NEKTAR THERAPEUTICS
Form 10-K
March 01, 2007
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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

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

For the fiscal year ended December 31, 2006

or,

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

Commission File Number: 0-24006

NEKTAR THERAPEUTICS

(Exact name of registrant as specified in its charter)

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

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:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.0001 par value	**Nasdaq Global Market**

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

Indicate by check mark 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. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (Check one):

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨

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

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, 2006, based upon the closing sales price of the registrant s common stock listed as reported on the NASDAQ Market was approximately $1,635,586,821. This calculation excludes approximately 773,472 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, 2006 that have represented 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.

91,397,227

(Number of shares of common stock outstanding as of February 1, 2007)

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Registrant s definitive Proxy Statement to be filed for its 2007 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

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NEKTAR THERAPEUTICS

2006 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, p 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 in Item 1A below and for the reasons described elsewhere in this annual report. All forward-looking

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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.

Trademarks

All Nektar brand and product names contained in this document are trademarks or registered trademarks of Nektar Therapeutics in the United States (U.S.) and other countries. The following, which appear in this document, are registered or other trademarks owned by the following companies: Exubera and Somavert (Pfizer Inc); PEGASYS (Hoffmann-La Roche Ltd.); Neulasta (Amgen Inc.); PEG-INTRON (Schering-Plough Corporation); Macugen ((OSI)-Eyetech); MIRCERA® (Hoffman-La Roche Ltd.); Ostabolin-C (Zelos Therapeutics, Inc.); Hematide (Affymax, Inc.) and Cimzia (UCB Group).

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PART I

Item 1. Business

General Business Overview

We are a biopharmaceutical company with a mission to develop breakthrough products that make a difference in patients lives. We create differentiated, innovative products by applying our platform technologies to established or novel medicines. Our two leading technology platforms are Pulmonary Technology and PEGylation Technology. Nine products using these technology platforms have received regulatory approval in the U.S. or the European Union (EU). Our two technology platforms are the basis of nearly all of our partnered and proprietary product and product candidates.

We create or enable potential breakthrough products in two ways. First, we develop products in collaboration with pharmaceutical and biotechnology companies that seek to improve and differentiate their products. Second, we apply our technologies to already approved drugs to create and develop our own differentiated, proprietary product candidates. Our proprietary product candidates are designed to target serious diseases in novel ways. We believe our proprietary product candidates have the potential to raise the standards of current patient care by improving one or more performance parameters including efficacy, safety and ease-of-use.

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

Strategy

The three key elements of our business strategy are described below.

Maximize the Diabetes Opportunity

Exubera® (insulin human [rDNA origin]) Inhalation Powder is rapid-acting, powder human insulin that is inhaled normally through the mouth into the lungs prior to eating using the hand-held Exubera Inhaler. We believe Exubera has the potential to substantially improve insulin therapy as it provides adults with Type 1 and Type 2 diabetes with the first non-invasive delivery form of insulin. Exubera was approved for marketing in January 2006 in both the U.S. and the EU and is also approved in both Brazil and Mexico. We also have other development programs that target the diabetes therapeutic area based on our technology platforms including a next-generation Exubera development program.

Develop Our Own Proprietary Products

We are developing a portfolio of proprietary product candidates that are intended to address critical unmet medical needs by exploiting our technology platforms and know-how in combination with already approved drugs. Our strategy is to identify molecules that would benefit from the application of our technologies and potentially improve one or more performance parameters including efficacy, safety and ease of use. Our objective is to create value by advancing these product candidates into clinical development and then deciding on a product by product basis whether we want to continue development on our own or seek a partner. Partnering options could range from a comprehensive license to a co-promotion and co-development arrangement depending on a number of factors, such as the cost and complexity of development, needs for commercialization and therapeutic area focus.

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Maintain and Create High Value Partnerships

We have collaborations or licensing arrangements with more than thirty pharmaceutical and biotechnology companies. Our partnering strategy enables us to develop a large and diversified pipeline of drug products and product candidates using our technologies. Historically, we have combined our technologies with molecules provided by or brought to us by our partners. As we continue to shift our focus towards developing proprietary product candidates, in addition to supporting our current partner development programs, we expect to engage in selecting high value partnerships in order to optimize revenue potential, probability of success and overall return on investment.

