$ (135)
Non-cash disclosure related to consolidation of Shearwater Polymers, LLC (in thousands):			
Tangible assets primarily property and equipment	$ —	$ 2,362	$ —
Capital lease obligation	$ —	$ 2,402	$ —

Note 13—Related Party Transactions

Redemption of Interest in Inhale 201 Partnership

In connection with a Contribution Agreement dated September 14, 2000 by and between Nektar and Bernardo Property Advisors, Inc., we had contributed certain property located at 201 Industrial Road, San Carlos, CA to the Partnership in exchange for a limited partnership interest in the Partnership. In addition, we entered into a Build-to-Suit Lease with the Partnership (the “Lease”) with respect to the property contributed to the Partnership and the building subsequently built on such property, now occupied by us as its headquarters (the “Building”).

Effective June 23, 2004, Nektar, SciMed Prop III, Inc. (the “General Partner”), Bernardo Property Advisors, Inc., and Inhale 201 Industrial Road Partnership (the “Partnership”) entered into a Redemption Agreement (the

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

"Redemption Agreement") with respect to our limited partnership interest in the Partnership. The Redemption Agreement provides for the redemption of our limited partnership interest in the Partnership in exchange for a cash payment of $19.5 million from Bernardo Property Advisors, Inc. to Nektar, the repayment from Bernardo Property Advisors, Inc., to Nektar of a $3.0 million outstanding loan from Nektar to the Partnership, and a modification of the Lease. The redemption contemplated by the Redemption Agreement and related transactions were subject to certain closing conditions which were met on August 18, 2004, resulting in the dissolution of the Partnership on that date. As of September 30, 2004, we are no longer consolidating the Partnership as part of our consolidated financial statements.

Pursuant to the Redemption Agreement, Nektar and Bernardo Property Advisors, Inc., entered into an Amended and Restated Build-to-Suit Lease (the "Amended Lease"). The Amended Lease provides for, among other things, a decrease in the term of our obligations with respect to a portion of the Building not currently occupied by Nektar from 12 years to 3 years and the elimination of our rights to occupy certain other space in the Building.

In accordance with FAS 98, *Accounting for Leases*, we recorded a capital lease asset and obligation equal to the fair market value of the leased asset of $25.5 million. We also recorded a deferred gain on the sale-leaseback transaction of $12.7 million. In accordance with FAS 66, *Accounting for Sales of Real Estate*, this deferred gain was recorded as a liability and is being amortized over the term of the lease as a reduction to depreciation expense. During the year ended December 31, 2004 we amortized $0.5 million of this gain.

Purchase of Nektar, AL Facility

On September 30, 2004, we purchased our Church Street facility in Alabama from Shearwater Polymers, LLC ("the LLC") for $2.9 million. The land and building were recorded as fixed assets at their fair market value as of the purchase date of $0.7 million and $2.2 million, respectively.

Prior to this purchase, Nektar, AL paid $0.2 million, $0.3 million, and $0.3 million in 2004, 2003, and 2002, respectively, as rent to the LLC. The LLC was 4% owned by Nektar AL with the remaining 96% owned by Dr. J. Milton Harris. Dr. Harris is an employee of Nektar, AL and prior to March 4, 2004, he was one of our executive officers. Both Nektar AL and Dr. Harris had jointly guaranteed a bank loan on the Nektar AL facility, and the lease income from Nektar AL was the sole source of revenue for the LLC. We had fully consolidated this entity in our consolidated financial statements since December 31, 2003, in accordance with FIN 46R, *Consolidation of Variable Interest Entities*. On September 30, 2004, the LLC paid the principal balance owed on the bank loan of $1.7 million, and we were relieved of the guarantee. As of September 30, 2004, the LLC was dissolved and we are no longer consolidating the LLC as part of our consolidated financial statements. As of December 31, 2003, the net book value of the building securing the guarantee was $2.4 million and our maximum exposure to loss with respect to Shearwater Polymers, LLC, was the outstanding capital lease obligation of $1.8 million.

Other

In 2004, 2003, and 2002, we paid $0.2 million $0.5 million, and $0.7 million, respectively, for legal services rendered by Alston & Bird LLP of which Paul F. Pedigo, Esq. is a Partner. Mr. Pedigo is a relative by marriage of J. Milton Harris. Prior to March 4, 2004, Dr. Harris was one of our executive officers.

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

Note 14—Subsequent Events

Effective January 11, 2005, BMR-201 Industrial Road LLC (landlord) and us, entered into an agreement to terminate our lease obligation for a portion of the building located at 201 Industrial Road, San Carlos. However, we will still be obligated to make certain reduced payments through August 2007 related to our prior lease for this portion of the building.

In February 2005, we amended our agreement with Alliance Pharmaceuticals with regard to the PulmoSphere® particle and particle processing technology, by agreeing to pay Alliance approximately $1.8 million in exchange for certain raw material used in our production process and the termination of all of our future royalty and payment obligations to Alliance.

Note 15—Selected Quarterly Financial Data (Unaudited)

Certain amounts reported in our Quarterly Reports on Form 10-Q during the years 2004 and 2003 have been restated to correct for certain misapplications of our accounting policies under U.S. GAAP.

Specifically, we have reclassified approximately $2.9 million, $2.8 million, and $2.7 million for the three month periods ended September 30, 2004, June 30, 2004, and March 31, 2004, respectively, from research and development expenses to general and administrative expenses. For the three month periods ended December 31, 2003, September 30, 2003, June 30, 2003, and March 31, 2003, the reclassification adjustment was approximately $2.3 million, $2.4 million, $2.4 million, and $2.3 million, respectively. This reclassification included legal expenses related to our intellectual property portfolio and a portion of finance, information systems, and human resource expenses that were not clearly related to research and development and are required to be classified outside of research and development expenses under Statement Financial Accounting Standards No. 2, *Accounting for Research and Development Costs*.

In addition, we reclassified approximately $0.2 million, $0.2 million, and $0.3 million for the three month periods ended September 30, 2004, June 30, 2004, and March 31, 2004, respectively, from general and administrative expenses to interest expense. For the three month periods ended December 31, 2003, September 30, 2003, June 30, 2003, and March 31, 2003, the reclassification adjustment was approximately $0.4 million, $0.4 million, $0.3 million, and $0.3 million, respectively. This reclassification was made to record the amortization of debt issuance costs to interest expense as required under Accounting Principles Board No. 21, *Interest on Receivables and Payables* and EITF 86-15 *Increasing-Rate Debt*.

These reclassifications did not result in any change to our cash position, revenue, or net loss for any quarterly period during the years ended December 31, 2004 or 2003.

We have experienced fluctuations in our quarterly results. Our results have included costs associated with acquisitions of various technologies, increases in research and development expenditures, and expansion of late stage clinical and early stage commercial manufacturing facilities. We expect these fluctuations to continue in the future. Due to these and other factors, we believe that quarter-to-quarter comparisons of our operating results will not be meaningful, and you should not rely on our results for one quarter as any indication of our future performance. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for a discussion of our critical accounting policies.

NEKTAR THERAPEUTICS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

December 31, 2004

The following table sets forth certain unaudited quarterly financial data, as adjusted to correct for the misapplications of our accounting policies under U.S. GAAP discussed above, for each of the eight quarters ended December 31, 2004. In our opinion, the unaudited information set forth below has been prepared on the same basis as the audited information and includes all adjustments necessary to present fairly the information set forth herein. The operating results for any quarter are not indicative of results for any future period. All data is in thousands except per share information.

	Fiscal Year 2004				Fiscal Year 2003			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Contract research revenue	$ 21,509	$ 22,102	$ 23,556	$ 22,018	$ 18,393	$ 21,210	$ 19,624	$ 19,735
Product sales	$ 4,322	$ 6,425	$ 4,990	$ 9,348	$ 7,135	$ 6,538	$ 7,733	$ 5,889
Gross margin on product sales	$ 1,786	$ (308)	$ 513	$ 3,296	$ 2,513	$ 2,830	$ 4,192	$ 3,082
Research and development expenses *	$ 31,292	$ 33,650	$ 34,534	$ 34,047	$ 29,824	$ 30,005	$ 29,342	$ 32,978
General and administrative expenses *	$ 6,828	$ 8,072	$ 7,382	$ 8,685	$ 7,177	$ 7,194	$ 7,193	$ 8,402
Operating loss *	$(15,806)	$(20,909)	$(18,828)	$(18,399)	$(17,222)	$(14,286)	$(13,701)	$(19,546)
Interest expense *	$ 16,357	$ 2,987	$ 3,259	$ 3,144	$ 4,470	$ 4,467	$ 5,213	$ 5,177
Net loss	$(40,000)	$(22,164)	$(20,452)	$(19,270)	$(19,949)	$(13,039)	$(17,206)	$(15,696)
Basic and fully diluted net loss per share	$ (0.64)	$ (0.27)	$ (0.24)	$ (0.23)	$ (0.36)	$ (0.23)	$ (0.31)	$ (0.28)

* These amounts have been restated for all quarters of 2003 and for the first three quarters of 2004 as discussed above.

SCHEDULE II

NEKTAR THERAPEUTICS

VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

YEARS ENDED DECEMBER 31, 2004, 2003, and 2002

Description	Balance at Beginning of Year	Charged to Costs and Expenses, Net of Reversals	Utilizations	Balance At End of Year
		(In thousands)		
2004:				
Accounts receivable allowance	$ 702	$ 43	$ (702)	$ 43
2003:				
Accounts receivable allowance	$ 633	$ 69	$ —	$ 702
2002:				
Accounts receivable allowance	$ —	$ 633	$ —	$ 633

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not applicable.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. Under the supervision and with the participation of management, including our Chief Executive Officer and our Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the 1934 Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as a result of the material weakness in our internal control over financial reporting discussed below, our disclosure controls and procedures were not effective as of the end of the period covered by this annual report.

Management's Report on Internal Control Over Financial Reporting. As Nektar's Chief Executive Officer and Chief Financial Officer, we are responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our internal control system was designed to provide reasonable assurance to management and our board of directors regarding the reliability of financial reporting and preparation of published financial statements in accordance with generally accepted accounting principles.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is a more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, we have assessed the effectiveness of our internal control over financial reporting as of December 31, 2004, and as a result of this assessment, we have concluded that we have a material weakness in our financial statement close process, including insufficient review of the following:

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

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

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

- a restatement of the 2002 and 2003 consolidated financial statements to reflect reclassifications of certain amounts between research and development expense, general and administrative expense, and interest expense;

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

In making our assessment of internal control over financial reporting, we used the criteria issued in the report Internal Control-Integrated Framework by the Committee of Sponsoring Organizations of the Treadway Commission. Because of the material weakness described above, our management has concluded that our internal control over financial reporting was not effective as of December 31, 2004 based on these criteria.

Our independent registered public accounting firm has issued an attestation report on management's assessment of our internal control over financial reporting which is included elsewhere herein.

Changes in Internal Control over Financial Reporting. In 2004, we began implementation of new processes and controls and hired additional personnel with technical accounting expertise to improve our financial statement close process. We intend to continue to improve our financial statement close process in 2005 including the remediation of the material weakness discussed above by identifying, recruiting, and training personnel with the appropriate accounting skills. In addition, the Company plans to enhance further its technical accounting review process for non-routine and complex transactions by:

- identifying and defining non-routine and complex transactions on a regular basis, and
- researching, identifying, analyzing, documenting, and reviewing applicable accounting principles.

Limitations on the Effectiveness of Controls. Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed 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.

Item 9B. Other Information

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

Information relating to our executive officers required by this item is set forth in Part I—Item 1 of this report under the caption "Executive Officers of the Registrant" and is incorporated herein by reference. The other information required by this item is incorporated by reference from the definitive proxy statement for our 2004 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Form (the "Proxy Statement") under the headings "Proposal 1, Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance."

Information regarding our audit committee financial expert will be set forth in the Proxy Statement under the heading "Audit Committee" which information is incorporated herein by reference.

In December 2003, we adopted a Code of Conduct applicable to all employees, including the principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. The Code of Conduct is posted on our website at www.nektar.com. Amendments to, and waivers from, the code of ethics that applies to any of these officers, or persons performing similar functions, and that relates to any element of the code of ethics definition enumerated in Item 406(b) of Regulation S-K will be disclosed at the website address provided above and, to the extent required by applicable regulations, on a Current Report on Form 8-K.

As permitted by SEC Rule 10b5-1, certain of our executive officers, directors and other employees have set up a predefined, structured stock trading program with his/her broker to sell our stock. The stock trading program allows a broker acting on behalf of the executive officer, director or other employee to trade our stock during blackout periods or while such executive officer, director or other employee may be aware of material, nonpublic information, if the trade is performed according to a pre-existing contract, instruction or plan that was established with the broker during a non-blackout period and when such executive officer, director or employee was not aware of any material, nonpublic information. Our executive officers, directors and other employees may also trade our stock outside of the stock trading programs set up under Rule 10b5-1 subject to our blackout periods and insider trading rules.

Scientific Advisory Group

We have assembled scientific and development advisors that provide us with expertise in critical scientific, development, engineering, manufacturing and business issues facing us. The scientific advisory group assists us on issues related to pulmonary delivery, pulmonary toxicology, aerosol science, government regulation, product selection and clinical trial design. Its members are called upon individually as needed and include, among others:

Name	Affiliation	Area of Expertise
Dean Hess, Ph.D.	Assistant Professor of Anesthesia, Harvard Medical School, Massachusetts General Hospital	Critical Care, Aerosol Delivery
Dennis Maki, M.D.	Ovid O. Meyer Professor of Medicine Head, Section of Infectious Disease, Department of Medicine, University of Wisconsin Medical School	Infectious Disease
Neil MacIntyre, M.D.	Medical Director of Respiratory Care Services, Pulmonary Function Laboratory, and Pulmonary Rehabilitation Program	Critical Care Medicine
Michael Matthay, M.D.	Professor of Medicine and Anesthesiology, University of California, San Francisco	Pulmonology
Jeanine Wiener-Kronish, M.D.	Professor of Anesthesia and Medicine, Investigator, CVRI, University of California, San Francisco	Anesthesia

Proprietary Products Strategic Advisory Board

We have assembled a regulatory affairs board to assist and advise us on matters relating to efficient and effective regulatory processing and to better assist us and our collaborative partners in obtaining regulatory approval for our products. The board currently includes the following:

Name	Affiliation	Area of Expertise
Carl C. Peck, M.D.	Professor of Pharmacology and Medicine, Director, Center for Drug Development, Georgetown University Medical Center	Clinical regulatory and development strategy
David Savello, Ph.D.	Executive Vice President and Chief Technology Officer, R.P. Scherer, Inc.	Pharmaceutical research and development and regulatory affairs
Phillip B. White	Director, Medical Device Consulting, AAC Consulting (Retired)	Device regulatory affairs
Allen J. Sedman, M.D., Ph.D.	Vice President, Clinical Sciences Head, Pfizer Global Research and Development, Ann Arbor, Michigan (Retired)	Clinical drug development in general; special expertise in clinical pharmacology

Pulmonary Advisory Committee

We have assembled a pulmonary advisory committee to assist and advise us on matters relating to identification and understanding of potential pulmonary issues encountered in our development programs. The committee currently includes the following:

Name	Affiliation	Area of Expertise
Jedd Shellito, M.D.	Professor of Microbiology, Immunology and Parasitology, Louisiana State University	Pulmonary Host Defense/Immunology
Talmadge King, M.D.	Chief of Medical Services at San Francisco General Hospital; Professor and Vice Chairman Department of Medicine, University of California, San Francisco	Pulmonary Medicine
Warren Gold, M.D.	Professor of Medicine, University of California, San Francisco	Pulmonary Function Testing
Michael Matthay, M.D.	Professor of Medicine and Anesthesiology, University of California, San Francisco	Pulmonary Medicine & Critical Care
Paul Blanc, M.D.	Professor of Medicine, University of California, San Francisco, Chief, Division of Occupational and Environmental Medicine, University of California, San Francisco	Occupational/Environmental Medicine
Rubin Tuder, M.D.	Director Cardiopulmonary Pathology, Johns Hopkins University	Pulmonary Pathology
Jay K Kolls, M.D.	Professor of Pediatrics, Chief of Pediatric Pulmonology	Children’s Hospital of Pittsburgh, PA

Item 11. Executive Compensation

Information required by this item will be set forth in the Proxy Statement under the headings “Executive Compensation,” “Election of Directors,” and “Compensation Committee Interlocks and Insider Participation,” which information is incorporated herein by reference. Information contained in the Proxy Statement under the caption “Report of the Compensation Committee of the Board of Directors on Executive Compensation,” “Report of the Audit Committee of the Board of Directors” and “Performance Measurement Comparison” is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information required by this item will be set forth in the Proxy Statement under the headings “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” which information is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

Information required by this item will be set forth in the Proxy Statement under the headings “Compensation Committee Interlocks and Insider Participation” and “Certain Transactions,” which information is incorporated herein by reference.

Item 14. Principal Accountants Fees and Services

Information regarding our Independent Registered Public Accounting Firm’s Fees and our procedure regarding approval of non audit work performed by our Independent Auditor will be set forth in the Proxy Statement under the heading “Ratification of Selection of Independent Auditors,” which information is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) The following documents are filed as part of this report:

(1) Consolidated Financial Statements:

The following financial statements are filed as part of this report under Item 8 “Financial Statements and Supplementary Data.”

(2) Financial Statement Schedules:

Schedule II, *Valuation and Qualifying Accounts and Reserves*, is filed as part of this Annual Report on Form 10-K. All other financial statement schedules have been omitted because they are not applicable, or the information required is presented in our consolidated financial statements and notes thereto under Item 8 of this Annual Report on Form 10-K.

(3) Exhibits.

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

Exhibit Number		Description of Documents
2.1	(1)	Agreement and Plan of Merger, dated June 4, 1998, by and between Inhale Therapeutic Systems, a California corporation, and Inhale Therapeutic Systems (Delaware), Inc., a Delaware corporation.
2.2	(5)	Recommended Offer, dated December 21, 2000, by Cazenove & Co. on behalf of Nektar Therapeutics for Bradford Particle Design plc.
2.3	(8)	Agreement and Plan of Merger and Reorganization, dated May 22, 2001, by and among Nektar Therapeutics, Square Acquisition Corp., Shearwater Corporation, Certain Shareholders of Shearwater Corporation and J. Milton Harris as Shareholders’ Agent.
2.4	(8)	Amendment to Agreement and Plan of Merger and Reorganization, dated June 21, 2001, by and among Nektar Therapeutics, Square Acquisition Corp., Shearwater Corporation, J. Milton Harris, as Shareholders’ Agent and a Designated Shareholder, and Puffinus, L.P.
3.1	(1)	Certificate of Incorporation of Inhale Therapeutic Systems (Delaware), Inc.
3.2	(1)	Bylaws of Nektar Therapeutics.
3.3	(3)	Certificate of Amendment of the Amended Certificate of Incorporation of Nektar Therapeutics.