Our Technology Platforms

Our technology platforms are designed to improve the performance of new and existing drugs including both small and macromolecules. Our two technology platforms are described below.

Pulmonary Technology. Our Pulmonary Technology includes technologies for drug formulation, powder processing, powder filling and packaging, as well as dry powder inhaler devices to create an integrated system that delivers therapeutics to the lung. We also have technology to deliver liquid aerosols to the deep lung in an efficient and reproducible manner. We are currently working with a variety of different dry powder inhalers and several different types of liquid nebulizers. Exubera is the only FDA approved product using our Pulmonary Technology.

We believe our Pulmonary Technology has the potential to offer one or more of the following benefits:

- Non-invasive delivery of certain peptides and proteins for systemic distribution;
- Systemic delivery of molecules that require fast onset of action; and
- Local lung targeting to treat pulmonary disease while reducing systemic exposure.

In addition to Exubera, our Pulmonary Technology is being used in six product candidates in clinical development including:

- an inhaled formulation of tobramycin being developed in partnership with Novartis Pharma AG for the treatment of lung infections in patients with cystic fibrosis and currently undergoing Phase 3 clinical trials;
- an inhaled formulation of dronabinol being developed in partnership with Solvay Pharmaceuticals for the treatment of migraines and currently undergoing Phase 2 clinical trials;
- inhaled ostabolin-C being developed in partnership with Zelos Therapeutics for the treatment of osteoporosis and currently undergoing Phase 1 trials; and

an inhaled formulation of Ciprofoxacin being developed in partnership with Bayer Healthcare for the treatment of lung infections in cystic fibrosis patients and currently undergoing Phase 1 trials. It is also used in two of our proprietary product candidates in early clinical trials. Exubera has received FDA and EMEA approval using this technology.

PEGylation Technology. Our PEGylation Technology is designed to enhance performance of a variety of 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 drugs to give them certain unique properties such as the potential to improve drug solubility and stability, increase drug half-life, reduce immune responses to an active drug, provide drug targeting and improve the efficacy or safety of a drug in certain instances.

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We believe our PEGylation Technology has the potential to offer one or more of the following benefits:

- Reduced rate of drug absorption from a subcutaneous injection and slowing the rate of elimination or metabolism by improving stability of the drug in the body thereby lowering the number of injections required for a patient for certain therapies;
- Reduced immune response to certain macromolecules which may prolong their effectiveness with repeated doses;
- Improved efficacy or safety in certain instances as a result of better pharmacokinetics of the drug in the body; and
- Improved targeting of a drug to act at the site of disease thus having the potential to improve efficacy or reduce toxicity.

Currently this technology is used in seven products approved in the U.S. and one in the EU. It is also used in two of our early stage proprietary product development programs.

Approved products and clinical pipeline

The following table summarizes select proprietary and partnered products and product candidates including product candidates in pre-clinical, clinical development, products for which a New Drug Application, or NDA, or Biologics License Application, or BLA, has been filed, and products that have received regulatory approval in one or more jurisdictions. The table includes the type of molecule or drug, the primary indication for the product or product candidate and the status of the program. Approval status applies to the U.S. market unless otherwise noted.

Molecule	Primary Indication	Partner	Status(1)
Pulmonary Technology			
Partnered			
Exubera® (insulin human [rDNA origin]) Inhalation Powder	Adult Type 1 and Type 2 Diabetes	Pfizer Inc	Approved in EU and U.S., Brazil and Mexico
Tobramycin inhalation powder	Lung infections in cystic fibrosis patients	Novartis Pharma AG	Phase 3
Pulmonary dronabinol (Dronabinol metered dose inhaler)	Migraine (with and without aura)	Solvay Pharmaceuticals, Inc.	Phase 2
Ciprofloxacin Inhalation Powder	Lung infections in cystic fibrosis patients	Bayer Healthcare	Phase 1
Pulmonary ostabolin-C	Osteoporosis	Zelos Therapeutics	Phase 1
Proprietary			
Inhaled Antibiotics (Aerosolized amikacin)	Adjunctive treatment of pneumonia in ventilated patients	Nektar Proprietary Program	Phase 2
Amphotericin B inhalation powder	Prevention of pulmonary aspergillosis	Nektar Proprietary Program	Phase 1 (pre-pivotal)
Pegylation Technology			
Partnered			
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
Macugen® (pegaptanib sodium injection)	Age-related macular degeneration	OSI Pharmaceuticals (formerly Eyetech)	Approved U.S. EU & Canada