Exhibit Number		Description of Documents
3.4	(7)	Certificate of Designation of Series A Junior Participating Preferred Stock of Nektar Therapeutics.
3.5	(9)	Certificate of Designation of Series B Convertible Preferred Stock of Nektar Therapeutics.
3.6	(10)	Certificate of Ownership and Merger of Nektar Therapeutics.
4.1		Reference is made to Exhibits 3.1, 3.2, 3.3, 3.4, 3.5 and 3.6.
4.2	(2)	Indenture, dated February 8, 2000, by and between Nektar Therapeutics, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.3	(10)	Specimen Common Stock certificate.
4.4	(4)	Specimen warrants to purchase shares of Common Stock.
4.5	(6)	Indenture, dated October 17, 2000, by and between Nektar Therapeutics, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.6	(7)	Rights Agreement, dated as of June 1, 2001, by and between Nektar Therapeutics and Mellon Investor Services LLC., as Rights Agent.
4.7	(7)	Form of Right Certificate.
4.8	(11)	Resale Registration Rights Agreement, dated June 30, 2003, by and among Nektar Therapeutics, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc., Friedman, Billings, Ramsey & Co. Inc. and SG Cowen Securities Corporation
4.9	(12)	Resale Registration Rights Agreement, dated October 9, 2003, by and among Nektar Therapeutics and the entities named therein.
10.1	(13)	Nektar Therapeutics' 1994 Non-Employee Directors' Stock Option Plan, as amended.
10.2	(14)	Nektar Therapeutics' 1994 Employee Stock Purchase Plan, as amended and restated.++
10.3	(15)	Standard Industrial Lease, dated September 17, 1992, as amended September 18, 1992, by and between Nektar Therapeutics and W.F. Batton & Co., Inc.
10.4	(15)	Addendum IV to Lease dated September 17, 1992, dated April 1, 1994, by and among Nektar Therapeutics, W.F. Batton and Marie A. Batton.
10.5	(16)	Amendment Agreement Number One to Lease dated September 17, 1992, dated October 20, 1995, by and between Nektar Therapeutics and W.F. Batton & Co., Inc.
10.6	(16)	Amendment Agreement Number Two to Lease dated September 17, 1992, dated November 15, 1995, by and among Nektar Therapeutics, W.F. Batton and Marie A. Batton, Trustees of the W.F. Batton and Marie A. Batton Trust UTA dated January 12, 1998 ("Batton Trust").
10.7	(17)	Amendment Agreement Number Three to Lease dated September 17, 1992, dated February 14, 1996, by and between Nektar Therapeutics and Batton Trust.
10.8	(17)	Amendment Agreement Number Four to Lease dated September 17, 1992, dated September 15, 1996, by and between Nektar Therapeutics and Batton Trust.
10.9	(15)	Sublicense Agreement, dated September 13, 1991, by and between Nektar Therapeutics and John S. Patton.++
10.10	(18)	Stock Purchase Agreement, dated March 1, 1996, by and between Nektar Therapeutics and Baxter World Trade Corporation.

Exhibit Number		Description of Documents
10.11	(19)	Sublease and Lease Agreement, dated October 2, 1996, by and between Nektar Therapeutics and T.M.T. Associates L.L.C. (“Landlord”).
10.12	(17)	First Amendment to Sublease and Lease Agreement dated October 2, 1996, dated October 30, 1996, by and between Nektar Therapeutics and Landlord.
10.13	(17)	Letter Agreement amending Sublease and Lease Agreement dated October 2, 1996, dated April 9, 1997, by and between Nektar Therapeutics and Landlord.
10.14	(17)	Third Amendment to Sublease and Lease Agreement dated October 2, 1996, dated April 16, 1997, by and between Nektar Therapeutics and Landlord.
10.15	(17)	Fourth Amendment to Sublease and Lease Agreement dated October 2, 1996, dated November 5, 1997, by and between Nektar Therapeutics and Landlord.
10.16	(2)	Sublease, dated November 3, 1999, by and between Webvan Group, Inc., as sublessor, and Nektar Therapeutics, as sublessee.
10.17	(20)	Nektar Therapeutics’ 2000 Equity Incentive Plan, as amended.++
10.18	(4)	Nektar Therapeutics’ Stock Option Agreement issued in accordance with Nektar Therapeutics’ 2000 Equity Incentive Plan, as amended.++
10.19	(4)	Contribution Agreement, made and entered into as of September 14, 2000, by and among Nektar Therapeutics, Inhale 201 Industrial Road, L.P., a California limited partnership and Bernardo Property Advisors, Inc., a California corporation.
10.20	(4)	Agreement of Limited Partnership of Inhale 201 Industrial Road., L.P., a California limited partnership, made and entered into September 14, 2000, by and among SCIMED PROP III, Inc., a California corporation, as general partner, 201 Industrial Partnership, a California general partnership, as limited partner and Nektar Therapeutics, as limited partner.
10.21	(4)	Build-To-Suit Lease, made and entered into as of September 14, 2000, by and between Inhale 201 Industrial Road, L.P., a California limited partnership, as Landlord, and Nektar Therapeutics, as Tenant.
10.22	(4)	Amendment to Lease, dated October 3, 2000, by and between Inhale 201 Industrial Road, L.P., a California limited partnership, as Landlord, and Nektar Therapeutics, as Tenant.
10.23	(4)	Parking Lease Agreement, entered into as of September 14, 2000, by and between Inhale 201 Industrial Road, L.P., a California limited partnership, as Landlord, and Nektar Therapeutics, as Tenant.
10.24	(20)	Nektar Therapeutics’ 2000 Non-Officer Equity Incentive Plan.++
10.25	(21)	Nektar Therapeutics 2000 Non-Officer Equity Incentive Plan Stock Option Agreement (Nonstatutory Stock Option).++
10.26	(21)	Nektar Therapeutics 2000 Non-Officer Equity Incentive Plan Stock Option Agreement (Nonstatutory (Unapproved) Stock Option).
10.27+	(22)	Manufacturing and Supply Agreement, dated August 16, 2000, by and among Nektar Therapeutics, Tech Group North America and Bespak Europe, LTD.
10.28	(23)	The Bradford Particle Design plc Approved Employee Share Option Scheme.
10.29	(23)	Form of The Bradford Particle Design plc Approved Employee Share Option Scheme Option Certificate.
10.30	(23)	The Bradford Particle Design plc Unapproved Employee Share Option Scheme.

Exhibit Number		Description of Documents
10.31	(23)	Form of The Bradford Particle Design plc Unapproved Employee Share Option Scheme Option Certificate.
10.32	(23)	Form of Agreement Granting an Enterprise Management Incentives Option.
10.33	(23)	Agreement Granting Options, dated November 5, 1999, by and between Mr. Joseph F. Bohan and Bradford Particle Design plc.
10.34	(23)	Agreement Granting Options, dated October 27, 2000, by and between Mr. Joseph F. Bohan and Bradford Particle Design plc.
10.35	(24)	Shearwater Corporation 1996 Nonqualified Stock Option Plan.
10.36	(24)	Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective May 22, 1998.
10.37	(24)	Second Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective February 26, 2000.
10.38	(24)	Third Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective October 5, 2000.
10.39	(24)	Fourth Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective June 22, 2001.
10.40	(24)	Form of Shearwater Corporation Nonqualified Stock Option Agreement.
10.41	(24)	Form of June 2001 Amendment to Shearwater Corporation Nonqualified Stock Option Agreement.
10.42	(20)	Nektar Therapeutics 401(k) Retirement Plan.++
10.43	(20)	Non-Standardized Adoption Agreement No. 001 for use with Nektar Therapeutics 401(k) Retirement Plan.
10.44+	(25)	Letter Agreement, dated July 31, 2002, by and between Nektar Therapeutics, and Douglas H. Altschuler.++
10.45	(26)	Letter Agreement, dated December 29, 2001 by and between Nektar Therapeutics and Dr. Arnold J. Repta.++
10.46	(26)	Nektar Therapeutics Severance Benefit Plan.++
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\+ Confidential treatment with respect to specific portions are omitted and filed separately with the SEC.
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(29) Filed herewith.

* Confidential Treatment Requested.

(b) Reports on Form 8-K for the three-month period ending December 31, 2004:

Current Report on Form 8-K, filed November 3, 2004, announcing that Nektar Therapeutics issued a press release announcing results of the quarter ended September 30, 2004. The information in that report, including the exhibit thereto, shall not be deemed "filed" for purposes of Section 18 of the 1934 Act, or otherwise subject to the liabilities of that Section or Sections 11 and 12(a)(2) of the 1933 Act. The information contained therein and in the accompanying exhibit thereto shall not be incorporated by reference into any filing with the SEC made by Nektar Therapeutics, whether made before or after the date thereof, regardless of any general incorporation language in such filing.

Current Report on Form 8-K, filed January 18, 2005, announcing that on January 17, 2005, Nevan Elam joined Nektar Therapeutics to serve as General Counsel and Secretary.

Current Report on Form 8-K, filed March 1, 2005, announcing that Nektar Therapeutics issued a press release announcing results of the quarter and the year ended December 31, 2004. The information in that report, including the exhibit thereto, shall not be deemed "filed" for purposes of Section 18 of the 1934 Act, or otherwise subject to the liabilities of that Section or Sections 11 and 12(a)(2) of the 1933 Act. The information contained therein and in the accompanying exhibit thereto shall not be incorporated by reference into any filing with the SEC made by Nektar Therapeutics, whether made before or after the date thereof, regardless of any general incorporation language in such filing.

SIGNATURES

Pursuant to 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, in the City of San Carlos, County of San Mateo, State of California on March 14, 2005.

By: /s/ AJIT S. GILL

Ajit S. Gill
Chief Executive Officer, President and Director

By: /s/ AJAY BANSAL

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

POWER OF ATTORNEY

KNOW ALL PERSON BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Ajit S. Gill and Ajay Bansal and each of them, as his or her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratify and confirming all that said attorneys-in-fact and agents, or any of them, or their or his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities and Exchange Act of 1934, as amended, this report has been signed by the following persons in the capacities and on the dates indicated:

SIGNATURE	TITLE	DATE
/s/ AJIT S. GILL **Ajit S. Gill**	President, Chief Executive Officer and Director (Principal Executive Officer)	March 14, 2005
/s/ ROBERT B. CHESS **Robert B. Chess**	Executive Chairman of the Board of Directors	March 14, 2005
/s/ AJAY BANSAL **Ajay Bansal**	Vice President, Finance and Administration and Chief Financial Officer (Principal Financial and Accounting Officer)	March 14, 2005
/s/ JOHN S. PATTON, PH.D. **John S. Patton, Ph.D.**	Founder, Chief Scientific Officer and Director	March 14, 2005
/s/ MICHAEL A. BROWN **Michael A. Brown**	Director	March 14, 2005
/s/ CHRISTOPHER A. KUEBLER **Christopher A. Kuebler**	Director	March 14, 2005
/s/ IRWIN LERNER **Irwin Lerner**	Director	March 14, 2005
/s/ MELVIN PERELMAN, PH.D. **Melvin Perelman, Ph.D.**	Director	March 14, 2005
/s/ SUSAN WANG **Susan Wang**	Director	March 14, 2005
/s/ ROY A. WHITFIELD **Roy A. Whitfield**	Director	March 14, 2005

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

Exhibit Number		Description of Documents
2.1	(1)	Agreement and Plan of Merger, dated June 4, 1998, by and between Inhale Therapeutic Systems, a California corporation, and Inhale Therapeutic Systems (Delaware), Inc., a Delaware corporation.
2.2	(5)	Recommended Offer, dated December 21, 2000, by Cazenove & Co. on behalf of Nektar Therapeutics for Bradford Particle Design plc.
2.3	(8)	Agreement and Plan of Merger and Reorganization, dated May 22, 2001, by and among Nektar Therapeutics, Square Acquisition Corp., Shearwater Corporation, Certain Shareholders of Shearwater Corporation and J. Milton Harris as Shareholders' Agent.
2.4	(8)	Amendment to Agreement and Plan of Merger and Reorganization, dated June 21, 2001, by and among Nektar Therapeutics, Square Acquisition Corp., Shearwater Corporation, J. Milton Harris, as Shareholders' Agent and a Designated Shareholder, and Puffinus, L.P.
3.1	(1)	Certificate of Incorporation of Inhale Therapeutic Systems (Delaware), Inc.
3.2	(1)	Bylaws of Nektar Therapeutics.
3.3	(3)	Certificate of Amendment of the Amended Certificate of Incorporation of Nektar Therapeutics.
3.4	(7)	Certificate of Designation of Series A Junior Participating Preferred Stock of Nektar Therapeutics.
3.5	(9)	Certificate of Designation of Series B Convertible Preferred Stock of Nektar Therapeutics.
3.6	(10)	Certificate of Ownership and Merger of Nektar Therapeutics.
4.1		Reference is made to Exhibits 3.1, 3.2, 3.3, 3.4, 3.5 and 3.6.
4.2	(2)	Indenture, dated February 8, 2000, by and between Nektar Therapeutics, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.3	(10)	Specimen Common Stock certificate.
4.4	(4)	Specimen warrants to purchase shares of Common Stock.
4.5	(6)	Indenture, dated October 17, 2000, by and between Nektar Therapeutics, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.6	(7)	Rights Agreement, dated as of June 1, 2001, by and between Nektar Therapeutics and Mellon Investor Services LLC., as Rights Agent.
4.7	(7)	Form of Right Certificate.
4.8	(11)	Resale Registration Rights Agreement, dated June 30, 2003, by and among Nektar Therapeutics, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc., Friedman, Billings, Ramsey & Co. Inc. and SG Cowen Securities Corporation
4.9	(12)	Resale Registration Rights Agreement, dated October 9, 2003, by and among Nektar Therapeutics and the entities named therein.
10.1	(13)	Nektar Therapeutics' 1994 Non-Employee Directors' Stock Option Plan, as amended.
10.2	(14)	Nektar Therapeutics' 1994 Employee Stock Purchase Plan, as amended and restated.++

Exhibit Number		Description of Documents
10.3	(15)	Standard Industrial Lease, dated September 17, 1992, as amended September 18, 1992, by and between Nektar Therapeutics and W.F. Batton & Co., Inc.
10.4	(15)	Addendum IV to Lease dated September 17, 1992, dated April 1, 1994, by and among Nektar Therapeutics, W.F. Batton and Marie A. Batton.
10.5	(16)	Amendment Agreement Number One to Lease dated September 17, 1992, dated October 20, 1995, by and between Nektar Therapeutics and W.F. Batton & Co., Inc.
10.6	(16)	Amendment Agreement Number Two to Lease dated September 17, 1992, dated November 15, 1995, by and among Nektar Therapeutics, W.F. Batton and Marie A. Batton, Trustees of the W.F. Batton and Marie A. Batton Trust UTA dated January 12, 1998 (“Batton Trust”).
10.7	(17)	Amendment Agreement Number Three to Lease dated September 17, 1992, dated February 14, 1996, by and between Nektar Therapeutics and Batton Trust.
10.8	(17)	Amendment Agreement Number Four to Lease dated September 17, 1992, dated September 15, 1996, by and between Nektar Therapeutics and Batton Trust.
10.9	(15)	Sublicense Agreement, dated September 13, 1991, by and between Nektar Therapeutics and John S. Patton.++
10.10	(18)	Stock Purchase Agreement, dated March 1, 1996, by and between Nektar Therapeutics and Baxter World Trade Corporation.
10.11	(19)	Sublease and Lease Agreement, dated October 2, 1996, by and between Nektar Therapeutics and T.M.T. Associates L.L.C. (“Landlord”).
10.12	(17)	First Amendment to Sublease and Lease Agreement dated October 2, 1996, dated October 30, 1996, by and between Nektar Therapeutics and Landlord.
10.13	(17)	Letter Agreement amending Sublease and Lease Agreement dated October 2, 1996, dated April 9, 1997, by and between Nektar Therapeutics and Landlord.
10.14	(17)	Third Amendment to Sublease and Lease Agreement dated October 2, 1996, dated April 16, 1997, by and between Nektar Therapeutics and Landlord.
10.15	(17)	Fourth Amendment to Sublease and Lease Agreement dated October 2, 1996, dated November 5, 1997, by and between Nektar Therapeutics and Landlord.
10.16	(2)	Sublease, dated November 3, 1999, by and between Webvan Group, Inc., as sublessor, and Nektar Therapeutics, as sublessee.
10.17	(20)	Nektar Therapeutics’ 2000 Equity Incentive Plan, as amended.++
10.18	(4)	Nektar Therapeutics’ Stock Option Agreement issued in accordance with Nektar Therapeutics’ 2000 Equity Incentive Plan, as amended.++
10.19	(4)	Contribution Agreement, made and entered into as of September 14, 2000, by and among Nektar Therapeutics, Inhale 201 Industrial Road, L.P., a California limited partnership and Bernardo Property Advisors, Inc., a California corporation.
10.20	(4)	Agreement of Limited Partnership of Inhale 201 Industrial Road., L.P., a California limited partnership, made and entered into September 14, 2000, by and among SCIMED PROP III, Inc., a California corporation, as general partner, 201 Industrial Partnership, a California general partnership, as limited partner and Nektar Therapeutics, as limited partner.
10.21	(4)	Build-To-Suit Lease, made and entered into as of September 14, 2000, by and between Inhale 201 Industrial Road, L.P., a California limited partnership, as Landlord, and Nektar Therapeutics, as Tenant.

Exhibit Number		Description of Documents
10.22	(4)	Amendment to Lease, dated October 3, 2000, by and between Inhale 201 Industrial Road, L.P., a California limited partnership, as Landlord, and Nektar Therapeutics, as Tenant.
10.23	(4)	Parking Lease Agreement, entered into as of September 14, 2000, by and between Inhale 201 Industrial Road, L.P., a California limited partnership, as Landlord, and Nektar Therapeutics, as Tenant.
10.24	(20)	Nektar Therapeutics' 2000 Non-Officer Equity Incentive Plan.++
10.25	(21)	Nektar Therapeutics 2000 Non-Officer Equity Incentive Plan Stock Option Agreement (Nonstatutory Stock Option).++
10.26	(21)	Nektar Therapeutics 2000 Non-Officer Equity Incentive Plan Stock Option Agreement (Nonstatutory (Unapproved) Stock Option).
10.27+	(22)	Manufacturing and Supply Agreement, dated August 16, 2000, by and among Nektar Therapeutics, Tech Group North America and Bespak Europe, LTD.
10.28	(23)	The Bradford Particle Design plc Approved Employee Share Option Scheme.
10.29	(23)	Form of The Bradford Particle Design plc Approved Employee Share Option Scheme Option Certificate.
10.30	(23)	The Bradford Particle Design plc Unapproved Employee Share Option Scheme.
10.31	(23)	Form of The Bradford Particle Design plc Unapproved Employee Share Option Scheme Option Certificate.
10.32	(23)	Form of Agreement Granting an Enterprise Management Incentives Option.
10.33	(23)	Agreement Granting Options, dated November 5, 1999, by and between Mr. Joseph F. Bohan and Bradford Particle Design plc.
10.34	(23)	Agreement Granting Options, dated October 27, 2000, by and between Mr. Joseph F. Bohan and Bradford Particle Design plc.
10.35	(24)	Shearwater Corporation 1996 Nonqualified Stock Option Plan.
10.36	(24)	Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective May 22, 1998.
10.37	(24)	Second Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective February 26, 2000.
10.38	(24)	Third Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective October 5, 2000.
10.39	(24)	Fourth Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective June 22, 2001.
10.40	(24)	Form of Shearwater Corporation Nonqualified Stock Option Agreement.
10.41	(24)	Form of June 2001 Amendment to Shearwater Corporation Nonqualified Stock Option Agreement.
10.42	(20)	Nektar Therapeutics 401(k) Retirement Plan.++
10.43	(20)	Non-Standardized Adoption Agreement No. 001 for use with Nektar Therapeutics 401(k) Retirement Plan.
10.44+	(25)	Letter Agreement, dated July 31, 2002, by and between Nektar Therapeutics, and Douglas H. Altschuler.++

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* Confidential Treatment Requested.