Cimzia (certolizumab pegol, CDP870)	Crohn s disease	UCB Pharma	Filed in U.S. & EU
MIRCERA® (C.E.R.A.) (Continuous Erythropoiesis Receptor Activator)	Renal anemia	Hoffmann-La Roche Ltd.	Filed in U.S.& EU

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Molecule	Primary Indication	Partner	Status(1)
Cimzia (certolizumab pegol, CDP870)	Rheumatoid arthritis	UCB Pharma	Phase 3
Macugen® (pegaptanib sodium injection)	Diabetic macular edema (DME)	OSI Pharmaceuticals (Eyetech)	Phase 2
Macugen® (pegaptanib sodium injection)	Retinal Vein Occlusion (RVO)	OSI Pharmaceuticals (Eyetech)	Phase 2
Hematide (synthetic peptide-based, erythropoiesis-stimulating agent)	Anemia	Affymax, Inc.	Phase 2
CDP 791 (PEG-antibody fragment angiogenesis inhibitor)	Non-Small Cell Lung Cancer	UCB Pharma	Phase 2
Undisclosed	Undisclosed	Pfizer Inc	Phase 2
Proprietary			
Undisclosed	Pain related	Nektar Proprietary Program	Phase 1
Undisclosed	Oncology	Nektar Proprietary Program	Pre-clinical

(1) Status definitions are:
Approved regulatory approval to market and sell product obtained in the U.S., EU and other countries.

Phase 3 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 2 Product in clinical trials to establish dosing and efficacy in patients.

Phase 1 Product in clinical trials typically in healthy subjects to test safety.

Pre-clinical Group of studies that test a drug on animals and other nonhuman test systems. This testing is conducted to gain more data about the pharmaceutical s efficacy and safety before tests on humans can begin.

Partnership with Pfizer for Exubera

In 1995, we entered into a collaboration with Pfizer to develop and commercialize Exubera® (insulin human [rDNA origin]) Inhalation Powder. Exubera is rapid-acting, powder human insulin that is inhaled normally through the mouth into the lungs prior to eating using the hand-held Exubera Inhaler. The Exubera Inhaler weighs four ounces and, when closed, is about the size of an eyeglass case. The Exubera Inhaler produces a cloud of insulin powder in its chamber, which is designed to pass rapidly into the bloodstream to regulate the body s blood sugar levels. In patients with type 2 diabetes, Exubera can be used alone or in combination with diabetes pills or longer-acting insulin. In patients with type 1 diabetes, Exubera will be used in combination with longer-acting insulin.

We developed both Exubera Inhalation Powder and the Exubera Inhaler in partnership with Pfizer using our Pulmonary Technology. Under our collaboration agreement, Pfizer has sole responsibility for marketing and selling Exubera. Pfizer has the ability to manufacture up to one-half of the Exubera Inhalation Powder and also has responsibility for the automated filling of all insulin blister packs for the Exubera Inhaler and packaging of the Exubera product. We currently perform all of the manufacturing for the Exubera Inhalation Powder and Exubera Inhalers. Pfizer has an Exubera Inhalation Powder manufacturing facility and will likely manufacture a portion of the Exubera Inhalation Powder beginning this year. We receive manufacturing revenues from the sale to Pfizer of the Exubera Inhalation Powder and Exubera Inhalers and a product royalty based on end product sales and Pfizer s cost of goods sold.

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 blindness, loss of circulation, kidney failure, heart disease or stroke. Insulin is a widely-used and relied upon standard of therapy for patients with both Type 1 and Type 2 diabetes.

According to the World Health Organization, 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

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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. This can result in poor control of blood sugars which can lead to the complications of the disease. Further, we believe that many Type 1 and Type 2 patients take less insulin than they should in part because of the dislike of injections. We also 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.

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. Similar results were demonstrated in Type 2 patients in a trial in the United Kingdom.

In January 2006, Exubera received marketing approval in the U.S. and E.U for the treatment of adults with Type 1 and Type 2 diabetes for the control of hyperglycemia. In July 2006, Pfizer began the initial commercial launch of Exubera. Pfizer is taking a phased approach to the Exubera commercial launch. In the second half of 2006, the early phase of the Exubera launch focused on Pfizer manufacturing scale-up activities and the education of diabetes specialists. In 2007, Pfizer has initiated the next phase of the launch by expanding the education, marketing and sales efforts more broadly to primary care physicians.

Nektar Proprietary Product Development Programs

Inhaled Antibiotics (Aerosolized amikacin) for Adjunctive Treatment of Pneumonias in mechanically ventilated patients

Our Inhaled Antibiotic development program focuses on the adjunctive aerosol treatment of intubated and mechanically ventilated patients diagnosed with gram negative pneumonia; a significant cause of hospital-based morbidity and mortality. Current therapy for these types of pulmonary infections relies almost exclusively upon high doses of intravenous antibiotics, which can be associated with severe side effects. Aminoglycosides is a particular class of antibiotics that can be effective for treating pneumonias associated with gram-negative organisms, such as *Pseudomonas aeruginosa,* when administered through intravenous therapy. However, this class of antibiotics penetrates poorly from the blood to the lung relative to other classes of antibiotics, which can cause unwanted systemic toxicities including damage to kidneys and hearing. Gram-negative bacteria accounts for a majority of hospital-acquired pneumonias and causes significant morbidity and mortality.

Our Inhaled Antibiotic program uses a proprietary liquid delivery system that delivers aerosolized amikacin to the lung to treat these pneumonias. This product candidate could be used in conjunction with standard intravenous antibiotics and has potential to improve the outcomes and reduce systemic toxicities in this difficult to-treat patient population. This product candidate has completed one Phase 2 trial to examine the pharmacokinetics, dosing, safety, and tolerability of aerosolized amikacin to treat gram-negative pneumonias in mechanically-ventilated patients. We are currently planning additional Phase 2 studies to examine the pharmacokinetics of the product. We are currently seeking a partner for this development program.

Amphotericin B Inhalation Powder (ABIP) for Prevention of Serious Pulmonary Infections In Immunocompromised Patients

Our ABIP program is intended to address the significant morbidity and mortality rates in immunocompromised patients at risk for serious pulmonary fungal infections. ABIP is being developed to prevent invasive pulmonary infections in patients at high risk of developing these infections due to being severely immunocompromised, such as those receiving hematopoietic stem cell transplant or patients receiving myelosuppresive treatment for myelodysplastic syndrome or acute myelogenous leukemia (AML). Our pocket-

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sized powder inhaler used in ABIP is a unique delivery mode designed to enable the targeting of therapeutic concentrations of Amphotericin B directly to the lungs at levels similar to or greater than the lung concentrations that can be achieved by intravenous dosing of Amphotericin B or lipid-associated Amphotericin B products. By targeting Amphotericin B directly at the site of a potential aspergillus infection, we believe ABIP has the potential to significantly reduce these life-threatening lung fungal infections, while at the same time minimize common toxicities associated with intravenous Amphotericin B therapy.

In February 2006, the FDA granted U.S. orphan drug designation for ABIP for prevention of pulmonary fungal infections in patients at risk for aspergillosis due to immunosuppressive therapy. In May 2006, the FDA granted Fast Track designation for ABIP for prevention of pulmonary fungal infections in patients at risk for aspergillosis due to immunosuppressive therapy, including those receiving organ or stem cell transplants, or treated with chemotherapy or radiation for hematologic malignancies (leukemias). In September 2006, the European Commission granted orphan medicinal product designation to ABIP. ABIP has completed multiple preclinical studies and three Phase 1 studies. We are currently seeking a partner for this product candidate.