EXHIBIT 10.52

[*] = CERTAIN CONFIDENTIAL INFORMATION CONTAINED IN THIS DOCUMENT, MARKED BY BRACKETS, HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO RULE 24B-2 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

COLLABORATIVE DEVELOPMENT

AND

LICENSE AGREEMENT

BETWEEN

INHALE THERAPEUTIC SYSTEMS

AND

PFIZER INC.

January 18, 1995

[*] = CERTAIN CONFIDENTIAL INFORMATION CONTAINED IN THIS DOCUMENT, MARKED BY BRACKETS, HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO RULE 24B-2 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

TABLE OF CONTENTS

Exhibits

Exhibit 7.1 Outline of Manufacturing and Supply Agreement
Exhibit 10.1 Clinical and Non-clinical Studies

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COLLABORATIVE DEVELOPMENT AND LICENSE AGREEMENT

This Agreement is made and entered into 18 January 1995 and is effective as of the Effective Date (as defined in Section 17.1) by and between INHALE THERAPEUTIC SYSTEMS, a California corporation ("INHALE"), and PFIZER INC., a Delaware corporation ("PFIZER"). INHALE and PFIZER are sometimes referred to herein individually as a "Party" and collectively as the "Parties", and references to "INHALE" and "PFIZER" shall include their respective Affiliates.

RECITALS

WHEREAS, INHALE is engaged in the research and development of proprietary devices, dry powder formulations and dry powder processing and filling technology for pulmonary drug delivery;

WHEREAS, PFIZER and INHALE entered into non-disclosure agreements dated 6 July 1993, 29 April 1994, and 29 July 1994 (collectively "Non-disclosure Agreements") relating to the exchange of confidential and proprietary information regarding the pulmonary delivery of Regular Insulin;

WHEREAS, PFIZER desires to have INHALE develop dry powder formulations of Regular Insulin and Devices for pulmonary delivery of such formulations and manufacture such dry powder formulations and Devices;

WHEREAS, PFIZER desires to obtain an exclusive license to market and sell in the Territory, such dry powder formulations of Regular Insulin with a suitable Device developed by INHALE and INHALE desires to grant such a license on the terms and conditions of this Agreement; and

WHEREAS, PFIZER and INHALE have entered into that certain Stock Purchase Agreement executed on the same date(s) as this Agreement (the "Stock Purchase Agreement!').

AGREEMENT

Now, THEREFORE, in consideration of the foregoing and the covenants and promises contained in this Agreement, the Parties agree as follows:

1. Definitions. As used herein, the following terms shall have the following in meanings:

1.1 "Affiliate" means a corporation, partnership, trust or other entity that directly, or indirectly through one or more intermediates, controls, is controlled by or is under

common control with a Party to this Agreement. For such purposes, "control," "controlled by" and "under common control with" shall mean the possession of the power to direct or cause the direction of the management and policies of an entity, whether through the ownership of voting stock or partnership interest, by contract or otherwise. In the case of a corporation, the direct or indirect ownership of more than fifty percent (50%) of its outstanding voting shares shall in any event be deemed to confer control, it being understood that the direct or indirect ownership of a lesser percentage of such shares shall not necessarily preclude the existence of control.

1.2 "Baseline Cost" means **[*]** cost that **[*]** in order to **[*]**. The Baseline Cost of **[*]** shall be **[*]**.

1.3 "Compulsory License" means a compulsory license under the INHALE Patents or INHALE Know-How obtained by a third party through the order, decree, or grant of a competent governmental authority, authorizing such third party to manufacture, use or sell Products in the Territory or in any portion thereof.

1.4 "Control" means the ability to grant a license or sublicense as provided for herein without violating the terms of any agreement or other arrangement with any third party.

1.5 "Corporate Overhead" means **[*]** expenses **[*]**.

1.6 "Cut of Goods Sold" shall be the sum of the following costs to the extent allocable to Products sold by PFIZER: **[*]**. The Cost of Goods Sold shall **[*]**. The Cost of Goods Sold shall be calculated in a manner consistent with Generally Accepted Accounting Principles ("GAAP") consistently applied. The methodology to be used in making the allocations referred to above shall be proposed by PFIZER and subject to the approval of INHALE, shall be consistent with PFIZER's methodology for other products, and shall be consistent from year-to-year.

1.7 "Device" means any device for the pulmonary delivery of macromolecules designed and/or manufactured by or for INHALE, including P2, P3, Commercial and Standard devices. "P2 Device" means a Device suitable for use in a take-home Phase II clinical trial of Regular Insulin which substantially meets the performance specifications set forth in a separate written agreement between the Parties. "P3 Device" means a Device suitable for use in a take-home Phase III clinical trial or equivalent pivotal study which substantially meets the performance specifications set forth in a separate written agreement between the Parties. "Commercial Device" means any Device that PFIZER sells commercially under this Agreement which substantially meets the performance specifications set forth in a separate written agreement between the Parties. "Standard Device" means any Device that has not been significantly modified at the request and expense of PFIZER. The foregoing performance specifications are subject to modifications recommended by the JDC and approved by the Parties. Unless otherwise noted, the use of the term "device" in this Agreement is not intended to indicate thereby the definition of "device" in the Federal Food, Drug and Cosmetic Act, as amended.

1.8 "Field" means the development, manufacture, use and sale of the Products that are or could be developed and sold under this Agreement.

1.9 "FTE" means 1880 labor hours per year. The FM rate shall be calculated annually by INHALE based on total budgeted research and development expenses divided by the total number of staff years (FTE) chargeable to projects plus a pro ram (based on research and development headcount) allocation of general, administrative and facilities expenses. This rate shall be **[*]** per staff year (FTE) for 1995 and shall not increase at a rate in excess of the Consumer Price Index when recalculated on an annual basis. The methodology to be used in making the allocations referred to above shall be consistent with INHALE's methodology for other products, and shall be consistent from year-to-year.

1.10 "Fully Burdened Cost" shall be the sum of the following costs to the extent allocable to Products sold to PFIZER **[*]** PFIZER: **[*]**. Fully Burdened Cost **[*]**. Fully Burdened Cost shall be calculated in a manner consistent with Generally Accepted Accounting Principles ("GAAP") consistently applied. The methodology to be used in making the allocations referred to above shall be proposed by INHALE and subject to the approval of PFIZER, shall be consistent with INHALE's methodology for other products and shall be consistent from year-to-year.

1.11 "Information" means (i) techniques and data relating to the Field, including, but not limited to, ideas (including patentable inventions), inventions, practices, methods, knowledge, know-how, trade secrets, skill, experience, documents, apparatus, clinical and regulatory strategies, test data, including pharmacological, toxicological and clinical test data, analytical and quality control data, manufacturing, patent and legal data or descriptions and (ii) Devices, chemical formulations, compositions of matter, product samples and assays relating to the Field.

1.12 "INHALE Know-how" means all Information that is (a) owned or Controlled by INHALE, at any time during the Term of this Agreement and (b) useful or necessary in the Field. INHALE Know-how does not include INHALE Patent Rights.

1.13 "INHALE Patent Rights" means the rights granted by any governmental authority under (a) the Patents listed in Exhibit 1.13, (b) any Patents that issue from the Patent Applications listed in Exhibit 1.13 and (c) any other Patent that covers a method, apparatus, material or manufacture necessary or useful in the Field, which Patent is owned or Controlled by INHALE and covers an invention made before or during the Term of this Agreement. INHALE Patent Rights do not include PFIZER Patent Rights.

1.14 "Major European Country" means each of **[*]**.

1.15 "Major Other Country" means each of **[*]**.

1.16 "Major Western Country" means each of **[*]**.

1.17 "Net Sales" means the dollar amount invoiced by PFIZER or its licensee for the sales to unaffiliated third parties of any Product upon which a royalty is owed INHALE pursuant to this Agreement less: (a) customary trade, cash and quantity discounts actually allowed and taken; (b) allowances actually given for returned or rejected Products; (c) actual charges for bad debts; (d) freight and insurance if included in the price; (e) government mandated and other rebates; and (f) value added tax, sales, use or turnover taxes, excise taxes and customs duties included in the invoiced price.

1.18 "NDA" means (a) the single application or set of applications for approval and/or pre-market approval to make and sell commercially both a formulation of Regular Insulin and a compatible Commercial Device, filed by PFIZER, with the United States Food and Drug Administration ("FDA") or any successor agency having the administrative authority to regulate the approval for marketing of new human pharmaceutical or biological therapeutic products, delivery systems and devices in the United States and (b) any related registrations with or notifications to the FDA.

1.19 "Non-clinical" means any non-human studies or data generated in anticipation of submission for Regulatory Approval.

1.20 "Other **[*]** Products" means **[*]**.

1.21 "Patent" means (i) valid and enforceable letters patent and utility models including any extension, registration, confirmation, reissue, re-examination or renewal thereof and (ii) to the extent valid and enforceable rights are granted by a governmental authority thereunder, a Patent Application.

1.22 "Patent Application" means an application for letters patent.

1.23 "PFIZER Know-how" means all Information that is (a) owned or Controlled by PFIZER at any time during the Term of this Agreement and (b) useful or necessary in the Field.

1.24 "PFIZER Patent Rights" means the rights granted by any governmental authority under a Patent that covers a method, apparatus, material or manufacture necessary or useful in the Field, which Patent is owned or Controlled by PFIZER and covers an invention made before or during the Term of this Agreement. PFIZER Patent Rights do not include INHALE Patent Rights.

1.25 "Product(s)" means any and all formulations of Regular Insulin and any and all Devices, the manufacture, use or sale of which would constitute a misappropriation of INHALE Know-how and/or infringement of INHALE Patent Rights but for the licenses granted in this Agreement

1.26 "Project" means the research and development program to be conducted by INHALE, and PFIZER under this Agreement pursuant to Section 3 with respect to Regular Insulin formulations and Devices for their delivery, and if the Parties mutually agree in writing, other research and development programs agreed to pursuant to Section 18.2.

1.27 "Regular Insulin" means **[*]**.

1.28 "Regulatory Approval" means (a) in the United States, approval by the FDA of an NDA and satisfaction of any related applicable FDA registration and notification requirements (if any) and (b) in any country other the United States, approval by regulatory authorities having jurisdiction over such country of a single application or set of applications filed by PFIZER comparable to an NDA and satisfaction of any related applicable regulatory and notification requirements, if any, together with my other approval necessary to make and sell commercially in such country both a formulation of Regular Insulin and a compatible Commercial Device including, where applicable, satisfactory labeling and pricing approval, and, if necessary for commercialization of Products, governmental or third party reimbursement approval and/or inclusion of such formulation and Commercial Device on any governmental formularies effective in such country.

1.29 "Term of this Agreement" means the period of time during which this Agreement is in effect under Section 17.2.

1.30 "Territory" means all the countries of the world.

2. Equity Investment by PFIZER in INHALE Common Stock. PFIZER shall make equity investments in INHALE in the form of the purchase of INHALE Common Stock according to the terms and conditions of the Stock Purchase Agreement executed on the same date(s) as this Agreement.

3. Development Program: Funding

3.1 Project. PFIZER and INHALE will engage in a Project for the joint development of Products. Both parties will use diligent efforts to develop Products in accordance with the Responsibility Chart attached as Exhibit 3.1.

3.2 Project Management, Joint Development Committee, Work Plan and Cost Estimate.

(a) Organization. On the Effective Date, the Parties shall organize a Joint Development Committee ("JDC") consisting of the members from each Party. Each Party will elect one of its three members to serve as a co-chairperson.

(b) Function. The function of the JDC shall be to plan, coordinate and manage the overall Project and to serve as a forum for communication between the Parties. Each co-chairperson of the JDC will be responsible for keeping the Party he or she represents informed of the status of the Project. The JDC is not intended to replace any internal management procedures of either Party but rather to be a vehicle to insure the overall Project proceeds in a timely and coordinated fashion.

(c) Decision Making The JDC **[*]** as having the **[*]** for such activity.

(d) Work Plan and Cost Estimate The JDC will develop and modify from time to time a Work Plan ("Work Plan") that covers the entire Project including but not limited to Device development, powder processing, powder filling, clinical supplies, pre-clinical development, clinical development, manufacturing and regulatory matters. The Work Plan will outline in detail the objectives, activities, responsibility, funding and timing of the Project work to be done for the next calendar year. The JDC will also develop in detail a cost estimate ("Cost Estimate") for the Project work to be done by INHALE and funded by PFIZER for the next calendar year. An outline of the 1995 Work Plan and Cost Estimate is the subject of a separate written agreement between the Parties. **[*]**, the JDC will develop and propose to the Parties for approval a detailed 1995 Work Plan and Cost Estimate, which the Parties shall either approve, modify or reject **[*]**, the JDC will develop and propose to the Parties for approval a detailed Work Plan and Cost Estimate for the next calendar year and an outline of the Work Plan and Cost Estimate for the **[*]** calendar years, which the Parties will either approve, modify or reject by **[*]**.

(e) Rules & Logistics The rules governing and logistics of the JDC shall include, but are not limited to, the following, which can be modified by the JDC from time to time:

(i) The timing, agenda, and minutes of each JDC meeting will be the responsibility of the co-chairperson hosting the meeting.

(ii) The location of the JDC meeting will alternate between INHALE's facility in Palo Alto and one of PFIZER's facilities.

(iii) The JDC will meet no fewer than four times annually

(iv) Non-members of the JDC are welcome to participate provided prior notice is given.

(v) Minutes of each JDC meeting will be summarized within two weeks after the meeting and will not be official until the non-drafting co-chairperson has agreed to them.

(vi) Each Party will bear its own travel and lodging expenses associated with the JDC and its meetings.

(vii) JDC members reporting to a Party may be changed from time to time at the sole discretion of the Party with notice to the other Party.

(viii) Each Party will have reasonable access on an informal basis to the other's personnel assigned to the Project. **[*]** by INHALE and **[*]** may **[*]** and subsequently the **[*]**, or such other **[*]**. However, there may be **[*]**.

(f) Dispute Resolution If the JDC fails to reach a consensus on any material matter within its jurisdiction, including the Work Plan and Cost Estimate, the Parties shall refer the matter to the Chief Executive Officer of INHALE and the Vice President-Central Research of PFIZER. If such executives cannot agree on such matter within thirty (30) days after the matter is referred to them, the following provisions shall apply:

(i) If the disputed matter **[*]** shall decide how the matter shall be resolved **[*]** decision **[*]** after the matter was referred to **[*]** for resolution.

(ii) If the disputed matter **[*]** shall either 1) decide how the matter shall be resolved in which event **[*]** shall be responsible for **[*]** or 2) terminate this Agreement according to the provisions of Section 17.4, below. **[*]** after the matter was referred to **[*]** for resolution. **[*]** of which of the above options it has selected. During such period, all work **[*]** shall cease, except **[*]** for legal or medical reasons.

(iii) If neither Section 3.2(f)(i) nor (ii) apply to a disputed matter, the Parties shall decide mutually how the matter shall be resolved.

(g) Changes in Cost Estimate. PFIZER agrees to notify INHALE as soon as reasonably practicable of any planned revision of more than **[*]** to the Annual Cost Estimate which will become effective **[*]** following such notice unless the JDC reaches an agreement on earlier implementation.

3.3 Product Development Program: Resources and Costs

(a) PFIZER agrees to pay INHALE in advance, according, to the Cost Estimate, for certain of the work to be performed under this Agreement, including research, development, process scale-up and manufacture of clinical supplies, at INHALE's annually adjusted FTE rate which is **[*]** per FTE for 1995. Within **[*]** following the end of each calendar quarter, INHALE shall provide PFIZER with a report detailing the actual time spent by INHALE personnel on the Project during such quarter. PFIZER shall have the right to audit INHALE records with respect to such reports and the calculation of and adjustment to the FTE rates, in accordance with Section 8.2. Budgets for INHALE's research work shall be set forth in the respective Cost Estimate and shall reflect any changes in the FTE rate.

(b) PFIZER shall make the payments due under this Section 3.3 to INHALE quarterly in advance, with reconciling payments to be made based on an actual accounting after each quarter based on the actual number of FTE labor hours and expenditures expended in the Project and actual fully-allocated research and development costs to the extent PFIZER is responsible for such costs and expenses under this Agreement. In the event that actual costs are less than the amounts budgeted, PFIZER shall be entitled to apply any such variance toward future costs. **[*]**. In the event that **[*]**, such **[*]**. Any such **[*]** shall require the **[*]**.

3.4 Milestone Payments. In, addition to the payments provided for in Section 3.3 above, PFIZER shall make the following non-refundable milestone payments to INHALE upon occurrence of the following events:

(a) [*] [*];

(b) [*] [*];

(c) [*] [*]

(d) [*] [*];

(e) [*] [*];

(f) [*] [*]; and

(g) [*] [*].

All or a portion of such payments may be used by INHALE to fund its research activities under this Agreement.

(h) Except for the Device referred to in Section 3.4(c), INHALE shall not deliver to PFIZER clinical materials and Devices unless requested to do so by PFIZER via written request from PFIZER's JDC Co-Chairperson to INHALE's JDC Co-Chairperson.

(i) Pfizer's Co-Chairperson must provide INHALE's Co-Chairperson with written notice **[*]** Devices or clinical **[*]**, or such other time as the JDC may determine to be reasonable, of receipt by PFIZER of such Devices and clinical materials. If PFIZER fails to provide such notice within the allotted time period, such Devices and clinical materials shall be deemed accepted by PFIZER, unless, prior to making the associated milestone payments, **[*]** that was not discovered during such time period despite **[*]** of the Devices or clinical materials.

(j) In partial consideration of the grant of the license under INHALE Patent Rights and INHALE Know-How in **[*]**, PFIZER shall also make non-refundable payments to INHALE in the amount of **[*]**, **[*]**, and **[*]**. In addition, if the milestone payment provided for in Section 3.4(d) becomes due and PFIZER elects to initiate a development program for the Products in **[*]**, PFIZER shall make an additional non-refundable payment of **[*]**. Thereafter, for so long as PFIZER retains the license under INHALE Patent Rights and INHALE Know-How in **[*]**, PFIZER shall make the following non-refundable payments upon occurrence of the following events:

(i) **[*]**;

(ii) **[*]**;

(iii) **[*]**.

(k) The payments by PFIZER to INHALE due under Sections 3.4(b), (c), (d) & (e) shall be made **[*]**. The payments due under Sections 3.4(f) and (g) shall be made **[*]**. With respect to the payment by PFIZER to INHALE due under Section 3.4(b), the **[*]** referred to therein shall be deemed successful and PFIZER shall be deemed to have elected to proceed unless **[*]** PFIZER notifies INHALE in writing that it has elected not to proceed with the Project or requires more time to determine **[*]**. The payments due under Section 3.40(j) shall be made at the times specified in Section 3.40(j). **[*]**.

3.5 Subcontracting Permitted.. The Parties acknowledge and agree that portions of the work involved in the Project may be performed on behalf of either Party by third parties, at such Party's sole discretion, provided that, for any material subcontract, (a) such Party shall first have entered into written confidentiality agreements with the subcontractors and obtained written assignments granting such Party sole ownership of all patent rights and know-how that may be developed by the subcontractors, (b) such Party and the subcontractor shall be jointly and severally liable for the complete and timely performance by the subcontractor of the work, and (c) if work which INHALE desires to subcontract is required to be performed according to current Good Laboratory Practices or Good Manufacturing Practices, as established and revised from time to time by the FDA, then either **[*]**.

4. Record-keeping.

Each Party shall record, to the extent practical, all, Information relating to the Project in standard laboratory notebooks, which shall be signed, dated and witnessed. To the extent practical, such notebooks shall be kept separately from notebooks documenting other research and development of such Party. Each Party shall, require its employees and consultants to disclose any inventions relating to the Project in writing promptly after conception

5. Product Development.

5.1 Selection of **[*]**. PFIZER shall **[*]** evaluating and selecting **[*]** resulting from the Project for potential development into Products. PFIZER shall consult with INHALE in advance of making such selections.

5.2 Clinical Trials; Expenses. PFIZER shall be responsible for all future Non-clinical and clinical testing of formulations, **[*]**, although INHALE shall continue to provide such support for such testing as PFIZER reasonably requests as part of the Work Plan and Cost Estimate

5.3 **[*]** the Data, Database and IND's. PFIZER will **[*]** (a) all the data generated by the Non-clinical and clinical testing of the Products, (b) the database for such data, and (c) all IND's filed for clinical studies of the Products and any comparable regulatory filings outside the United States. INHALE shall **[*]**. Upon PFIZER's request, INHALE shall promptly assist PFIZER, and shall contractually obligate its vendors and subcontractors to assist PFIZER, in preparing and obtaining favorable review of IND's relating to the Products and the foreign equivalents of such IND's. If PFIZER so desires, INHALE shall transfer to PFIZER **[*]**.

5.4 Regulatory Filings. PFIZER or its licensees shall be responsible for the preparation of suitable applications for Regulatory Approval in the Territory and shall be the owner and party of record of all such applications. Subject to Section 6.6, PFIZER shall determine those initial countries of the Territory in which to file such applications. At PFIZER's request, INHALE shall promptly assist PFIZER, and shall contractually obligate its vendors and subcontractors to assist PFIZER in the preparation of such applications and the obtaining of Regulatory Approvals by, among other things, (a) **[*]**, (b) making INHALE's facilities available for inspections by the FDA and other governmental authorities, and making INHALE's personnel available to the FDA and other governmental authorities and (c) contractually obligating its vendors and subcontractors to make their facilities available for inspections by the FDA and other governmental authorities and to make their personnel available to the FDA and other governmental authorities.

5.5 Development Diligence. Both Parties acknowledge that the successful development of Products (including improvements thereto) under this Agreement will require a collaborative effort throughout the Term of this Agreement. Both Parties also acknowledge that because of the unprecedented nature of many of the components of the Project such as **[*]**, prediction of a development time line is likely to be a very dynamic process and difficult to fix with any certainty at this time. Therefore, both Parties agree to use diligent efforts to **[*]**. Each Party agrees to **[*]**. Neither Party will be responsible for delays due to factors beyond its control.

5.6 Packaging. If INHALE so requests, and to the extent allowable by law, PFIZER will identify, **[*]**, INHALE as the licensor and/or manufacturer of such Products. If INHALE so requests, and to the extent allowable by law, **[*]** will carry the INHALE mark. Notwithstanding the foregoing, if PFIZER reasonably believes, based on objective information, that identifying INHALE or using the INHALE mark will have an adverse impact on the image or commercialization of the Products, **[*]**, PFIZER will discuss the situation with INHALE and may, after such discussion, discontinue identifying INHALE or using the INHALE mark.

6. License Grant: Commercial Rights.

6.1 License to PFIZER. INHALE hereby grants PFIZER the sole and exclusive license in the Territory, with a right to sublicense, under INHALE Patent Rights and INHALE Know-how, to develop, use, make (subject to the terms and conditions of this Agreement and any supply agreement), and sell the Products.

6.2 License to INHALE. Except as otherwise provided in this Agreement, PFIZER hereby grants INHALE a non-exclusive, royalty-free license under PFIZER Patent Rights and PFIZER Know-how to the extent necessary to fulfill INHALE's obligations under this Agreement.

6.3 Royalties.

(a) INHALE Patents Royalty. In consideration of the grant of the license under INHALE Patent Rights to PFIZER under Section 6.1, PFIZER shall pay INHALE a royalty on Net Sales of each Product sold by PFIZER or its licensees in each country in which and for so long as the manufacture, use or sale of such Product would infringe INHALE Patent Rights in the absence of a license thereunder. The royalty percentage rate at which such royalty shall **[*]** be **[*]**:

[*]

However, in no event shall such royalty percentage rate **[*]**.

(b) INHALE Know-How Royalty. In consideration of the grant of the license under the INHALE Know-how to PFIZER under Section 6.1, PFIZER shall pay INHALE a royalty on Net Sales of each Product sold by PFIZER or its licensees in a country, for the longer of (i) the duration of PFIZER's royalty obligation under Section 6.3(a) with respect to Net Sales of the Product in such country, if any, and (ii) **[*]** after the first commercial sale of such Product in that country. Subject to the provisions of Section 6.3(c), the royalty percentage rate at which such royalty shall be **[*]**:

[*]

However, in no event shall such rate **[*]**.

(c) Royalty Basis. The royalties payable **[*]** shall be based upon **[*]**.

(d) Compulsory License. If in any country a third party obtains a Compulsory License, then INHALE shall promptly notify PFIZER. If the royalty rate payable by the grantee of the Compulsory License is **[*]**, the above royalty rates **[*]**.

6.4 Payments. Royalties payable under Section 6.3 will be paid to INHALE not later than **[*]** and each such payment shall be accompanied by a report in writing showing the period to which such payment applies, the amount billed to unaffiliated third parties for Products during such calendar quarter, the deductions from the amount billed to arrive at Net Sales, the total Net Sales for the period and the royalties due on such Net Sales. No later than **[*]**, the **[*]** for each Product shall be calculated by PFIZER for such calendar year and the actual royalty percentage rate shall be determined for such calendar year. Any variance from the royalties paid during such calendar year and the actual royalty due shall be reconciled **[*]**. The actual **[*]** for each Product for any calendar year shall be used to calculate the **[*]** royalty

payments due according to this Section 6.4 for the then current calendar year. For purposes of calculating the royalty percentage rate for the first fall calendar year of Product sales and any partial prior year, the **[*]** for each Product shall be **[*]**. Royalties payable under this Section 6.4 will be deposited by PFIZER, by the date due in a bank chosen by INHALE. Starting **[*]**, the payment shall bear interest at a rate of **[*]**.

6.5 Currency of Payment. All payments to be made by PFIZER to INHALE hereunder shall be made in U.S. Dollars. Net Sales outside the U.S. shall be first determined in the currency of the country in which they are earned and shall be converted quarterly into an amount in U.S. Dollars based on PFIZER's internal exchange rates used in preparing PFIZER's consolidated earnings statements for such quarter. All such converted Net Sales and Cost of Goods Sold (if applicable) shall be consolidated with U.S. Net Sales for the corresponding period and the applicable royalty payable determined therefrom.

6.6 Regulatory and Marketing Diligence.

(a) **[*]**. The license granted to PFIZER under Section 6.1 shall remain in effect in **[*]** provided PFIZER satisfies the following conditions:

(i) PFIZER directly or through third parties undertakes activities reasonably calculated to **[*]** in **[*]**; and

(ii) **[*]**, PFIZER directly or through a licensee **[*]**.

(b) **[*]**. The license granted to PFIZER under Section 6.1 shall in effect in **[*]** provided PFIZER satisfies the following conditions:

(i) For **[*]**, PFIZER directly or through third parties, (A) **[*]** and (B) undertakes activities reasonably calculated to **[*]**; and

(ii) If applications for Regulatory Approval are filed **[*]**, PFIZER will directly or through third parties undertake activities reasonably calculated to **[*]**, and will continue to undertake such activities until either Regulatory Approval is received in **[*]**; and

(iii) Within **[*]**, PFIZER directly or though a licensee **[*]**.

(c) **[*]**. Within **[*]**, PFIZER will either elect to initiate a development program for the Products **[*]**. If PFIZER elects to initiate the development program in **[*]**, the license granted to PFIZER under Section 6.1 shall remain thereafter in effect in **[*]** provided PFIZER satisfies the following conditions:

(i) PFIZER directly or through third parties (A) **[*]** and (B) following the date of PFIZER's election to initiate the development program in **[*]**, undertakes activities reasonably calculated to **[*]** in **[*]**.

(ii) Within **[*]**, PFIZER directly or through a licensee **[*]**.

(d) Other Countries. The license granted to PFIZER under Section 6.1 shall remain in effect outside the **[*]** provided PFIZER satisfies the following conditions:

(i) For **[*]**, directly or through third parties, (A) **[*]** and (B) undertakes activities reasonably calculated to **[*]** for such countries; and

(ii) If applications for Regulatory Approval are filed for **[*]** and any of such applications are denied definitively, PFIZER will directly or through third parties undertake activities reasonably calculated to **[*]**, and will continue to undertake such activities until either Regulatory Approval is received in **[*]** of the Major Other Countries or PFIZER concludes that continuing such activities cannot be justified; and

(iii) Within **[*]**, PFIZER directly or through a licensee launches the approved Products in each such country.

(e) PFIZER will be deemed to have satisfied the conditions set forth in clause (i) of Sections 6.6(a) through (d) if PFIZER directly or indirectly through third parties **[*]**. In addition, **[*]**.

(f) If PFIZER concludes that continuing to **[*]** cannot be justified due to **[*]**, PFIZER may satisfy its due diligence obligations under this Section 6.6 with respect to such country by **[*]**.

(g) Failure to satisfy the above conditions shall **[*]** in those countries of the specified geographic region in which PFIZER or its licensees **[*]**. Neither INHALE nor any third party will **[*]** in connection with **[*]**, absent agreement with PFIZER, **[*]** for such use.

6.7 Single Royalty. Royalties payable under Section 6.3 will be payable **[*]**.

6.8 Sublicensing. In the event PFIZER grants sublicenses under Section 6.1 to others to use or sell Products, such sublicenses shall require the sublicensee to account for and report its Net Sales of Products on the same basis as if such sales were Net Sales of Products by PFIZER, and PFIZER shall pay royalties to INHALE as if the Net Sales of the sublicensees were Net Sales of PFIZER.

6.9 Maintenance of Licenses from Third Parties. So as not to adversely affect PFIZER's rights to INHALE Patent Rights and INHALE Know-how under this Agreement, INHALE agrees during the Term of this Agreement: (a) not to take any actions to terminate or restrict its rights under any third party license agreements or other agreements which give rise to such rights and know-how, (b) to discharge all of INHALE's material obligations and responsibilities under any such third party license agreements or other agreements, including without limitation, making all required payments thereunder and (c) to notify PFIZER promptly of INHALE's receipt of any notices of breach under any such third party license agreements or other agreement.

7. Supply of Formulation and Devices.

7.1 General. Sections 7.2 through 7.6 set forth the terms and conditions that will govern the manufacture of Products for use in the Project prior to the commercialization, of Products, unless and until superseded by a manufacturing and supply agreement to be entered into after the Effective Date. The key terms that the Parties intend to include in any such manufacturing and supply agreement arc attached as Exhibit 7.1. The goal is to conclude such an agreement no later than the beginning of Phase III clinical trials or an equivalent pivotal study.

7.2 Manufacture of Regular Insulin Formulations for the Project

(a) **[*]**. At PFIZER's cost and in accordance with the Work Plan, PFIZER will supplement INHALE's existing inventory of **[*]** by delivering to INHALE such additional quantities of such **[*]** as are required in order to meet the Project needs throughout the Research Term. Notwithstanding such delivery, PFIZER **[*]**. INHALE will retain exclusive control over the **[*]** and not transfer any portion of the **[*]** to any third party not working on the Project without the advance written approval of PFIZER. Unless otherwise agreed in writing, INHALE agrees to donate to the Project any supply of **[*]** on hand as of the Effective Date.

(b) Powder Processing by INHALE. For a processing fee equal to **[*]** and in accordance with the Work Plan, INHALE will process **[*]** so as to manufacture dry powder formulations of Regular Insulin in sufficient quantities to meet the Project needs for Phase I and Phase II clinical studies. It is anticipated that the formulations for use in Phase I and Phase II clinical studies will be manufactured in one of INHALE's existing facilities. For a processing fee equal to **[*]**, and in accordance with the Work Plan, INHALE will process Regular Insulin crystals so as to manufacture dry powder formulations of Regular Insulin in sufficient quantities to meet the Project needs for Phase III clinical studies. Formulations for Phase III clinical studies will be manufactured in an INHALE commercial facility at a minimum scale of **[*]** unless otherwise agreed upon by the JDC. **[*]**.

(c) Powder Processing by PFIZER. At PFIZER's request and cost, PFIZER, subject to the provisions of Exhibit 7.1. Section B.3.(c), will be permitted to manufacture sufficient quantities of dry powder formulations of Regular Insulin at a facility to qualify such facility for approval in any application for an NDA or other application for Regulatory Approval.

(d) Powder Filling by INHALE. For a filling fee equal to **[*]** and in accordance with the Work Plan, INHALE will fill into blisters and seal sufficient quantities of dry powder formulations of Regular Insulin to meet the Project needs for Phase I and Phase 11 clinical studies. For a filling fee equal to **[*]**, and in accordance with the Work Plan, INHALE will fill into blisters and seal sufficient quantities of dry powder formulations of Regular Insulin to meet the Project needs for Phase III clinical studies.

(e) PowderFillingbyPFIZER. At PFIZER's option and cost, PFIZER will fill into blisters and seal sufficient quantities of dry powder formulations of Regular Insulin at a PFIZER facility to qualify such facility for approval in any application for an NDA or other application for Regulatory Approval.

7.3 Manufacture of Devices for the Project. For a purchase price equal to **[*]** and in accordance with the Work Plan, INHALE will supply PFIZER with a sufficient number of P2 Devices to meet the Project needs. For a purchase price equal to **[*]**, and in accordance with the Work Plan, INHALE will supply PFIZER with a sufficient number of P3 Devices to meet the Project needs. INHALE acknowledges that the design and manufacture of P3 Devices used in Phase III clinical studies and of Commercial Devices will need to be substantially the same.

7.4 Representations and Warranties. The Party which supplies any Product to the other under Sections 7.2 and 7.3 hereby represents and warrants to the other Party as follows: (a) the Product shall be manufactured and packaged in compliance with current Good Manufacturing Practice, as established and revised from time to time by the FDA, applicable Investigational New Drug applications, and all other U.S. and other governmental rules and regulations applicable to the Product and its manufacture, (b) shall conform to the specifications for the Product in effect at the time of delivery, (c) shall not be adulterated or misbranded within the meaning of the U.S. Food, Drug and Cosmetic Act of 1938, as amended from time to time, nor constitute an article that may not be introduced into interstate commerce under the provisions of Section 505 of said Act, (d) shall conform to the certificates of analysis supplied with the shipment of the Product, (e) shall be packaged and shipped in accordance with mutually agreed to procedures, and (f) shall be free and clear of any lien or encumbrance.

7.5 Shipping Test and Pelletization. Within **[*]** and in accordance with the Work Plan, INHALE will complete a shipping test with a processed Regular Insulin powder formulation in bulk to determine whether shipment of such bulk **[*]**. The protocol for the test will be subject to approval by the JDC. Based on the results of the test, the Parties will determine whether or not powder processing and powder filling **[*]**.

7.6 Inspections. During regular business hours and upon reasonable advance notice, PFIZER personnel shall be permitted to inspect the facilities of INHALE, **[*]** and observe manufacturing activities, to the extent necessary and for the sole purpose of assessing compliance with applicable regulatory, environmental and other governmental regulations and identifying safety and occupational risks (if any) associated with the manufacturing activities.

8. Record Keeping and Audits

8.1 Records Retention. Each Party shall keep complete and accurate records pertaining to the development, use and sale of Products in sufficient detail to permit the other Party to confirm, in the case of INHALE, its research and development efforts and costs and its audit, manufacturing and processing activities and costs hereunder, and in the case of PFIZER, its clinical research, regulatory approval and commercialization efforts and the accuracy of calculations of all royalty payments hereunder. Such records shall be maintained for **[*]**.

8.2 Audit Request. Each of the Parties shall have the right to audit such records, at its own expense and on an annual basis, to determine, with respect to any calendar year, the correctness of any report or payment made under this Agreement, but only once with respect to each calendar year. If a Party desires to audit such records, it shall engage an independent, certified public accountant reasonably acceptable to the other Party, to examine such records. Such accountant shall be instructed to provide to the other Party a report on the findings of the agreed upon procedures verifying any report made or payment submitted by the audited party during such period. Such accountant's findings shall be **[*]**. The expense of such audit shall be borne by the auditing party; provided, however, that if an error in favor of the auditing party of **[*]** is discovered, then such expenses shall be paid by the audited party. Any Information received by a Party pursuant to this Section 8.2 shall be deemed to be Confidential Information (as defined in Section 15.1) hereunder. This Section 8.2 shall survive any termination of this Agreement for a period of four (4) years.

9. Patents

9.1 Existing INHALE Patent Applications. The following provisions shall apply to each pending Patent Application existing as of the Effective Date underlying INHALE Patent Rights in the Field: (a) INHALE shall remain the owner of the application, (b) INHALE shall continue to bear the full costs of and responsibility for preparing, filing and prosecuting the application and (c) the application and any patents issuing thereon shall constitute Patents for purposes of this Agreement. INHALE will keep PFIZER reasonably informed of the status of Existing INHALE Patent Applications.

9.2 Future Patent Applications on Existing Sole Inventions in the Field. The following provisions shall apply to each Patent Application for existing sole inventions in the Field owned or controlled by INHALE which could be filed in the future:

(a) Ownership – INHALE shall remain the owner of each such sole invention.

(b) Consequences of **[*]** - If PFIZER elects to file a Patent Application for the invention, the following provisions shall apply: (i) INHALE will **[*]** furnish a copy of the draft to PFIZER for comment **[*]**, (ii) INHALE will **[*]**, and file the application in each country in which PFIZER elects to do so, (iii) PFIZER will bear the full costs of preparing, filing and prosecuting the application and, through INHALE, will **[*]**, (iv) in any country in which PFIZER **[*]**, INHALE may **[*]**, and (v) Each application and any patents issuing thereon will constitute Patents for purposes of this Agreement.

(c) Consequences of **[*]** - If PFIZER **[*]**, the following provisions shall apply: **[*]**.

9.3 Future Sole Inventions.

(a) Ownership - Except as provided in Clause B.3.(c)5) of Exhibit7.1, each Party shall be the initial sole owner of each future invention and discovery ("Future Sole Invention") acquired or developed solely by such Party or its employees, consultants or subcontractors under this Agreement.