Pre-clinical and clinical proprietary product development programs

We have two additional proprietary product candidates in preclinical and clinical development based on our PEGylation Technology. One preclinical product candidate is in the disease area of oncology and the other Phase I product is pain-related. We anticipate that these product candidates will be in human clinical trials in 2007. We also have a number of proprietary product candidates in preclinical stages that use either our PEGylation Technology or Pulmonary Technology. We are also evaluating various other drug candidates including generically-available drugs and proprietary third party drugs.

Our Partner Product Development Programs

In a typical collaboration involving our Pulmonary Technology, our partner provides the active pharmaceutical ingredient (many of which have already received regulatory approval in another delivery form), funds research and development, obtains regulatory approvals, and markets the resulting commercial product. We supply our technology and we may manufacture and supply the inhaler device or drug formulation. In consideration for our efforts, we typically receive reimbursement for research and development, milestone payments, revenues from clinical drug and inhaler device and components manufacturing, and royalties from commercial sales of products. In addition, for products and product candidates using our Pulmonary Technology, we typically receive revenues from the manufacture and supply of our inhaler device and drug processing or filling activities.

In a typical collaboration involving our PEGylation Technology, we manufacture and supply the polyethylene glycol, or PEG, reagents to our partners and we may receive upfront fees, milestone payments, manufacturing revenues and royalties from sales of the resulting commercial product.

Significant Partnered Product Development Programs

Cimzia Program

We are a party to a license, manufacturing and supply agreement for Cimzia (certolizumab pegol, CDP870) with UCB Pharma. Under this agreement, we have the right to receive milestone payments, manufacturing revenues and royalties on product sales if the product candidate is commercialized. We will share a portion of the royalties on this product with Enzon pursuant to a license agreement.

In March 2006, UCB filed a BLA with the FDA for Cimzia for the treatment of Crohn s disease. In April 2006, UCB submitted a Marketing Authorization Application, or MAA, to the EMEA for Cimzia for the same indication. Crohn s disease is a chronic digestive disorder of the intestines, and is commonly referred to as inflammatory bowel disease. In December 2006, UCB announced that the FDA had requested additional

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information on its BLA. UCB is also conducting clinical trials on Cimzia for other indications. The product candidate is in Phase 3 trials for the treatment of rheumatoid arthritis and Phase 2 trials for the treatment of psoriasis.

Tobramycin Inhalation Powder Program

We are party to a collaborative research, development and commercialization agreement with Novartis Pharma AG to develop Tobramycin inhalation powder, or TIP, for the treatment of *Pseudomonas aeruginosa* in cystic fibrosis patients. Novartis s existing tobramycin product, TOBI® (Tobramycin Inhalation Solution), was introduced in 1998 as the first inhaled antibiotic approved for treating *Pseudomonas aeruginosa* lung infections in cystic fibrosis patients. Under the terms of this agreement, we are responsible for the development of the powder formulation and pulmonary inhaler, as well as the clinical and commercial manufacturing of the drug formulation and inhaler. Novartis is responsible for the clinical development and worldwide commercialization of the drug formulation and inhaler combination. We have the right to receive research and development funding, milestone payments, as well as royalty payments and manufacturing revenues if the product candidate is commercialized. A Phase 3 clinical trial for TIP was commenced in October 2005 and is continuing.

Ciproflaxin Inhalation Powder Program

We are party to a collaborative research, development and commercialization agreement with Bayer HealthCare AG to develop an inhaleable powder formulation of a novel form of Ciprofloxacin to treat chronic lung infections caused by Pseudomonas aeruginosa in cystic fibrosis patients. Under the terms of the collaboration, we are responsible for formulation of the dry powder drug and development of the inhalation system, as well as clinical and commercial manufacturing of the drug formulation and device combination. Bayer is responsible for the clinical development and worldwide commercialization of the system. We are entitled to research and development funding, milestone payments as the program progresses through further clinical testing, as well as royalty payments on product sales and manufacturing revenues if the product is commercialized. This product candidate is currently in Phase 1 clinical trials.

Ostabolin-C Inhalation Powder Program

We are party to a collaborative research, development and commercialization agreement with Zelos Therapeutics, Inc. to develop an inhaleable powder form of Ostablin-C, a parathyroid hormone analogue. Under the terms of the agreement, we are responsible for development of the formulated dry powder drug and inhalation system, as well as clinical and commercial manufacturing of the drug formulation and device combination. Zelos is responsible for supply of the active pharmaceutical ingredient or API, clinical development and commercialization. We are entitled to receive research and development funding, milestone payments, as well as royalty payments on product sales and manufacturing revenues if the product candidate is commercialized. This product candidate is currently in Phase 1 clinical trials.