(b) Filing Discretion - Each Party shall be solely responsible for electing, in its sole discretion, whether or not to file a patent application for each of its Future Sole Inventions.

(c) Consequences of **[*]** - If a Party elects to file a patent application for one of its Future Sole Inventions in at least one country, then the following provisions shall apply: (i) The filing Party will **[*]**, (ii) The filing Party will furnish a copy of the draft to the other Party **[*]**, (iii) The filing Party **[*]**, (iv) In any countries in which the filing Party **[*]**, the other Party may **[*]** The applications and patents referred to in this Section 9.3(c) will constitute Patents for purposes of this Agreement.

(d) Consequences of **[*]** - If a Party elects **[*]**, then the following provisions shall apply: **[*]**.

(e) PFIZER, hereby grants INHALE a royalty free, worldwide, non-exclusive license, with the right to sublicense, **[*]**. The term of such license shall be for the life of any patents covering such **[*]** owned by PFIZER.

9.4 Joint Inventions

(a) Definitions - For purposes of this Section 9, the following terms shall have the specified definitions:

“Joint Invention” means each invention or discovery acquired or developed jointly (as determined by U.S. law of inventorship) by each Party (together with its employees, consultants and subcontractors) under this Agreement.

“Field Joint Invention” means a Joint Invention that is at the time of its invention necessary or useful within the Field.

“INHALE Business Joint Invention” means a Joint Invention (other than a Field Joint Invention) that is at the time of its invention necessary or useful to INHALE in connection with **[*]**.

“Other Joint Invention” means a Joint Invention that is neither a Field Joint Invention nor an INHALE Business Joint Invention.

9.5 Field Joint Inventions.

(a) To the extent it is practical to do so, Patent Applications for Field Joint Inventions shall be separately defined and prosecuted.

(b) Ownership - Upon INHALE’s request and subject to Section 19, PFIZER, shall assign to INHALE its joint ownership interest in any Field Joint Invention.

(c) Consequences of **[*]** - If PFIZER, elects to authorize the filing of a Patent Application for a Field Joint Invention, the following provisions shall apply: (i) INHALE will **[*]** furnish a copy of the draft to PFIZER for comment at least 30 days before filing the application, (ii) INHALE will **[*]**, (iii) PFIZER, will bear the full costs of preparing, filing and prosecuting the application and, through INHALE, will **[*]**, (iv) in any country in which PFIZER **[*]**, INHALE may **[*]**, and (v) Each application and any patents issuing thereon will constitute Patents for purposes of this Agreement.

(d) Consequences of **[*]** - If PFIZER elects **[*]**, the following provisions shall apply: **[*]**.

9.6 INHALE Business Joint Inventions.

(a) Ownership - Upon INHALE's request and subject to Section 19, PFIZER shall assign to INHALE its joint ownership interest in any INHALE Business Joint Invention.

(b) Consequences of **[*]** - If INHALE elects to file a Patent Application for an INHALE Business Joint Invention, the following provisions shall apply: (i) INHALE will prepare a first draft of the application and furnish a copy of the draft to PFIZER, **[*]**, (ii) INHALE will **[*]**, (iii) INHALE will **[*]**, (iv) in any country in which INHALE **[*]** file an application and (v) Each application and any patents issuing thereon will constitute Patents for purposes of this Agreement.

(c) Consequences of **[*]** – If INHALE **[*]**, the following provisions shall apply: **[*]**.

9.7 Other Joint Invention.

(a) Ownership - Each Party shall retain its joint ownership interest in each Other Joint Invention.

(b) Mutual Decision to File An Application - If the Parties mutually decide to file a patent application for an Other Joint Invention in one or more countries, then the following provisions shall apply to each such application: (i) INHALE shall prepare a first draft of the patent application, (ii) INHALE will **[*]**, (iii) The Parties will **[*]**, (iv) In any countries in which **[*]** and (v) The applications and patents referred to in this Section 9.7(b) will constitute Patents for purposes of this Agreement.

(c) **[*]** - If **[*]**, then the following provisions shall apply: **[*]**.

(d) PFIZER hereby agrees **[*]**, except as reasonably necessary for the production of PFIZER products, or otherwise **[*]**, whichever is longer.

9.8 Cooperation. Each Party will cooperate with the other, and will cause its employees, consultants and subcontractors to cooperate with the other, in completing any Patent Applications for Joint Inventions, and in executing and delivering any instrument required to permit the other Party to exercise its rights and discharge its obligations under this Section 9, including where appropriate instruments assigning its joint ownership interest, in a Joint Invention. On a semi-annual basis, each Party agrees to present an up-date of its Patent Rights to the JDC and to discuss the strategy for the protection of intellectual property rights related to the Project.

9.9 Issued Patents. INHALE shall take all steps necessary to maintain for the full life thereof all issued Patents, whether claiming Joint Inventions or inventions owned or Controlled solely by INHALE, which underlie INHALE Patent Rights.

9.10 Patent Extension.

(a) Drug Product Patents. **[*]**, all applications and to take all actions necessary (i) to obtain the benefits of the Drug Price Competition and Patent Term Restoration Act of 1984 and any amendments thereto to the extent such benefits relate to Products constituting drug products and (ii) to extend the lives of the INHALE Patents that claim Products constituting drug products or otherwise invoke the protection of such Products to the extent permitted by any other law or regulation by, among other things, applying for supplemental protection certificates. **[*]** agrees to **[*]** as may be **[*]** to implement the foregoing.

(b) Device Patents. To the extent INHALE Patents claiming Products that constitute medical devices, or such Products themselves, are subject to regulations or statutes comparable to those referred to in Section 9.6(a), INHALE agrees to exercise its rights under such regulations and statutes in a fair and equitable manner that takes into account the commercial interests of PFIZER, upon consultation with PFIZER.

9.11 Public Disclosure. Each Party agrees to delay any public disclosure of the subject matter of any Patent Application to which this Article 9 applies until the filing of all U.S. and intended foreign applications but in no event more than one (1) year from the first filed (priority) application.

10. Representations and Warranties

10.1 INHALE.

INHALE hereby represents and warrants to PFIZER as follows:

(a) To the best of INHALE's knowledge, INHALE has delivered to PFIZER copies of **[*]**, together with any other information now owned or controlled by INHALE that is **[*]**, including without limitation complete reports on **[*]**;

(b) Exhibit 10.1(b) is a complete list of all Non-clinical and clinical studies of the Products of which INHALE is aware, and **[*]**;

(c) To the best of INHALE's knowledge, **[*]** of a material nature delivered by INHALE to PFIZER was accurate, correct, and complete;

(d) Exhibit 1.13 is an accurate, correct and complete list of all Patent Applications owned or Controlled by INHALE claiming inventions that may be useful or necessary **[*]**, and all Patents owned or Controlled by INHALE claiming inventions that may be useful or necessary **[*]**, and INHALE has disclosed to PFIZER all material information known to INHALE relating to **[*]** of such Patents;

(e) INHALE has sufficient legal and/or beneficial right, title and interest in, to and under the INHALE Patent Rights, the INHALE Know-How and its other intellectual property rights to conduct its business as now conducted **[*]** and to grant the licenses contained herein;

(f) To the best of INHALE's knowledge, the conduct of its business as currently conducted does not violate, **[*]**, any of the **[*]** of any other person or entity relating to the Products;

(g) To the best of INHALE's knowledge, there is no material unauthorized use, infringement or misappropriation of any INHALE Know-how or INHALE Patent Rights;

(h) To the best of INHALE's knowledge, its execution and delivery of this Agreement and its performance of its obligations under this Agreement will not violate any federal, state, municipal statute or regulation or any order of any court or other governmental department, authority, agency or instrumentality;

(i) All of INHALE's employees, officers, relevant subcontractors and relevant consultants have executed agreements requiring assignment to it of all inventions made during the course of and as a result of their association with it and obligating the individual to maintain as confidential the confidential information of it, as well as the confidential information of a third party which it may receive;

(j) INHALE has not, and during the Term of this Agreement will not, grant any right to any third party relating to INHALE Patent Rights and INHALE Know-how which would conflict with the rights granted to PFIZER hereunder; and

(k) To the best of INHALE's knowledge, neither it, nor any of its employees, officers, subcontractors or consultants who has rendered services relating to the Products or the Field (i) has ever been debarred or convicted of a crime for which an entity or person could be debarred under 21 USC Section 335a or (ii) is the subject of a debarment proceeding or under indictment for a crime for which a person or entity could be debarred under said Section.

(1) The Products used in its clinical studies of the Products have been manufactured in registered GMP-compliant facilities in accordance with applicable GMP regulations.

(m) During the Term of this Agreement, INHALE will not **[*]** in its conduct of any activity under the Project.

10.2 PFIZER. PFIZER hereby represents and warrants to INHALE as follows:

(a) To the best of PFIZER's knowledge, its execution and delivery of this Agreement and its performance of its obligations under this Agreement will not violate any federal, state, municipal statute or regulation or any order of any court or other governmental department, authority, agency or instrumentality;

(b) To the best of PFIZER's knowledge, the conduct of its business as currently conducted does not violate, **[*]**, any of the **[*]** of any other person or entity relating to the Products;

(c) All of PFIZER's employees, officers, relevant subcontractors and relevant consultants have executed agreements requiring assignment to it of all inventions within the Field made during the course of and as a result of their association with it and obligating the individual to maintain as confidential the confidential information of it, as well as the confidential information of a third party which it may receive; and

(d) PFIZER has not, and during the Term of this Agreement will not, grant any right to any third party relating to PFIZER Patent Rights and PFIZER Know-how in the Field which would conflict with the rights granted to INHALE hereunder.

(e) During the Term of this Agreement, PFIZER will not **[*]** in its conduct of any activity under the Project.

10.3 **[*]**. Notwithstanding any other provision of this Agreement or any inference arising from any other provision, PFIZER makes no representation or warranty that PFIZER will succeed in contracting for a **[*]** on commercially acceptable terms.

11. Non-Solicitation of INHALE Employees. PFIZER agrees that it will not recruit, solicit or induce any employee of INHALE to terminate his or her employment with INHALE:

(a) during the Term of this Agreement; and

(b) if the Agreement is terminated prior to commercialization of Products, for a period of **[*]** thereafter; or

(c) if the Agreement is terminated following commercialization of ' Products, for a period of **[*]** thereafter.

12. Infringement of Third Party Rights.

12.1 Notice. If the development, manufacture, use or sale of Products results in a claim for patent infringement, the party to this Agreement first having notice shall promptly notify the other party in writing. The notice shall set forth the facts of the claim in reasonable detail.

12.2 Definitions. For purposes of this Section 12, the following four terms shall have the specified meanings:

(a) An **[*]** means any claim, other than **[*]** that is based on **[*]**.

(b) A **[*]** means any claim **[*]** that is based on **[*]**.

(c) A **[*]** means any claim referred to in Section 12.1 that is based **[*]**.

(d) **[*]** means any claim referred to in Section 12.1 **[*]** that is based on **[*]**.

(e) "Subject Claim" means any **[*]**.

12.3 Control of Defense against **[*]**. INHALE shall have the initial right to manage solely the defense of the Parties against any **[*]**. If INHALE elects to exercise such right as to such a claim, PFIZER shall cooperate with INHALE at INHALE's request and shall have the right to be represented by counsel selected by PFIZER. If INHALE elects not to exercise such right as to such a claim, PFIZER shall have the right to manage solely the defense of the Parties against the claim, and INHALE shall cooperate with PFIZER at PFIZER's request and shall have the right to be represented, by counsel selected by INHALE.

12.4 Control of Defense against **[*]**. PFIZER shall have the initial right to manage solely the defense of the Parties against any **[*].** If PFIZER elects to exercise such right as to such a claim, INHALE shall cooperate with PFIZER at PFIZER's request and shall have the right to be represented by counsel selected by INHALE. If PFIZER elects not to exercise such right as to the claim, INHALE shall have the right to manage solely the defense of the Parties against the claim, and PFIZER shall cooperate with INHALE at INHALE's request and shall have the right to be represented by counsel selected by PFIZER.

12.5 Settlements. The Party that manages solely the defense of the Parties against Subject Claims under Section 12.3 or 12.4 shall also have the sole right to settle such claims on terms deemed appropriate by such Party; provided that (a) such Party shall consult with the other Party concerning the terms of any settlement agreement before entering into such an agreement and (b) neither Party shall settle any Subject Claim without the prior written consent of the other, which the other shall not unreasonably withhold or delay.

12.6 Costs of Defense. **[*]** shall be responsible for the reasonable fees and costs of attorneys and consultants, together with the court costs, incurred by both Parties in defending against **[*]**. **[*]** shall be responsible for the reasonable fees and costs of attorneys and consultants, together with the court costs, incurred by both Parties in defending against **[*]**. **[*]** shall be responsible for the reasonable fees and costs of attorneys and consultants, together with the court costs, incurred by both Parties in defending against any **[*]**. **[*]** shall be responsible for the reasonable fees and costs of attorneys and consultants, together with the court costs, incurred by both Parties in defending against any **[*]**.

12.7 Payments to Third Parties. If either Party is required by a final court order or a settlement agreement entered into in good faith to make royalty payments or other payments to a third party in connection with the disposition of any **[*]**. If either Party is required by a final court order or a settlement agreement entered into in good faith to make royalty payments or other payments to a third party in connection with the disposition of any **[*]** Claim, **[*]**. If either Party is required by a final court order or a settlement agreement entered into in good faith to maim royalty payments or other payments to a third party in connection with the disposition of any **[*]**. If either Party is required by a final court order or a settlement agreement entered into in good faith to make royalty payments or other payments to a third party in connection with the disposition of any **[*]**.

12.8 No Third Party Effect. Neither this Section 12, nor any exercise of rights or fulfillment of obligations under this Section 12, shall affect by itself any indemnification or contribution rights of either Party against any third party.

13. Infringement by Third Parties.

13.1 Notice. If any of the INHALE Patent Rights or INHALE Know-how in the Field is infringed by a third party, the Party first having knowledge of such infringement shall promptly notify the other in writing. The notice shall set forth the facts of such infringement in reasonable detail.

13.2 Prosecution of Actions Related to Devices and Powder Processing.

(a) INHALE shall have the primary right, but not the obligation, to institute, prosecute and control any action or proceeding with respect to any infringement of any of the INHALE Patent Rights or INHALE Know-how arising from the manufacture, use or sale of **[*]**, by counsel of its own choice. PFIZER shall cooperate with INHALE at INHALE's request in the prosecution of such action or proceeding. If INHALE determines that PFIZER is an indispensable party to the action, PFIZER hereby consents to be joined. In such event, PFIZER shall have the right to be represented in that action by counsel of its own choice and expense.

(b) If INHALE fails to bring an action or proceeding within a period of **[*]** after receiving written notice from PFIZER or otherwise having knowledge of that infringement, PFIZER shall have the right to bring and control any such action by counsel of its own choice and expense. If PFIZER determines that INHALE is an indispensable party to the action, INHALE hereby consents to be joined. In such event INHALE shall have the right to be represented in that action by counsel of its own choice and expense.

(c) No settlement, consent judgment or other voluntary final disposition of a suit under this Section 13 may be entered into without the joint consent of PFIZER and INHALE (which consent shall not be withheld unreasonably).

(d) **[*]**.

(e) **[*]**.

13.3 Prosecution of Actions Related to **[*]**. Infringements by third parties arising from their manufacture, use or sale of **[*]** shall be handled as provided in Section 13.2, except that the roles of INHALE and PFIZER shall be reversed.

13.4 Infringement Outside the Field. In the event that any of the INHALE Patent Rights or INHALE Know-how outside the Field is infringed by a third party, the Party first having knowledge of such infringement shall notify the other as set forth above and the Parties shall consult with each other as to how they should proceed, **[*]**.

14. Mutual Indemnification.

14.1 Employees. Each Party shall indemnify the other Party, such other Party's successors and assigns, and the directors, officers, employees, agents and counsel thereof (the "Other Party's Indemnitees"), defend and hold each Other Party's Indemnitee harmless from and against, **[*]**, any and all liabilities, damages, settlements, claims, actions, suits, penalties, fines, costs or expenses (including without limitation reasonable attorneys' fees) (any of the foregoing being referred to collectively as "Damages") incurred by or asserted against any Other Party's Indemnitee by or on behalf of the indemnifying Party's employees that arise out of activities conducted under this Agreement by such employees.

14.2 INHALE's Right to Indemnification. PFIZER shall indemnify each of INHALE its successors and assigns, and the directors, officers, employees, agents and counsel thereof (the "INHALE Indemnitees"), defend and hold each INHALE Indemnitee harmless from and against, **[*]**, any and all Damages incurred by or asserted against any INHALE Indemnitee of whatever kind or nature, including, without limitation, any claim or liability based upon negligence, warranty, strict liability, violation of government regulation or infringement of patent or other proprietary lights, but only to the extent arising from or occurring as result of a claim or demand made by a third party (a "Third Party Claim") against any INHALE Indemnitee because of (a) breach of any warranty made by PFIZER in Section 10 hereof; (b) the **[*]** of the Product, unless attributable to **[*]** which is under the responsibility of INHALE; (c) the **[*]** of any Product, or the establishment of specifications for the **[*]** of a Product by or on behalf of PFIZER or its licensees (except activities undertaken by INHALE); (d) the **[*]** regarding any Product; (e) the **[*]** by or on behalf of PFIZER, or its licensees or (f) any breach of this Agreement by PFIZER, except, in each such case, to the extent that such Damages result from

the negligence or misconduct of INHALE. INHALE shall promptly notify PFIZER of any Third Party Claim, upon becoming aware thereof, shall permit PFIZER at PFIZER's cost to defend INHALE against such Third Party Clam and to control the defense and disposition (including, without limitation, all decisions to litigate, settle or appeal) of such claim and shall cooperate in the defense thereof. INHALE may, at its option and expense, have its own counsel participate in any proceeding that is under the direction of PFIZER and shall cooperate with PFIZER and its insurer in the disposition of any such matter.

14.3 PFIZER's Right to Indemnification. INHALE shall indemnify each of PFIZER, its successors and assigns, and the directors, officers, employees, agents and counsel thereof (the "PFIZER Indemnitees"), defend and hold each PFIZER Indemnitee harmless from and against, **[*]**, any and all Damages incurred by or asserted against any Indemnitee of whatever kind or nature, including, without limitation, any claim or liability based upon negligence, warranty, strict liability, violation of government regulation or infringement of patent or other proprietary rights, but only to the extent arising from or occurring as a result of a Third Party Claim against any PFIZER Indemnitee because of (a) breach of any warranty made by INHALE in Section 10; (b) the failure of INHALE to **[*]**, and the **[*]** of any Product by or on behalf of INHALE (except activities undertaken by PFIZER); (c) the **[*]** regarding any Product; (d) the **[*]** by INHALE; or (e) any breach of this Agreement by INHALE, except in each such case, to the extent that such Damages result from the negligence or misconduct of PFIZER or its licensees (except activities undertaken by INHALE). PFIZER shall promptly notify INHALE of any Third Party Claim, upon becoming aware thereof, and permit INHALE at INHALE's cost to defend PFIZER against such Third Party Claim and to control the defense and disposition (including, without limitation, all decisions to litigate, settle or appeal) of such Third Party Claim and shall cooperate in the defense thereof. PFIZER may, at its option and expense, have its own counsel participate in any proceeding that is under the direction of INHALE and will cooperate with INHALE and its insurer in the disposition of any such matter.