Hemophilia A Program

We are party to a collaborative research, development and commercialization agreement with Baxter Healthcare SA and Baxter Healthcare Corp., to develop a product candidate to extend the half-life of Hemophilia A proteins using our PEGylation Technology. These product candidates are in pre-clinical development for treatment of Hemophilia A. We are entitled to receive research and development funding, milestone payments, as well as royalty payments on product sales if the product candidate is commercialized. Nektar will supply, and will receive manufacturing revenues for, the poly(ethylene) glycol reagent used in the products for preclinical, clinical and commercial purposes.

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MIRCERA (C.E.R.A.) (Continuous Erythropoiesis Receptor Activator) Program

We have a license and manufacturing license agreement with Roche for the license of our proprietary PEGylation reagent to be used in the manufacture of Roche s MIRCERA product. Under the terms of the agreement, we are entitled to receive milestone payments and manufacturing revenues during development, as well as royalty payments and certain manufacturing revenues if the product candidate is commercialized.

In April 2006, Roche filed a BLA for MIRCERA with the FDA for the treatment of anemia associated with chronic kidney disease including patients on dialysis or not on dialysis and an MAA with the EMEA for the same indication. MIRCERA is currently the subject of a significant patent infringement lawsuit brought by Amgen related to Roche s patents with respect to the use of MIRCERA to treat chemotherapy anemia in the U.S. Although we are not a party to this lawsuit, if the outcome of such litigation were adverse to Roche, this could have a material adverse impact on this program. In December 2006, Roche submitted additional data to the FDA to support its BLA application for MIRCERA. As a result of this action, the FDA extended the review period of the BLA by three months.

Certain Business Developments in 2006

In June 2006, our collaboration agreement with InterMune, Inc. for the development of PEG-Infergen was terminated upon mutual agreement. In addition, due to lack of progress, our partnered development program for a PEG-Axokine product with Regeneron Pharmaceuticals, Inc. was terminated.

During 2006, we began winding down the operations of our subsidiary, Nektar Therapeutics UK, which had been focused primarily on the research and development of our Super Critical Fluids Technology. There are no longer any full-time employees of Nektar UK and we have disposed of or transferred substantially all of its assets.

Research and Development

Our portfolio of ongoing research and development programs can be segregated into two categories: 1) partnered programs and 2) proprietary programs and platform technology research and development. The costs associated with these categories to be as follows (in millions):

	Years ended December 31,		
	2006	2005	2004
Partner development programs	$ 51.0	$ 72.9	$ 85.0
Proprietary programs and platform technology research and development	98.4	78.8	48.5
Total	$ 149.4	$ 151.7	$ 133.5

These costs include certain allocations including facilities, cGMP quality personnel and other shared resources. We have generally allocated these shared costs based on personnel hours.

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

	Years ended December 31,		
	2006	2005	2004
Salaries and employee benefits	$ 69.9	$ 66.8	$ 61.2
Stock compensation expense	9.7		
Facility and equipment	31.0	26.3	20.5
Outside services	24.1	32.0	29.8
Supplies	8.9	22.0	19.6
Travel and entertainment	2.4	1.8	2.0
Other	3.4	2.8	0.4
Total	$ 149.4	$ 151.7	$ 133.5

In connection with our research and development for partner programs, we earned $56.3 million, $81.6 million and $89.2 million in contract research revenue in the years ended December 31, 2006, 2005 and 2004, respectively.

Manufacturing

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

Our device for use with Exubera is a pulmonary inhaler. In 2006, we began large-scale commercial manufacturing of Exubera Inhalers and Exubera Inhalation Powder. We currently manufacture all of the Exubera Inhalation Powder in our San Carlos, California facility and we have two contract manufacturers that manufacture and supply the Exubera Inhalers. We are also evaluating additional contract manufacturers for inhalers used with other our other partnered and proprietary pulmonary product candidates. As we and our contract manufacturing partners continue to produce Exubera Inhalation Powder and Inhalers for commercial manufacturing, additional investment in equipment and facilities may be required to provide sufficient quantities to meet market demand.