15. Confidentiality; Authorized Disclosures: Disclosure of Information

15.1 Confidentiality of Disclosed Information. Except to the extent expressly authorized by this Agreement or otherwise agreed in writing, the Parties agree that for the Term of this Agreement and for **[*]** thereafter, the receiving Party shall keep confidential and shall not publish or otherwise disclose or use for any purpose other than as provided for in this Agreement any Information or other information furnished to it by the other Party pursuant to this Agreement (collectively, "Confidential Information"), except to the extent that it can be established by the receiving Party that such Confidential Information:

(a) was already known by the receiving Party, other than under an obligation of confidentiality, at the time of disclosure to the receiving Party;

(b) was generally available to the public or otherwise part of the public domain at the time of disclosure to the receiving Party;

(c) became generally available to the public or otherwise part of the public domain after the time of disclosure to the receiving Party other than through any act or omission of the receiving Party in breach of this Agreement; or

(d) was disclosed to the receiving Party, other than under an obligation of confidentiality, by a third party not obligated to the disclosing Party not to disclose such Information to others.

15.2 Authorized Disclosures. Each Party may disclose the other Party's Confidential Information hereunder to the extent reasonably necessary in connection with the exercise of its rights and discharge of its obligations under this Agreement, provided all such disclosures are subject to written confidentiality obligations containing provisions no less protective than those contained herein. Such permitted disclosures include those made in connection with filing or prosecuting patent applications, prosecuting or defending litigation, complying with applicable governmental regulations, or conducting Non-clinical or clinical trials. If a Party is required by law or regulation to make any such disclosure of the other Party's Confidential Information it will, except where impractical for necessary disclosures (for example in the event of medical emergency), give reasonable advance notice to the other Party of such disclosure requirement and, except to the extent inappropriate in the case of patent applications, will use reasonable efforts to secure confidential treatment of such Confidential Information required to be disclosed.

15.3 **[*]**. In light of **[*]**; provided that (a) INHALE may continue to disclose publicly the results of the **[*]** which INHALE has already disclosed publicly and (b) INHALE may continue to disclose any of such **[*]** previously generated by INHALE which are confidential as of the Effective Date to third parties in connection with discussions concerning possible collaborations with such third parties, provided that all such disclosures are subject to written confidentiality obligations containing provisions no less protective than those contained herein.

15.4 Disclosures by the Parties.

(a) In accordance with the procedures established by the JDC, and at any time upon the reasonable written request of the other Party, each Party shall disclose to the other all Confidential Information and Information reasonably necessary in connection with the exercise of each Party's rights and discharge of its obligations under this Agreement.

(b) In furtherance of the foregoing, upon PFIZER's request from time to time, INHALE shall allow PFIZER's personnel to visit the manufacturing and research facilities of INHALE, **[*]**, monitor the quality of manufactured Products and consult with personnel to discuss and review such Confidential Information or Information. The Parties shall schedule all such activities at mutually agreeable times.

(c) As soon as practicable INHALE shall report to PFIZER any serious adverse experience information associated with the uses of the Devices (including such information relating to side effects, injuries, toxicity associated with clinical uses, and product failures) provided that **[*]**.

15.5 Termination of Prior Non-disclosure Agreements. All Confidential Information previously disclosed by the Parties shall be subject to the terms of Sections 15.1 and 15.2 and shall no longer be subject to the terms of the Non-disclosure Agreements.

15.6 Survival. Sections 15.1 and 15.2 shall survive the termination or expiration of this Agreement for a period of **[*]**.

16. Publicity Use of Name and Trademarks.

16.1. Publicity Related to This Agreement. Except as provided in Section 16.2 and as required by law (such as SEC laws), neither Party shall (i) disclose to any third party any financial or other terms or conditions of this Agreement nor (ii) originate any publicity, news release or public announcement, written or oral, whether to the public, press, stockholders or otherwise, relating the scope or economic terms of this Agreement, performance under it or any of its specific terms or conditions, without the express written consent of the other Party.

16.2 Publicity Related to the Project. Subject to the other provisions of this Agreement, **[*]** may disclose Information generated **[*]**, or disclose any conclusions based on such Information, after giving **[*]** a reasonable opportunity to review and comment (but not approve) any such disclosure. In addition, each Party may announce periodically whether Phase I, II or III studies involving the Products are underway or to be initiated. Any other disclosures of information generated by the Project may only be made with the joint approval of the Parties, except to the extent such Information is publicly known through no fault of INHALE or PFIZER.

16.3 Investigator Publications. Notwithstanding anything set forth in this Agreement to the contrary, **[*]**, provided they agree to submit a draft of the publication **[*]** before submission to the publisher. **[*]** as soon as practicable. Both Parties understand that neither Party will **[*]** the publication.

16.4 Post-Approval Use. Notwithstanding anything set forth in this Agreement to the contrary, following approval of the Products PFIZER shall be permitted to use and publicize Information generated by the Project in connection with the commercialization and promotion of the Products, **[*]**, in accordance with applicable laws and regulations. **[*]**.

16.5 Use of Name and Trademarks. Unless specifically authorized by this Agreement, neither Party shall use in any manner the names or trademarks of the other Party without the express written consent of such Party.

17. Effective Date; Term and Termination.

17.1 Effective Date. Notwithstanding its mutual execution on the dates indicated below, this Agreement shall not become effective until the Initial Closing (as that term is defined

in the Stock Purchase Agreement, Section 2.1) of the sale and purchase of shares of Common Stock of INHALE, under the terms of the Stock Purchase Agreement. The date on which such Initial Closing occurs is referred to in this Agreement as the Effective Date.

17.2 Term. This Agreement shall commence as of the Effective Date and, unless sooner terminated in whole or in part as specifically provided in the Agreement, shall continue in effect until the expiration of all of the royalty obligations contained in Section 6.3 above, subject to extension pursuant to Section 17.3. After expiration (but not termination) of this Agreement, any licenses to PFIZER from INHALE then in effect shall become non-exclusive, fully paid, perpetual and royalty-free.

17.3 Extension. PFIZER may extend this Agreement for **[*]**.

17.4 Termination by PFIZER.

(a) **[*]**. Prior to making the **[*]**, above, PFIZER may terminate this Agreement because of a material adverse development related to the safety, efficacy, pulmonary delivery system efficiency, significant adverse change in the market for Products, the quality of the Products ("Adverse Development") or, in its sole discretion, without cause (i.e., not because of an Adverse Development or default by INHALE). If PFIZER elects to terminate this Agreement **[*]** because of an Adverse Development or without cause PFIZER shall: (1) give INHALE **[*]** advance notice of such termination, (2) provide INHALE free-of-charge, with the Termination Documents (as defined below), which INHALE may use as INHALE sees fit and which INHALE may provide to a third party partner for use in continuing development of the Products and, (3) if terminated for reasons other than an Adverse Development or default by INHALE, **[*]**, within thirty (30) days of giving INHALE notice, which **[*]**. For purposes of this Section 17.4 "Termination Documents" means the following documents: (i) a copy of all protocols prepared by PFIZER and regulatory filings made by PFIZER under this Agreement, (ii) a copy of all reports on Non-clinical and clinical studies sponsored by PFIZER under this Agreement which have been filed or prepared for filing with the FDA or other regulatory authorities, (iii) the data underlying any Non-clinical and clinical database owned by PFIZER in computer-readable form if readily available in a non-proprietary format, and (iv) a copy of all case report forms for patients enrolled in clinical studies sponsored by PFIZER for which no report has been prepared at the time of termination.

PFIZER will have no obligation to complete or prepare study reports that have not been completed at the time of termination, but will assist INHALE reasonably in doing so.

(b) **[*]**. After **[*]**, if PFIZER elects to terminate this Agreement because of an Adverse Development or without cause, the provisions of Section 17.4(a)(1) and (2) shall apply with respect to such termination and the provisions of Section 17.4(a)(3) shall not apply.

17.5 Termination for Default. Subject to Section 20.4, if either Party is in default of any of its material obligations under this Agreement and fails to remedy that default within

sixty (60) days after receipt of written notice of such default, or thirty (30) days in the case of default of any payment hereunder, the Party not in default may terminate this Agreement immediately by giving written notice of such termination. In the event of a dispute regarding royalties owing hereunder, all undisputed amounts shall be paid when due and, the balance, if any, shall be paid promptly after settlement of the dispute. If PFIZER terminates this Agreement because of INHALE's material breach, the licenses granted pursuant to Sections 6.1 shall survive such termination, subject to any ongoing royalty obligations under Sections 6.3 and 6.4. If INHALE terminates this Agreement because of PFIZER's material breach, all license rights granted to shall terminate forthwith.

17.6 Surviving Rights. Termination of this Agreement shall not terminate PFIZER's obligation to pay all milestone payments, royalties and other payments which shall have accrued hereunder (including any milestone payments then accrued but not yet due under Section 3.5). The obligations of the Parties under Sections 8 (Record Keeping and Audits), 9 (Patents), 12 (Infringement by Third Parties), 14 (Mutual Indemnification), 15.1 (Confidentiality), 15.2 (Authorized Disclosures) and 15.6 (Survival) of this Agreement will survive the termination or expiration of this Agreement.

17.7 Accrued Rights, Surviving Obligations. Termination, relinquishment or expiration of the Agreement for any reason shall be without prejudice to any rights which shall have accrued to the benefit of either Party prior to such termination, relinquishment or expiration. Such termination, relinquishment or expiration shall not relieve either Party from obligations that are expressly indicated to survive termination or expiration of the Agreement.

18. Exclusivity: **[*]**.

18.1 Exclusivity. During the Term of this Agreement, INHALE and PFIZER shall work on the **[*]** of Regular Insulin **[*]** exclusively pursuant to this Agreement.

18.2 Option for **[*].** Either Party shall have the option to propose **[*]** of **[*]**. If either Party makes such a proposal, the Parties shall negotiate the terms and conditions of such **[*]**. **[*]**.

19. Protective Provisions.

19.1 General.

(a) INHALE agrees to cooperate with PFIZER in negotiating agreements with vendors that supply INHALE critical goods and services relating to the Products under which PFIZER has the right to demand that the goods and services be sold and provided directly to PFIZER **[*]** after INHALE's failure to cure any material breach of its obligations under Section 7 and/or the Manufacturing and Supply Agreement contemplated thereunder.

(b) Upon INHALE's failure to cure any material breach of its obligations under Section 7 and/or the Manufacturing and Supply Agreement contemplated thereunder, PFIZER shall automatically have the right to engage in or make arrangements for substitute performance.

19.2 U.S.

(a) On the date hereof, INHALE has entered into a Security Agreement with PFIZER.

(b) The Parties acknowledge that the INHALE Patents and INHALE Know-How and all embodiments thereof constitute intellectual property for the purposes of 11 USC 365.

19.3 Outside the U.S. INHALE hereby **[*]** that relate **[*]**, the development, manufacture, use and sale of Products. PFIZER agrees to **[*]**.

20. Miscellaneous.

20.1 Agency. Neither Party is, nor shall be deemed to be, an employee, agent, co-venturer or legal representative of the other Party for any purpose. Neither Party shall be entitled to enter into any contracts in the name of, or on behalf of the other Party, nor shall either Party be entitled to pledge the credit of the other Party in any way or hold itself out as having the authority to do so.

20.2 Assignment. Except as otherwise provided herein neither this Agreement nor any interest hereunder shall be assignable by any Party without the prior written consent of the other (which consent shall not be unreasonably withheld following the conclusion of the Project); provided, however, that either Party may assign this Agreement to any wholly-owned subsidiary or to any successor by merger or sale of substantially all of its business unit to which this Agreement relates in a manner such that the assignor (if it continues as a separate entity) shall remain liable and responsible for the performance and observance of all its duties and obligations hereunder. This Agreement shall be binding upon the successors and permitted assignees of the Parties and the name of a party appearing herein shall be deemed to include the names of such Party's successor's and permitted assigns to the extent necessary to carry out the intent of this Agreement. Any assignment not in accordance with this Section shall be void.

20.3 Further Actions. Each Party agrees to execute, acknowledge and deliver such further instruments, and to do all such other acts, as may be necessary or appropriate in order to carry out the purposes and intent of the Agreement.

20.4 Force Majeure. Neither Party shall be liable to the other for loss or damages or shall have any right to terminate this Agreement for any default or delay attributable to any force majeure event, including but not limited to acts of God, acts of government, fire, flood, earthquake, strikes, labor disputes, and the like, if the party affected shall give prompt notice of any such cause to the other Party. The Party giving such notice shall thereupon be excused from such of its obligations hereunder as it is thereby disabled from performing for so long as it is so disabled and for **[*]** thereafter, provided, however, that such affected Party commences and

continues to take reasonable and diligent actions to cure such cause. Notwithstanding the foregoing, nothing in this Section 20.4 shall excuse or suspend the obligation to make any payment due hereunder in the manner and at the time provided. If a Party's performance cannot be resumed within **[*]** of its suspension, this Agreement may be terminated by the other Party upon **[*]** advance written notice.

20.5 Notices All notices and other communications required or permitted hereunder shall be in writing and shall be deemed effectively given and received (a) upon personal delivery, (b) on the fifth day following mailing by registered or certified mail, return receipt requested, postage prepaid, addressed to the INHALE and PFIZER, at their respective addresses as listed below (or at such other address for a Party as shall be specified by like notice; provided, that notices of a change of address shall be effective only upon receipt thereof), (c) upon transmission of telegram or facsimile (with telephonic notice), or (d) upon confirmed delivery by overnight commercial courier service:

If to PFIZER, addressed to:	Pfizer Inc. 235 E. 42nd Street New York, New York 10017 Attention: Vice President-Central Research
With copy to:	General Counsel
If to INHALE, addressed to:	INHALE Therapeutic System 1001 East Meadow Circle Palo Alto, CA 94303 Attention: Chief Executive Officer
With copy to:	Cooley Godward Castro Huddleson & Tatum 5 Palo Alto Square, Suite 400 Palo Alto, CA 94306 Attention: Mark Tanoury, Esq.

20.6 Amendment; Approval. No amendment, modification or supplement of any provision of the Agreement shall be valid or effective unless made in writing and signed by a duly authorized officer of each Party. No approval provided for in this Agreement shall be valid or effective unless confirmed in writing.

20.7 Waiver. No provision of the Agreement shall be waived by any act, omission or knowledge of a Party or its agents or employees except by an instrument in writing expressly waiving such provision and signed by a duly authorized officer of the waiving Party.

20.8 Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed an original, but all of which together shall constitute one instrument.

20.9 Descriptive Headings. The descriptive headings of this Agreement are for convenience only, and shall be of no force or effect in consuming or interpreting any of the provisions of this Agreement.

20.10 Governing Law. This Agreement shall be governed by and interpreted in accordance with the substantive laws of the New York and the United States of America, without regard to choice of law rules.

20.11 Severability. Whenever possible, each provision of the Agreement will be interpreted in such manner as to be effective and valid under applicable law, but if any provision of the Agreement is held to be prohibited by or invalid under applicable law, such provision will be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of the Agreement. In the event of such invalidity, the parties shall seek to agree on an alternative enforceable provision that preserves the original purpose of this Agreement.

20.12 Compliance with Law. Nothing in the Agreement shall be deemed to permit PFIZER to export, re-export or otherwise transfer any Information transferred hereunder or Products manufactured therefrom without compliance with applicable laws.

20.13 Entire Agreement of the Parties.. This Agreement, including the other written agreements referred to herein and the Exhibits attached hereto, constitutes and contains the complete, final and exclusive understanding and agreement of the Parties hereto, and cancels and supersedes any and all prior negotiations, correspondence, understandings and agreements, whether oral or written, between the Parties respecting the subject matter hereof. To the extent appropriate, the provisions of this Agreement shall apply to the other agreements referred to herein.

20.14 Sections and Articles. Unless specified otherwise, references to Sections and Articles are to Sections and Articles of this Agreement.

20.15 European Union. The Parties acknowledge that this Agreement may need to be notified to the European Commission at some point during the Term of this Agreement. Accordingly, upon reasonable request of either Party, the Parties shall cooperate in notifying this Agreement and seeking a conclusion of the notification process satisfactory to both Parties. If at any time the European Commission determines that any provision of this Agreement is unenforceable or otherwise not permitted under the laws, rules and regulations of the European Union, the Parties agree to initiate good faith negations aimed at modifying such provision in a manner that is acceptable to the European Commission and the Parties.

IN WITNESS WHEREOF, the Parties hereto have as of the Effective Date duly executed this Agreement, including the attached Exhibits that are incorporated herein and made a part hereof.

PFIZER INC.	INHALE THERAPEUTIC SYSTEMS
By: J. Niblack	By: Stephen Hurst
Name: John Niblack	Name: Stephen Hurst
Title: Executive Vice President Research & Development	Title: Vice President Intellectual Property

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Schedule of Exhibits

Exhibit 1.13 List of Patent and Patent Applications owned or Controlled by INHALE

Exhibit 3.1 Allocation of Development Responsibilities

Exhibit 7.1 Outline of Manufacturing and Supply Agreement

Exhibit 10.1 Clinical and Non-clinical Studies

Exhibit 1.13
Inhale Patent Rights

[*]

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EXHIBIT 3.1

DEVELOPMENT PROJECT PLAN

[*]

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Exhibit 7.1
Outline of Manufacturing and Supply Agreement

A. Manufacture of Formulations and Devices for the Project

If the Parties so elect, the manufacturing and supply agreement may incorporate the terms set forth in Sections 7.2 through 7.6 of the Collaborative Development and License Agreement, so that all of manufacturing and supply terms reside in a single document.

B. Manufacture of Commercial Formulations

Following is an outline of key terms relating to commercial formulations of dry powder. Regular Insulin that the Parties intend to include in the manufacturing and supply agreement:

1. Supply of **[*]**. At no cost to INHALE, PFIZER will deliver to INHALE such quantities of **[*]** as is commercially required. Notwithstanding such delivery, PFIZER will **[*]** and continue to bear the risk of any loss **[*]**. INHALE will retain exclusive control over the **[*]** and not transfer any portion of the **[*]** to any third party not authorized under the terms of the agreement without the advance written approval of PFIZER.

2. Powder Processing by INHALE. For a processing fee equal to **[*]**, INHALE will process the bulk **[*]** delivered by PFIZER so as to manufacture dry powder formulations of Regular Insulin in sufficient quantities to meet all of PFIZER's reasonably forecast worldwide commercial needs. The location of the initial INHALE facility at which the processing will be performed is yet to be determined. In order to assure continuity of supply in the event of disruption at one facility, unless PFIZER exercises its processing option, **[*]**.

3. **[*]**. At PFIZER's option and cost, PFIZER may elect to have the **[*]**. If PFIZER exercises its option, the following provisions shall apply:

(a) INHALE would be relieved of its obligation **[*]**.

(b) PFIZER would have the option of producing at the PFIZER facility up to the following percentages of its worldwide commercial needs:

[*]

(c) In order to protect INHALE Know-how related to **[*]**, PFIZER would take the following steps:

[*].

4. Powder Filling by PFIZER. At PFIZER's cost and subject to INHALE's option referred to in Clause B(5) below, PFIZER will fill into blisters and seal (and pelletize if required) sufficient quantities of dry powder formulations of Regular Insulin at a PFIZER facility to meet its commercial needs.

5. Powder Filling by INHALE. At INHALE's option and for a filling fee equal to **[*]**, INHALE may elect to fill into blisters and seal (and pelletize if required) up to **[*]**.

6. Pelletization. If pelletization of the dry powder formulations is required for filling purposes and technically feasible, PFIZER may at its option and cost perform the pelletization, subject to paragraph 5, above.

7. Co-Location. If for technical reasons it is necessary for **[*]** facilities to be co-located, i.e. located at the same site, PFIZER will **[*]**. Notwithstanding the foregoing, if the Parties each identify compelling reasons for an alternative arrangement they are free to mutually agree on an alternative arrangement.

C. Manufacture of Commercial Devices. Following is an outline of the key terms relating to Commercial Devices that the Parties intend to include in the manufacturing and supply agreement:

1. INHALE will supply all of PFIZER's requirements of Commercial Devices.

2. If the total number of Commercial Devices purchased by PFIZER in a calendar year is **[*]**, the price per unit will be **[*]**.

3. If the total number of Commercial Devices purchased by PFIZER in a calendar year is **[*]**, the price per unit will be **[*]**.

4. In no event will the purchase price of the Commercial Devices **[*]**. Also, if the Commercial Device is significantly different than INHALE's Standard Device and the Fully Burdened Cost of the Commercial Device is substantially higher than estimated, the supply terms for the Commercial Device shall be **[*]**. Finally, if the average life expectancy of the Commercial Device is **[*]**, the Parties agree to **[*]**.

D. Establishment of Specifications

With the assistance of and in consultation with INHALE, PFIZER shall be responsible for establishing the specifications for the Products and selecting the manufacturing processes (except for Devices which shall be selected by INHALE), quality control procedures and analytical methodologies to be used in manufacturing the Products.

E. Secured Line of Credit

1. PFIZER shall provide INHALE a **[*]** secured line of credit after the start of Phase III clinical trials or equivalent pivotal study for the purchase of **[*]**, on terms and subject to conditions to be set forth in a secured credit agreement to be entered into by the Parties. The agreement shall include provisions for the following:

2. Before INHALE draws down on the line of credit to purchase a particular item of equipment, it shall obtain PFIZER's prior consent, which consent shall not be unreasonably withheld.

3. Any borrowings against the line of credit shall be repaid to PFIZER by the following mechanism:

[*].

4. In the event this Agreement is terminated for reasons other than INHALE's breach before all borrowings are repaid to PFIZER, INHALE may, in its sole discretion and at its cost, **[*]**.

5. Any remaining outstanding indebtedness shall **[*]**.

F. Warranties The Parties also intend to include warranty provisions similar to Section 7.4 of the Collaborative Development and License Agreement together with a warranty that the manufacturing and supply activities of the Parties do not constitute willful infringement of any valid third party rights of which it is aware.

G. Other Terms. The Parties also intend to include in the manufacturing and supply agreement other provisions customarily found in such agreements, including provisions dealing with forecasts, rejection, recall, inspection, indemnification, debarment and compliance with governmental regulations (including FDA and environmental regulations).

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EXHIBIT 10.1

CLINICAL AND NON-CLINICAL STUDIES

Clinical Studies

1. Study/Protocal Number HA001

   A PILOT CROSSOVER STUDY COMPARING SERUM INSULIN CONCENTRATIONS OF NORMAL ADULT VOLUNTEERS TREATED BY SUBCUTANEOUS AND INTRAPULMONARY ADMINISTRATION OF HUMAN INSULIN

Non-clinical Studies

1. FIVE-DAY REPEATED DOSE INHALATION TOXICITY STUDY OF AEROSOL INSULIN IN CYNOMOLGUS MONKEYS

   Dated August 1993

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INHALE

12 September 1995

Mr. James S. Hilboldt, Jr., Esq.
Senior Corporate Counsel - Pharmaceuticals
Legal Division
Pfizer Inc.
235 East 42nd Street
New York, NY 10017-5755

Re: Amended Exhibit 1.13 dated 24 August 1995 to
Pfizer/Inhale Collaboration Agreement

Dear Jim:

Pursuant to Inhale's obligation under section 9.8 of our Collaboration Agreement dated 18 January 1995, enclosed is an amended Exhibit 1.13, Inhale Patent Rights, dated 24 August 1995. Jim Jones has already been provided with copies of the new applications listed in this exhibit. These are items 6-8.

Copies of this amended exhibit will be provided to members of the JDC at the next scheduled JDC meeting.

Thank you for your attention to this matter.

Sincerely,

/s/ Stephen Hurst

Stephen L. Hurst
Vice President, Intellectual Property

Enclosure.

cc: J. Jones
A. Gill
M. Glembourtt

Exhibit 1.13
Inhale Patent Rights
as amended 24 August 1995

[*]

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Draft of September 25, 1996

AMENDMENT TO COLLABORATIVE DEVELOPMENT AND LICENSE AGREEMENT

This Amendment is made and entered into as of September 27,1996 by and between INHALE THERAPEUTIC SYSTEMS, a California corporation ("INHALE") and PFIZER INC., a Delaware corporation ("PFIZER").

RECITALS

WHEREAS, Inhale and Pfizer are parties to a Collaborative Development and License Agreement made as of January 18, 1995 and effective as of February 28, 1995 (the "Agreement");

WHEREAS, by letter dated September 12, 1995 (the "First Amendment"), Inhale and Pfizer amended Exhibit 1.13 of the Agreement;

WHEREAS, Inhale and Pfizer desire to amend the Agreement, as set forth below.

NOW THEREFORE, in consideration of the foregoing and the covenants and promises contained in this Agreement, Inhale and Pfizer agree as follows:

1. Definitions.

As used herein, capitalized terms shall have the meanings ascribed to them in the Agreement, except as expressly specified otherwise.

2. Amendments

2.1 Section 3.4(d) is hereby amended by deleting the entire text thereof and replacing it with the following:

(d) **[*]** **[*]**

2.2 Section 3.4(h) is hereby amended by deleting the entire text thereof and replacing it with the following:

(h) Except for the Devices referred to in Sections 3.4(c) , INHALE shall not deliver clinical materials and Devices to PFIZER or clinical study sites designated by Pfizer, as the case may be, clinical materials and Devices unless requested to do so by PFIZER via written request from PFIZER's JDC Co-Chairperson to INHALE's JDC Co-Chairperson.

2.3 The first sentence of Section 3.4(i) is hereby amended by deleting the entire text thereof and replacing it with the following:

PFIZER's Co-Chairperson must provide INHALE's Co-Chairperson with written notice **[*]** Devices or clinical **[*]**, or such other time as the JDC may determine to be reasonable, of receipt by PFIZER of such Devices and clinical materials; provided, however, that such written notice accepting or rejecting the Devices and materials referred to in Section 3.4(d) shall be made within **[*]** after the later of (A) PFIZER's receipt from INHALE of photocopies of the Site Device Receipt Forms and Site Drug Receipt Forms countersigned by the initial clinical study sites designated by PFIZER to certify their receipt of the required quantities of such Devices and materials in good condition and (B) receipt by PFIZER of release documentation from INHALE that demonstrates, **[*]**, that the Devices and materials shipped to such sites meet the specifications and requirements set forth in PFIZER's IND for the outpatient Phase II Trials.

2.4 The second sentence of Section 3.4(j) is hereby amended by deleting the entire text thereof and replacing it with the following:

In addition, if the milestone event referred to in Section 3.4(d) is achieved and PFIZER elects to initiate a development program for the Products in **[*]**, PFIZER shall make one additional non-refundable payment of **[*]** on **[*]**, and one further non-refundable payment of **[*]** on **[*]**.

2.5 The first sentence of Section 3.4(k) is hereby amended by deleting the entire text thereof and replacing it with the following two sentences:

The payments by PFIZER to INHALE due under Sections 3.4(b), (c) and (e) shall be made **[*]**. The payment by PFIZER to INHALE due under Section 3.4(d) shall be **[*]**.

3. Miscellaneous

3.1 This Amendment shall be governed by and interpreted in accordance with the substantive laws of the State of New York and the United States of America, without regard to choice of law rules.

3.2 As amended by this Amendment and the First Amendment, the Agreement remains in full force and effect and is hereby ratified and confirmed.

IN WITNESS WHEREOF, this Amendment is hereby executed as of the date first above written.

PFIZER INC.	**INHALE THERAPEUTIC SYSTEMS**
By: /s/ J. Niblack	By: /s/ Robert Chess
Name: John F. Niblack	Name: Robert Chess
Title: Executive Vice President	Title: President and CEO

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EXHIBIT 10.55

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AMENDMENT AND AGREEMENT

This Amendment and Agreement is made and entered into as of October 9, 1998 by and between INHALE THERAPEUTIC SYSTEMS, INC., a Delaware corporation ("INHALE"), and PFIZER INC., a Delaware corporation ("PFIZER").

RECITALS

WHEREAS, INHALE and PFIZER are parties to a Collaborative Development and License Agreement made as of January 18, 1995 and effective as of February 28, 1995, as amended as of September 27, 1996 ("the Agreement "); and

WHEREAS, INHALE and PFIZER desire to amend the Agreement and enter into certain other agreements, as set forth below.

Now, THEREFORE, in consideration of the foregoing and the covenants and promises contained herein, INHALE and PFIZER agree as follows:

1. Definitions.

As used herein, capitalized terms shall have the meanings ascribed to them in the Agreement, except as expressly specified otherwise.

2. Amendments.

2.1 Section 1.14 of the Agreement is amended in its entirety to provide as follows:

1.14 "Major European Country" means each of **[*]**. *On a one-time basis, PFIZER may, on notice to INHALE, replace one, but only one, of the foregoing countries with a different country which may be* **[*]**, *provided that such replacement country* **[*]**. *Subject to the foregoing, the replacement county may be a Major Other Country.*

2.2 Section 3.2(e)(viii) is amended deleting the last two sentences thereof.

2.3 Section 6.6 of the Agreement is amended in its entirety to provide as follows:

6.6 Regulatory and Marketing Diligence.

(a) **[*]**. *Subject to Section 6.6(h), the license granted to PFIZER under Section 6.1 shall remain in effect in* **[*]** *provided PFIZER satisfies the following conditions:*

(i) PFIZER directly or through third parties undertakes activities reasonably calculated to **[*]***; and*

(ii) **[*]**, *PFIZER directly or through a licensee* **[*]**.

(b) Plans for Launch **[*]**. *As used in this Section 6.6 the term "Region" shall mean each of* **[*]** *(the "ROW").*

(i) **[*]**, *PFIZER shall notify INHALE of its plans regarding the* **[*]** *as provided for in Sections 6.6(c), (d), and (e), below.*

(ii) If at such time PFIZER notifies INHALE that it does not intend to **[*]** *in accordance with the applicable time frame(s) provided in Sections 6 6(c), (d), and (e), then the provisions of Section 6.6(g) shall apply to* **[*]**.

(iii) If at such time PFIZER notifies INHALE that it intends to **[*]**, *then PFIZER shall provide INHALE in writing with (A) a description of applicable commercial, medical, regulatory, manufacturing or other causes or factors* **[*]** *such as, for example and without limitation,* **[*]** *and, (B) a plan to address such causes and factors that Pfizer believes will reasonably enable it to* **[*]** *and within the time frames established by Sections 6.6(c), (d), or (e). Such plan shall contain PFIZER's commercial forecast for sales of Products in the projected year of* **[*]** *in the countries covered by Sections 6.6(c), (d), and (e). Subject to the other terms of this Section 6.6, PFIZER shall retain its license under Section 6.1 as to those Regions for which it* **[*]**. *The provisions of Section 6.6(g) shall apply to any particular Region for which PFIZER fails to provide such* **[*]** *at such time. PFIZER from time to time may amend such plan as may be warranted* **[*]** *from time to time. PFIZER shall make diligent efforts to implement such plan, as so amended. As INHALE shall request, PFIZER shall advise INHALE from time to time as to the progress of implementation of such plan, as so amended. If, at any time after delivery of such* **[*]**, *PFIZER shall* **[*]**, *it shall so advise INHALE and the provisions of Section 6.6(g) shall thereupon apply to such Region.*

(c) **[*]**. *Subject to Section 6.6(h), the license granted to PFIZER under Section 6.1 shall remain in effect in* **[*]** *provided PFIZER satisfies the following condition:*

(i) For **[*]**, *PFIZER directly or through third parties,* **[*]**.

(d) **[*]**. *Within* **[*]**, *PFIZER will either elect to initiate a development program for the Products in* **[*]**. *If PFIZER elects to initiate the development program in* **[*]**, *subject to Section 6.6(h), the license granted to Pfizer under Section 6.1 shall remain thereafter in effect in* **[*]** *provided PFIZER satisfies the following condition:*

(i) PFIZER directly or through third parties, **[*]**.

(e) Other Countries. Subject to Section 6.6(h) the license granted to PFIZER under Section 6.1 shall remain in effect in **[*]**, *provided PFIZER satisfies the following condition:*

(i) For **[*]**, *PFIZER, directly or through third parties,* **[*]**. *If PFIZER elects to make one of the* **[*]**, *as permitted by Section 1.14, as amended, then the foregoing shall apply to* **[*]**.

(f) Notwithstanding any provision of this Section 6.6, **[*]**. *For the purposes of applying Section 6.6(a), (c), (d) and (e), PFIZER shall be deemed to have met the* **[*]** *requirement in any country in which* **[*]**.

(g) If PFIZER shall fail to satisfy any conditions(s) specified in Sections 6.6(a), (c), (d) or (e), and shall fail to remedy such failure within **[*]** *after receipt of written notice from lNHALE of such failure, INHALE may* **[*]** *hereunder with respect to all countries in the particular Region(s) involved, on a further* **[*]** *written notice, provided that PFIZER shall retain its license in those countries of any such particular Region in which it shall have* **[*]**. *Neither lNHALE nor any third party will* **[*]** *in connection with* **[*]**, *absent agreement with PFIZER,* **[*]** *for such use.*

(h) The **[*]** *deadlines provided for in Section 6.6(a), (c), (d), and (e) shall be extended for the Region(s) affected according to the following*

(i) The **[*]** *deadline shall be the later of the applicable deadline under Section 6.6 (a), (c), (d) or (e) and: (A) in the case of* **[*]**; *(B) in the case of* **[*]**; *and (C) in the case of* **[*]**; *provided, PFIZER shall have* **[*]**.

(ii) If there is **[*]** *as a result of (A) a delay in the* **[*]**, *including, without limitation,* **[*]**, *(B)* **[*]**, *or (C) any circumstances beyond the reasonable control Pfizer, then the* **[*]** *deadline shall be* **[*]**, *provided that PFIZER shall* **[*]**. *For example, and without limitation, it is acknowledged that* **[*]** *may be caused, without limitation, by* **[*]**.

(iii) If there is **[*]** *shall have decided to* **[*]**, *then the* **[*]** *deadlines for the Regions affected shall be extended for* **[*]** *on the condition that (A) PFIZER, after* **[*]**, *shall have* **[*]** *to provide at least* **[*]** *under Section 6.6(b)(iii), provided that such conditions shall not apply to the extent that such* **[*]**, *and (B) PFIZER shall furnish INHALE with a* **[*]** *that provides for* **[*]** *according to the terms of Section 6.6 (c), (d) and/or (e) within such extended deadline(s). Pfizer may from time to time amend such plan as may be warranted, in its commercial judgment, by* **[*]** *as may pertain from time to time. PFIZER shall* **[*]** *as so amended. As INHALE shall request, PFIZER shall advise INHALE from time to time as to the progress of implementation of such plan. If, at any time after delivery of such plan, PFIZER shall decide* **[*]** *to maintain its license in such Region, it shall so advise INHALE and the provisions of Section 6.6(g) shall apply to such Region.*

(iv) As to **[*]**, *if PFIZER concludes that continuing to* **[*]** *in any of the countries referred to in this Section 6.6 cannot be justified due to* **[*]**, *PFIZER may replace such country with another country in any Region* **[*]**.

(i) The Parties shall form a Commercialization Consultation Committee ("CCC") to which PFIZER's Global Development Team ("GDT") or such other teams as PFIZER may establish to manage Commercialization of Products will: (A) report on a periodic basis (but no less than quarterly) their strategy, plans and activities including, but not limited to, **[*]** *relevant to INHALE's understanding of PFIZER's commercial plans, and (B) receive input from INHALE on such strategy, plans and activities. The CCC shall operate under the following terms:*

(A) Organization. The CCC shall consist of three members from each Party. Each Party shall appoint to the CCC a member of the JDC, a person with marketing expertise and one other member. Each Party will elect one of its three members to serve as a co-chairperson.

(B) Function. The function of the CCC shall be to receive information on commercialization of Products by PFIZER as provided above, to receive comment from INHALE on PFIZER's commercialization plans and to otherwise serve as a forum for communication between the Parties for commercial issues outside the scope of the JDC. Each co-chairperson of the CCC will be responsible for keeping the Party he or she represents informed of the status of the Project. The CCC is not intended to replace any internal management procedures of either Party but rather to be a vehicle to promote the optimal commercialization of Products.

(C) Decision Making. The CCC will **[*]**.

(D) Rules & Logistics. The rules governing and logistics of the CCC shall include, but are not limited to, the following, which can be modified by the CCC from time to time:

(1) The timing, agenda, and minutes of each CCC meeting will be the responsibility of the co-chairperson hosting the meeting.

(2) The location of the CCC meeting will alternate between INHALE's facility in San Carlos and one of PFIZER's facilities.

(3) The CCC will meet no fewer than four times annually.

(4) With the consent of both Parties non-members of the CCC may participate in CCC meetings. Each Party shall give the other reasonable prior notice of its intention to have a non-member attend any CCC meeting.

(5) Minutes of each CCC meeting will be summarized within three (3) weeks after the meeting and will not be official until the non-drafting co-chairperson has agreed to them.

(6) Each Party will bear its own travel and lodging expenses associated with the CCC and its meetings.

(7) Subject to Section 6.6(i)(A), CCC members reporting to a Party may be changed from time to time at the sole discretion of the Party with notice to the other Party.

(8) INHALE agrees that information provided to the CCC by PFIZER will constitute Confidential Information of PFIZER subject to the confidentiality and non-use provisions of Section 15 of this Agreement and that as provided in such Section 15 such Confidential Information shall be used only for the purposes contemplated hereby and, without limitation, shall not be disclosed to, or used in connection with projects for, any third party with whom INHALE has an agreement for product development or a similar project.

2.4 Section 6.8 of the Agreement is amended by adding at the end thereof the following sentence:

If PFIZER wishes to grant a third party a sublicense, as permitted by the terms hereof, under any INHALE Patent Rights and/or INHALE Know-how, and PFIZER does not have the right to grant sublicenses under such INHALE Patent Rights or INHALE Know-how (the absence of such right being a result of the circumstance, for example without limitation, that INHALE procured rights to such INHALE Patent Rights and/or INHALE Know-how under contractual arrangements that permitted the grant of a sublicense by INHALE but did not permit the holder of such sublicense to grant further sublicenses), then INHALE agrees in any such circumstance to grant a license under such INHALE Patent Rights and/or INHALE Know-how directly to any such third party, such license being of appropriate scope under the circumstances.

2.5 The Agreement is amended by adding thereto a new Section 6.10 providing as follows:

6.10 No Other Use of INHALE Patents or INHALE Know-how; No Implied Licenses. PFIZER hereby covenants to lNHALE that PFIZER will not practice the INHALE Know-how or the INHALE Patent Rights outside the scope of the license granted to PFIZER pursuant to Section 6.1. Except as expressly provided in Sections 6.1 and 6.2, this Agreement shall not be construed to grant to either Party any licenses under any Patents or know-how owned or Controlled by the other Party.

2.6. The Agreement is amended by adding after Section 15.6 a new Section 15.7 providing as follows:

15.7 INHALE agrees that, notwithstanding any provision of the Agreement or any other agreement between PFIZER and INHALE relating to inhaled insulin now in effect or that may be entered into in the future during the Term of this Agreement, PFIZER shall be permitted to furnish to the third party with whom PFIZER on the date of this Amendment and Agreement is contemplating entering into agreements concerning the production of Bulk Insulin ("Third Party") any information, whether in written, oral or other form, provided to PFIZER by INHALE having any relation to the transactions contemplated by this Agreement, or any related agreement between PFIZER and INHALE including, without limitation, any information that constitutes INHALE Know-how (as such term is defined in the Agreement, or defined in the Manufacturing and Supply Agreement (Processed Insulin) or Manufacturing and Supply

Agreement (Devices) dated on or around October 9, 1998) or that constitutes other confidential or proprietary information furnished to PFIZER by INHALE in connection with such transactions. lNHALE agrees that **[*]**. *The foregoing provisions of this Section 15.7 shall be subject to the agreement by the Third Party to enter into a written agreement with INHALE with respect to confidentiality concerning such information and rights to intellectual property developments that contains provisions no less protective to INHALE than such provisions to which PFIZER is subject under this Agreement.*

2.7 The Agreement is amended by adding after Section 16.2 a new Section 16.2A providing as follows:

16.2A. Procedure for Review of Press Releases and Other Publications.

This section 16.2A shall apply to press releases and other public disclosures that are permitted by the last sentence of Section 16.2, it being understood that it shall not apply to disclosures that are described in the first two sentences of Section 16.2 or to disclosures that require joint approval of the Parties under the third sentence of Section 16.2. Each Party shall submit to the other Party a draft of all press releases and other public disclosures ("Proposed Disclosures") for review and comment by the other Party at least **[*]** *prior to the date upon which such Party plans to release such Public Disclosure. If INHALE is the Party providing such Proposed Disclosure for review, it shall provide a copy of such Public Disclosure to each of the following individuals (or such others as PFIZER may notify INHALE) at PFIZER:*

[*]

If PFIZER is the Party providing such Proposed Disclosure to INHALE for review, it shall provide a copy of such Proposed Disclosure to each of the following individuals (or such other individuals as INHALE may notify PFIZER) at INHALE:

[*]

Press releases and public disclosures that have been redrafted in response to comments by the reviewing Party shall be recirculated pursuant to procedures provided for herein for review and comment by the reviewing Party at least **[*]** *prior to planned disclosure, provided that any such* **[*]** *review period shall not extend the* **[*]** *period provided for above. It is understood that disclosures of clinical or other scientific information that is proposed for disclosure may be communicated orally rather than by written draft and that such oral disclosures shall be deemed to be Proposed Disclosures hereunder. Any Proposed Disclosure shall be deemed to have been reviewed by a Party if either (i) the proposing Party actually receives comments, either oral or written, from any one of the above individuals, or (ii)* **[*]**, *as applicable, elapse since a given Proposed Disclosure has been provided for comment to the other Party and the proposing Party makes reasonable efforts to obtain the comments of one of the listed individuals. Each Party shall give due regard and consideration to any comments made by the other Party with respect to a given Proposed Disclosure prior to providing such Proposed Disclosure to any third party. Notwithstanding the foregoing, either Party may make any disclosure required by law (as advised by its respective legal counsel) without prior notice to the other Party. In such event, the disclosing Party will use diligent efforts to provide a copy of such Proposed Disclosure as far in advance of such Public Disclosure as is reasonable under the circumstances.*

2.8 Section 18 of the Agreement is amended in its entirety to provide as follows:

18.1 Exclusivity. During the Term of this Agreement, INHALE and PFIZER shall work on the research, development and commercialization of **[*]** *of Regular Insulin for pulmonary delivery and compatible Devices and of* **[*]** *of* **[*]** *exclusively pursuant to this Agreement. Without limitation, the foregoing shall apply to both* **[*]** *of both Regular Insulin and* **[*]** *for pulmonary delivery and compatible Devices.*

18.2 Option for **[*]**. *Either Party shall have the option to propose* **[*]** *of* **[*]**. *If either Party makes such a proposal, the Parties shall negotiate the terms and conditions of such* **[*]**. **[*]**.

3. Other Agreements.

3.1 PFIZER and lNHALE acknowledge that under the Agreement, the royalties payable by PFIZER to INHALE will depend in part on **[*]**. As of the date of this Amendment and Agreement, PFIZER is in negotiations with a third party (the "Third Party") to establish a jointly-owned manufacturing entity (the "Manufacturing Entity") that would carry out the manufacture of Bulk Insulin which would be provided to PFIZER. Since the Agreement did not explicitly anticipate the formation of the Manufacturing Entity, PFIZER and INHALE hereby agree on the manner in which the **[*]** under the Agreement:

(a) For the purpose of calculating **[*]**, the cost of **[*]** ("Cost of **[*]**") shall be **[*]**. The Cost of **[*]** shall exclude **[*]**. The Cost of **[*]** shall be calculated in a manner consistent with **[*]**.

(b) If the Manufacturing Entity **[*]** from the Cost of **[*]**. Cost of **[*]** shall **[*]**. To the extent PFIZER or the Third Party provides **[*]**, the cost of **[*]** at the **[*]** of providing such **[*]**, or, in the case of the **[*]** provided by the Third Party, such will be included **[*]** or on other commercial terms as approximate the **[*]** of providing such services, materials or equipment.

(c) In negotiations with the Third Party, PFIZER shall make reasonable efforts to obligate the Third Party and/or Manufacturing Entity such that INHALE will have the same right to audit (subject to the same conditions), through an independent certified public accountant, the books and records of the Manufacturing Entity, for the purpose of determining the accuracy of the calculation of royalties due to it under the Agreement, as INHALE has to audit the books and records of PFIZER under the Agreement for such purpose. In the event that PFIZER is unsuccessful in securing for lNHALE such audit rights, PFIZER shall, at the request of lNHALE and consistent with the Agreement (and the terms of relevant agreements with the Third Party and/or the Manufacturing Entity), audit the books and records of the Manufacturing Entity for purposes of determining the accuracy of the calculation of royalties due to INHALE

under the Agreement and, to the extent permitted under, and subject to the terms provided in, any such agreement, and, consistent with the Agreement, shall report the results of such audit to INHALE. Notwithstanding the above, if PFIZER becomes aware of an inaccuracy in the calculation of the **[*]**, the Parties and INHALE shall remedy the financial consequences as soon as possible.

(d) References in this Section 3.1 to PFIZER and the Third Party include the Affiliates of each of them, except that references herein to the Third Party do not include the Manufacturing Entity. Capitalized terms used but not defined in this Section 3.1 have the same meaning ascribed to them in the Agreement.

(e) The Agreement remains in fall force and effect, and except for the matters expressly addressed herein, this Section 3.1 shall not amend the terms or conditions of the Agreement.

3.2 PFIZER and INHALE each represents and warrants to the other that the execution, delivery and performance of (a) the Manufacturing and Supply Agreement (Processed Insulin), (b) the Manufacturing and Supply agreement (Devices), (c) the Inhale Capital Plan, and (d) the Equipment Agreement, each between the PFIZER and INHALE and each dated on or around the date of this Amendment and Agreement, and (e) this Amendment and Agreement, have all been duly and validly authorized and approved by its appropriate respective corporate action.

4. Miscellaneous

4.1 This Amendment and Agreement shall be governed by and interpreted in accordance with the substantive laws of the State of New York and the United States of America, without regard to choice of law rules.

4.2 As amended by this Amendment and Agreement, the Agreement remains in full force and effect and is hereby ratified and confirmed.

IN WITNESS WHEREOF, this Amendment and Agreement is hereby executed as of the date first above written.

PFIZER INC	**INHALE THERAPEUTIC SYSTEMS, INC.**
By: /s/ J. Niblack	By: /s/ Stephen Hurst
Name: John F. Niblack	Name: Stephen Hurst
Title: Executive Vice President	Title: General Counsel

[*] = CERTAIN CONFIDENTIAL INFORMATION CONTAINED IN THIS DOCUMENT, MARKED BY BRACKETS, HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO RULE 24B-2 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

Exhibit 10.56

December 30, 2004

Nevan Elam

Dear Nevan:

I am pleased and excited to offer you the position of General Counsel and Secretary at Nektar Therapeutics, reporting to Ajit Gill, CEO and President. Your targeted compensation will be $375,000.00 on an annual basis. Of this amount, your fixed compensation will be $281,250.00 and your target variable compensation at 25% will be $93,750.00 per year. Of this variable amount ($93,750.00), the first 6 months of the first year of employment will be guaranteed at 100% regardless of company performance.

In addition, you will receive a sign-on bonus of $50,000.00. You will receive half of this amount ($25,000) at 3 months from date of hire and the remaining balance ($25,000) at 9 months from date of hire. This amount will be subject to payroll withholding and deductions. If your employment terminates other than “without cause” by Nektar or if you resign before your first anniversary, you agree to reimburse Nektar for the full amount of this sign-on bonus.

You are also eligible to participate in the Nektar Stock Option Plan. Subject to the approval of the Compensation Committee, you will be granted an option to purchase 80,000 shares in accordance with this plan. The price of the shares from the Stock Option Plan will be set at the closing price of Nektar’s stock on the day preceding your date of hire. You will also be eligible to participate in Nektar’s benefits program including Medical, Dental and Vision Insurance, Term Life Insurance, 401(k), Flexible Health Spending Account and Short & Long Term Disability.

Nevan, we are delighted to offer you an opportunity to be part of Nektar. As a key member of the Senior Management team, we expect you will play an important role in building our company. In a rapidly growing company like Nektar, quality and committed people like you are the major ingredients of success.

Your employment is by continued mutual agreement and may be terminated without cause by either you or the company at any time without any obligation or compensation by either party.

In compliance with the terms of the Federal Immigration Reform and Control Act, you will be required to provide us with proof of authorization to work and proof of identity.

This offer is valid through January 7, 2005

Sincerely,

/s/ EG Frisby

Elizabeth Frisby
Vice President, Human Resources

OFFER ACCEPTED:

/s/ Nevan Elam — 1/3/05

Nevan Elam — Date

1/17/05

Start Date

Exhibit 10.57

David Johnston

November 9, 2003

Dear David,

I am pleased and excited to offer you the position of Senior Vice President, Research and Development at Nektar, reporting to me. Your targeted compensation will be $400,000.00 on an annual basis. Of this amount, your fixed compensation will be $300,000.00 and your target variable compensation at 25% will be $100,000.00 per year.

In addition, you will receive a sign-on bonus of $30,000.00, which will be paid to you in your first paycheck. This amount will be subject to payroll withholding and deductions. If your employment terminates other than 'without cause' by Nektar or if you resign before your first anniversary, you agree to reimburse Nektar for the full amount of this sign-on bonus.

You are also eligible to participate in the Nektar Stock Option Plan. Subject to the approval of the Option Grant Subcommittee, you will be granted an option to purchase 50,000 shares in accordance with this plan. The option price will be set at the closing price of Nektar's stock on the day preceding your date of hire. You will also be eligible to participate in Nektar's benefits program including Medical, Dental and Vision Insurance, Term Life Insurance, 401(k), Flexible Health Spending Account and Short & Long Term Disability.

Nektar will provide you with the following relocation items:

- Partial shipment of your household goods from Wilmington, NC to your new apartment in the SF Bay Area.
- Shipment of your household goods from Wilmington, NC to the SF Bay Area.
- Storage of your household goods up to 12 months.
- Temporary housing for you and your family up to 60 days (The cost of this housing is taxable to you and will be included in your total W-2 income).
- Travel for you and your family to the SF Bay Area.
- Use of a rental car for up to 14 days or until your car arrives.

You will also receive a relocation allowance of $10,000.00, which will be paid to you in your first paycheck. This amount will be subject to payroll withholding and deductions. If your employment terminates other than ‘without cause’ by Nektar or if you resign before your first anniversary, you agree to reimburse Nektar for the full amount.

Moreover, provided you take advantage of the following portion of the relocation assistance package within your first 12 months of employment with Nektar, Nektar will:

- Provide normal and customary closing costs on the sale of your home in, Wilmington NC. Those items considered not deductible for income tax purposes will be ‘grossed up’ and added to those costs considered deductible. (That portion is subject to withholding.) We will provide you an amount up to 6% of the sale.
- Provide normal and customary closing costs, loan discount points not to exceed 1%, on the purchase of a home in the Bay Area. Those items considered not deductible for income tax purposes will be ‘grossed up’ and added to those costs considered deductible. (That portion is subject to withholding.) We will provide you an amount up to 3% of the purchase.

In the event that you should voluntarily terminate your employment with Nektar or be terminated other than ‘without cause’ by Nektar within one (1) year after these closings, you agree that you will reimburse Nektar for the full amount of these closing costs.

Nektar will also provide you with the following rental assistance:

- 1st year $34,000.00 (paid over 24 pay periods and subject to withholding)

You are eligible to receive reimbursement for all expenses noted above as they relate to your relocation. However, if you voluntarily elect to terminate your employment within twelve months of the effective date a relocation expense was incurred, you agree to repay the relocation dollars reimbursed and/or advances, including all expenses that were directly billed to Nektar. (See attached Repayment Agreement).

David, we are delighted to offer you an opportunity to be part of Nektar. As a key member of the Research and Development team, we expect you will play an important role in building our company. In a rapidly growing company like Nektar, quality and committed people like you are the major ingredients of success.

Your employment is by continued mutual agreement and may be terminated at will with or without cause by either you or the company at any time with or without advanced notice.

In compliance with the terms of the Federal Immigration Reform and Control Act, you will be required to provide us with proof of authorization to work and proof of identity.

This offer is valid through Tuesday November 11, 2003, and is contingent upon the verification by Nektar of information you have provided to us regarding your qualifications for employment.

Sincerely,

/s/ Ajit Gill

Ajit Gill
President and CEO

OFFER ACCEPTED:

/s/ David Johnston — 11/10/03

David Johnston — Date

Start Date

Exhibit 10.58

Addendum of Offer of Employment

David Johnston

November 21, 2003

Dear David,

This letter is to inform you of an addendum to your Offer of Employment signed in November 2003, with Nektar Therapeutics.

In addition to all other terms and agreements provided in your signed Offer of Employment and to assist you with your relocation to the San Francisco Bay Area, Nektar agrees to provide you with a second move of household goods from your apartment in Boston, MA to your new permanent residence in the San Francisco Bay Area. Up to 12 months storage in transit will also be offered with this shipment.

Per the terms of the Nektar relocation policy supplied to you in your original Offer of Employment, in the event that you should voluntarily terminate your employment with Nektar or be terminated other than “without cause” by Nektar within one (1) year after this relocation expense has incurred on your behalf, you agree to repay the pro-rated relocation dollars. (Including all expenses and closing costs that were directly billed to Nektar).

All other terms and conditions of your Offer of Employment are and will remain in effect.

Sincerely,

/s/ EG Frisby

Elizabeth G. Frisby
Vice President, Human Resources

OFFER ACCEPTED:

/s/ David Johnston	12/11/03
David Johnston	Date

Exhibit 21.1

NEKTAR THERAPEUTICS
SUBSIDIARIES*

Name	Jurisdiction of Incorporation or Organization
Nektar Therapeutics AL, Corporation	Alabama
Nektar Therapeutics UK, Ltd.	United Kingdom
Inhale Therapeutic Systems Deutschland GmbH	Germany

* Includes subsidiaries that do not fall under definition of “Significant Subsidiary” as defined under Rule 1-02(w) of Regulation S-X.

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statement (Form S-8 Nos. 333-07969, 333-59735, 333-65919, 333-74669, 333-32788, 333-54078, 333-55032, 333-67342, 333-71936, 333-76638, 333-98321, 333-103040 and 333-117975) pertaining to the amended and restated 1994 Equity Incentive Plan, the 1998 Non-Officer Equity Incentive Plan, the 2000 Non-Officer Equity Incentive Plan, the 401(k) Retirement Plan, the Employee Stock Purchase Plan of Nektar Therapeutics, the Bradford Particle Design plc Share Option Schemes, the Shearwater Corporation 1996 Nonqualified Stock Option Plan, and in the Registration Statements (Form S-3 Nos. 333-36152, 333-53678, 333-54080, 333-108859, and 333-120009) and in the related Prospectuses, respectively, of our reports dated March 11, 2005, with respect to the consolidated financial statements and schedule of Nektar Therapeutics, Nektar Therapeutics management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of Nektar Therapeutics included in this Annual Report (Form 10-K) for the year ended December 31, 2004.

/s/ Ernst & Young LLP

Palo Alto, California
March 11, 2005

Exhibit 31.1

CERTIFICATIONS

I, Ajit S. Gill, certify that:

1. I have reviewed this Annual Report on Form 10-K, of Nektar Therapeutics for the year ended December 31, 2004;

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

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

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

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2005

/s/ AJIT S. GILL

Ajit S. Gill
Chief Executive Officer, President and Director

Exhibit 31.2

CERTIFICATIONS

I, Ajay Bansal, certify that:

1. I have reviewed this Annual Report on Form 10-K, of Nektar Therapeutics for the year ended December 31, 2004;

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

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

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

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2005

/s/ AJAY BANSAL

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

Exhibit 32.1

SECTION 1350 CERTIFICATIONS*

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350, as adopted), Ajit S. Gill, Chief Executive Officer, President and Director of Nektar Therapeutics (the "Company"), and Ajay Bansal, Chief Financial Officer and Vice President, Finance and Administration of the Company, each hereby certifies that, to the best of his knowledge:

1. The Company's Annual Report on Form 10-K, for the year ended December 31, 2004, to which this Certification is attached as Exhibit 32.1 (the "Periodic Report"), fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Annual Report fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Annual Report and results of operations of the Company for the period covered by the Annual Report.

Dated: March 14, 2005

/s/ AJIT S. GILL

Ajit S. Gill
Chief Executive Officer, President and Director

/s/ AJAY BANSAL

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

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this statement required by section 906, has been provided to Nektar Therapeutics and will be retained by Nektar Therapeutics and furnished to the Securities and Exchange Commission ("SEC") or its staff upon request.

* This certification accompanies the Annual Report on Form 10-K, to which it relates, is not deemed filed with the SEC and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-K), irrespective of any general incorporation language contained in such filing.