We operate a drug powder manufacturing and packaging facility in San Carlos, California capable of producing drug powders in quantities we believe are sufficient for clinical trials of product candidates utilizing our Pulmonary Technology and the commercial supply of Exubera Inhalation Powder to Pfizer. 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). The facility received a pre-approval inspection from U.S. and international regulatory authorities and was found acceptable for commercial manufacture. Our facilities are subject to ongoing routine inspection and a continuing obligation to adhere to cGMP.

We have developed a high capacity automated filling technology that we believe is capable of filling drug powder blisters on a commercial production scale. We licensed this technology to Pfizer who performs the commercial filling of the Exubera Inhalation Powder into blisters to be used with the Exubera Inhaler.

We have a manufacturing and supply agreement with two contract manufacturers for the manufacture and supply of the Exubera Inhaler. To date, these contract manufacturers have been successful in meeting the commercial supply requirements for the Exubera Inhaler. We believe that these contract manufacturers have successfully implemented our pulmonary device technology, scaled up the manufacturing process to commercial levels, and met the requirements of cGMP. Qualification and validation of their facilities are complete. These manufacturers received a pre-approval inspection from regulatory authorities and were found acceptable for commercial manufacture. Their facilities are subject to ongoing routine inspection and a continuing obligation to adhere to cGMP. We will continually examine scale-up opportunities to expand commercial operations if

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necessary based on Exubera product demand. Increasing manufacturing capacity at our contract manufacturers, if necessary, involves significant risks and uncertainties, including significant lead-time requirements, large capital investments, the recruitment and training of additional qualified personnel, and operational complexities

With respect to products using our PEGylation Technology, we have two manufacturing facilities in Huntsville, Alabama. One is for the manufacture of PEG-derivatives for use by collaboration partners and for our own use. In 2006, we completed construction on a second facility which was designed for the manufacture of Active Pharmaceutical Ingredients, or APIs. This facility will be used to produce APIs for clinical development for our proprietary product candidates that utilize our PEGylation Technology. Both facilities are designed and operated to be in compliance with ICH Q7A guidelines.

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, in animals and in human clinical trials), manufacture, labeling, storage, recordkeeping, approval, marketing, advertising and promotion of our products.

The approval process required by the FDA before a product using our technologies may be marketed in the United States depends on whether the compound has previously been approved 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, or IND, prior to commencing clinical trials;
- 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 BLAs for biological products or a Premarket Approval Application, or PMAs, or Premarket Notification, or 510(k)s, for medical device products.

If the active ingredient has been previously approved by FDA, the approval process is similar, except that certain preclinical tests relating to systemic toxicity normally required for the IND and NDA or BLA may not be necessary if the company has a right of reference to such data or is eligible for approval under Section 505(b)(2) of the Federal Food, Drug, and Cosmetic Act.

Preclinical tests include laboratory evaluation of product chemistry and animal studies to assess the 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, or GLP, regulations. The results of the preclinical tests for drugs, biological products and combination products subject to the primary jurisdiction of FDA s Center for Drug Evaluation and Research, or CDER, or Center for Biologics Evaluation and Research, or CBER, 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 a protocol submitted FDA for review in the IND. Drug products to be used in clinical trials must be manufactured according to cGMP. Clinical trials are conducted in accordance with protocols that detail the objectives of the study and the parameters to be used to monitor participant safety and product efficacy as well as other criteria to be evaluated in the study. Each protocol is submitted to the FDA under the original IND.

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Apart from the IND process described above, each clinical study must be reviewed by an independent Institutional Review Board, or IRB, and the IRB must be kept current with respect to the status of the clinical study. 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 reviews and approve the informed consent form to be signed by the trial participants and any significant changes in the clinical study.

Clinical trials are typically conducted in three sequential phases. In Phase 1, the initial introduction of the drug into healthy human subjects, the product generally is tested for tolerability, pharmacokinetics, absorption, metabolism and excretion. Phase 2 involves studies in a limited patient population to: