NEKTAR THERAPEUTICS
Form 10-Q
August 09, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2007

or,

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

For the transition period from _____ to _____

Commission File Number: 0-24006

NEKTAR THERAPEUTICS

(Exact name of registrant as specified in its charter)

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

San Carlos, California 94070

(Address of principal executive offices)

650-631-3100

(Registrant s telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated file in Rule 12b-2 of the Exchange Act. (check one):

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

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

The number of outstanding shares of the registrant s Common Stock, $0.0001 par value 91,987,765 on July 31, 2007.

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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 quarterly 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 Part II Item 1A below and for the reasons described elsewhere in this quarterly 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.

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: FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements Unaudited:

NEKTAR THERAPEUTICS

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share information)

	June 30, 2007 Unaudited	December 31, 2006 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 82,856	$ 63,760
Short-term investments	323,933	394,880
Accounts receivable, net of allowance of $534 and $357 at June 30, 2007 and December 31, 2006, respectively.	49,829	47,148
Inventory	17,228	14,656
Other current assets	9,520	14,595
Total current assets	$ 483,366	$ 535,039
Long-term investments		8,337
Property and equipment, net	131,024	133,812
Goodwill	78,431	78,431
Other intangible assets, net	3,153	3,626
Other assets	7,491	8,932
Total assets	$ 703,465	$ 768,177
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,941	$ 7,205
Accrued compensation	14,376	12,994
Accrued expenses	16,342	17,942
Interest payable	3,106	3,814
Capital lease obligations, current portion	811	711
Deferred revenue, current portion	13,762	16,409
Convertible subordinated notes, current portion	66,627	102,653
Other current liabilities	3,362	3,586
Total current liabilities	$ 121,327	$ 165,314
Convertible subordinated notes	315,000	315,000
Capital lease obligations	19,328	19,759
Deferred revenue	43,296	23,697
Other long-term liabilities	15,834	17,347
Total liabilities	$ 514,785	$ 541,117
Commitments and contingencies		
Stockholders equity:		
Preferred stock		
	9	9

Common stock, $0.0001 par value; 300,000 authorized; 91,944 shares and 91,280 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively		
Capital in excess of par value	1,298,380	1,283,982
Accumulated other comprehensive income	467	62
Accumulated deficit	(1,110,176)	(1,056,993)
Total stockholders equity	188,680	227,060
Total liabilities and stockholders equity	$ 703,465	$ 768,177

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

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

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share information)

(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Revenue:				
Product sales and royalties	$ 49,302	$ 47,147	$ 122,321	$ 60,043
Contract research	16,615	13,076	28,612	29,139
Total revenue	65,917	60,223	150,933	89,182
Operating costs and expenses:				
Cost of goods sold	39,490	36,773	96,012	45,768
Research and development	41,000	40,610	78,492	72,011
General and administrative	13,178	27,083	29,913	47,456
Litigation settlement		17,710		17,710
Amortization of other intangible assets	237	1,259	473	2,623
Total operating costs and expenses	93,905	123,435	204,890	185,568
Loss from operations	(27,988)	(63,212)	(53,957)	(96,386)
Interest income	5,452	6,374	10,925	11,256
Interest expense	(4,702)	(4,938)	(9,635)	(10,080)
Other expense, net	(22)	(1,055)	(16)	(1,092)
Loss before provision for income taxes	(27,260)	(62,831)	(52,683)	(96,302)
Provision for income taxes	(250)		(500)	
Net loss	$ (27,510)	$ (62,831)	$ (53,183)	$ (96,302)
Basic and diluted net loss per share	$ (0.30)	$ (0.70)	$ (0.58)	$ (1.08)
Shares used in computing basic and diluted net loss per share	91,804	89,697	91,630	89,312

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six months ended June 30,	
	2007	**2006**
Cash flows used in operating activities:		
Net loss	$ (53,183)	$ (96,302)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	11,690	22,558
Depreciation and amortization	15,250	18,549
Amortization of gain related to sale of building	(437)	(437)
Loss on disposal of assets	904	90
Changes in assets and liabilities:		
Increase in trade accounts receivable	(2,681)	(35,231)
Decrease (increase) in inventories	(2,572)	2,380
Decrease (increase) in prepaids and other assets	5,388	(18,541)
Decrease in accounts payable	(4,264)	(13,708)
Increase in accrued compensation	954	7,357
Increase (decrease) in accrued expenses	(1,600)	16,396
Increase (decrease) in interest payable	(708)	23
Increase in deferred revenue	16,952	19,346
Increase (decrease) in other liabilities	(380)	6,058
Net cash used in operating activities	$ (14,687)	$ (71,462)
Cash flows from investing activities:		
Purchases of investments	(273,540)	(157,774)
Maturities of investments	353,171	124,447
Purchases of property and equipment	(11,543)	(11,541)
Net cash provided by (used in) investing activities	$ 68,088	$ (44,868)
Cash flows from financing activities:		
Repayments of convertible subordinated notes	(36,026)	
Payments of loan and capital lease obligations	(823)	(4,894)
Proceeds from issuance of common stock related to employee stock purchase plan	572	769
Proceeds from issuance of common stock related to employee stock option exercises	2,136	11,127
Net cash (used in) provided by financing activities	$ (34,141)	$ 7,002
Effect of exchange rates on cash and cash equivalents	(164)	44
Net increase (decrease) in cash and cash equivalents	$ 19,096	$ (109,284)
Cash and cash equivalents at beginning of period	63,760	261,273
Cash and cash equivalents at end of period	$ 82,856	$ 151,989

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2007

(Unaudited)

Note 1 Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation

We are a biopharmaceutical company headquartered in San Carlos, California and incorporated in Delaware. Our mission is to develop breakthrough products that make a difference in patients lives. We create differentiated, innovative products by applying our platform technologies to established or novel medicines. Our two leading technology platforms are Pulmonary Technology and PEGylation Technology. Ten products using these technology platforms have received regulatory approval in the U.S. or the European Union (EU), or both.

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

Revenues, expenses, assets, and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year. The information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and the accompanying notes to these financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006.

Principles of Consolidation

Our condensed consolidated financial statements include the financial position, results of operations and cash flows of our wholly-owned subsidiaries: Nektar Therapeutics AL, Corporation (Nektar AL); Nektar Therapeutics UK, Ltd. (Nektar UK), Nektar Therapeutics (India) Private Limited, and Aerogen, Inc. All intercompany accounts and transactions have been eliminated in consolidation.

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

Segment Information

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

Reclassifications

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

Revenue Recognition

On January 1, 2007, we began recognizing Exubera revenue upon shipment of product. Prior to January 1, 2007, we deferred Exubera revenue until the expiration of Pfizer s 60-day contractual right of return for non-conformity with product quality specifications, even though we and our contract manufacturers test, inspect and validate that all products meet contractual quality specifications prior to shipment. In 2006, we deferred Exubera revenue over the contractual right of return period (60 days) because

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our first shipments commenced in the beginning of the year and we did not have sufficient historical returns data to reasonably estimate product returns. As of June 30, 2007, we have over 18 months of product shipment history and have not had any warranty returns from Pfizer. During the six months ended June 30, 2007, we began estimating Exubera product returns and recognized revenue and costs of goods sold related to the May and June 2007 Exubera shipments which would have previously been deferred for 60 days. As a result, our gross margin increased $3.0 million and net loss per share decreased $0.03.

Income Taxes

We account for income taxes under the liability method in accordance with FASB Statement No. 109, *Accounting for Income Taxes,* and FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109.* Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax reporting bases of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Realization of deferred tax assets is dependent upon future earnings, the timing and amount of which are uncertain.

FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained upon tax authority examination, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement.

We adopted FIN 48 on January 1, 2007. Upon adoption, we did not recognize an increase or a decrease in the liability for net unrecognized tax benefits, which would be accounted for through retained earnings. Further, we did not have any significant unrecognized tax benefits on the date of adoption.

We have incurred net operating losses since inception and we do not have any significant unrecognized tax benefits. Our policy is to include interest and penalties related to unrecognized tax benefits, if any, within the provision for taxes in the consolidated condensed statements of operations. If we are eventually able to recognize our uncertain positions, our effective tax rate would be reduced. We currently have a full valuation allowance against our net deferred tax asset which would impact the timing of the effective tax rate benefit should any of these uncertain tax positions be favorably settled in the future. Any adjustments to our uncertain tax positions would result in an adjustment of our net operating loss or tax credit carry forwards rather than resulting in a cash outlay.

We file income tax returns in the U.S. as well as California, Alabama, Arizona and various foreign jurisdictions. We are currently not the subject of any income tax examinations. In general, the earliest open year subject to examination is 2002, although depending upon jurisdiction, tax years may remain open, subject to certain limitations.

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Note 2 Cash and Cash Equivalents, Short-Term Investments, and Investments in Marketable Securities

Cash, cash equivalents and investments in marketable securities are as follows (in thousands):

	Estimated Fair Value at June 30, 2007	December 31, 2006
Cash and cash equivalents	$ 82,856	$ 63,760
Short-term investments (less than one year to maturity)	323,933	394,880
Long-term investments (one to two years to maturity)		8,337
Total Cash and Available-for-Sale Securities	$ 406,789	$ 466,977

Our portfolio of cash and available for sale debt securities include (in thousands):

	Estimated Fair Value at June 30, 2007	December 31, 2006
U.S. corporate commercial paper	$ 213,047	$ 234,512
Obligations of U.S. corporations	120,838	151,288
Obligations of U.S. government agencies	32,929	27,372
Repurchase agreements	16,141	33,948
Cash and other debt securities	23,834	19,857
Total Cash and Available-for-Sale Securities	$ 406,789	$ 466,977

At June 30, 2007, the average portfolio duration was approximately four months and the contractual maturity of any single investment did not exceed twelve months. At December 31, 2006, the average portfolio duration was approximately four months and the contractual maturity of any single investment did not exceed twenty-four months.

Gross unrealized gains on the portfolio were $0.2 million and nil as of June 30, 2007 and December 31, 2006, respectively. Gross unrealized losses on the portfolio were $0.3 million and $ 0.5 million as of June 30, 2007 and December 31, 2006, respectively. We have a history of holding our investments to maturity. Additionally, we have the ability and intent to hold our debt securities to maturity at which time they will be redeemed at full par value. Accordingly, management considers these unrealized losses to be temporary and has not recorded a provision for impairment.

At June 30, 2007 and December 31, 2006, we had letter of credit arrangements with certain financial institutions and vendors including our landlord totaling $2.1 million and $2.6 million, respectively, which are secured by investments of similar amounts.

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Note 3 Inventory

Inventory consists of the following (in thousands):

	June 30, 2007	December 31, 2006
Raw materials	$ 9,668	$ 8,609
Work-in-process	6,373	4,736
Finished goods	1,187	1,311
Total	$ 17,228	$ 14,656

Raw materials primarily include materials used in the production of our PEGylation products. Exubera inhalers are manufactured and supplied by our two contract manufacturers, then drop shipped to our customer. We do not hold inventory of Exubera inhalers; however, work-in-process includes $1.8 million in Exubera inhalation powder inventory at June 30, 2007.

Reserves are determined using specific identification plus an estimated reserve for potential defective or excess inventory based on historical experience or projected usage. Inventories are reflected net of reserves of $5.8 million and $4.7 million as of June 30, 2007 and December 31, 2006, respectively.

Note 4 Workforce Reduction

As part of an overall effort to reduce ongoing operating costs and improve the organizational structure, efficiency and productivity of Nektar, on May 18, 2007, the Board of Directors approved a plan (the Plan) to reduce our workforce by approximately 180 employees, or approximately 25 percent of its regular full-time staff. On May 23, 2007, we notified the affected employees impacted by the Plan. The total cost of implementing the Plan is expected to be approximately $8.5 million, comprised of cash payments for severance, medical insurance and outplacement services.

For the three-month period ended June 30, 2007, workforce reduction charges were recorded in the following financial statement lines as follows (in thousands):

	Three months ended June 30, 2007
Cost of goods sold	$ 340
Research and development expense (1)	5,220
General and administrative expense	1,546
Inventory	598
Total workforce reduction charges	$ 7,704

(1) Includes $1.6 million of non-commercial operations, manufacturing, and quality and $3.6 million of R&D infrastructure support. No Pulmonary or PEGylation R&D programs were curtailed due to the workforce reduction.

During the second half of 2007, we expect to record an additional $0.8 million related to the severance, medical insurance and outplacement services for employees impacted by the Plan with termination dates longer than two months from the date of notification. The execution of the Plan is expected to be complete by December 31, 2007.

The following table summarizes the activity during the three-month period ended June 30, 2007 and the liability included in Accrued compensation in our Condensed Consolidated Balance Sheet in connection with the Plan as of June 30, 2007 (in thousands):

	June 30, 2007
Balance at March 31, 2007	$
Workforce reduction charges recorded	7,704
Workforce reduction payments	(5,229)
Balance at June 30, 2007	$ 2,475

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Note 5 Convertible Subordinated Notes

The outstanding balance of our Convertible subordinated notes is as follows (in thousands):

	Semi-Annual Interest Payment Dates	June 30, 2007	December 31, 2006
5% Notes due February 2007	August 8, February 8	$	$ 36,026
3.5% Notes due October 2007	April 17, October 17	66,627	66,627
3.25% Notes due September 2012	March 28, September 28	315,000	315,000
Total outstanding Convertible subordinated notes		$ 381,627	$ 417,653
Less: current portion		(66,627)	(102,653)
Convertible subordinated notes		$ 315,000	$ 315,000

Our Convertible subordinated notes are unsecured and subordinated in right of payment to any future senior debt. The carrying value approximates fair value for both periods presented. Costs related to the issuance of these convertible notes are recorded in Other assets in our Condensed Consolidated Balance Sheets and are generally amortized to interest expense on a straight-line basis over the contractual life of the notes. The unamortized deferred financing costs were $6.2 million and $7.3 million as of June 30, 2007 and December 31, 2006, respectively.

Our 5% Convertible subordinated notes were repaid on February 7, 2007. There are no remaining deferred financing costs related to the 5% Convertible subordinated notes.

Note 6 Significant Collaborative Research and Development Agreements

On March 30, 2007 and May 24, 2007, respectively, Nektar and Pfizer executed interim agreements for joint development, clinical supply and clinical testing relating to the next generation insulin (NGI) program. The NGI program includes a newly designed pulmonary inhaler and an insulin powder formulation.

In connection with the March 30, 2007 agreement, we received a $17.6 million payment from Pfizer in April 2007 for reimbursement of development costs incurred by Nektar from 2004 through January 31, 2007, as well as the shipment of small quantities of insulin powder formulation. In connection with the May 24, 2007 agreement, we agreed to invoice Pfizer $7.1 million for NGI development activities from February 2007 though April 2007, which we subsequently collected in July 2007.

We accounted for these non-refundable payments as upfront fees and recorded these amounts as Deferred revenue in our Condensed Consolidated Balance Sheets. We are amortizing the deferred revenue over the expected life of the NGI program.

Also under the terms of the May 24, 2007 agreement with Pfizer, we will be reimbursed for the cost of work performed on a revenue per annual full-time equivalent (FTE) basis, plus out-of-pocket third party costs.

Note 7 Commitments and Contingencies

Legal Matters

On August 1, 2006, Novo Nordisk filed a lawsuit against Pfizer in federal court claiming that Pfizer willfully infringes on Novo s patents covering inhaled insulin with Exubera. The case is currently proceeding with discovery and other pre-trial activities. Although we are not currently a named party in this litigation, we have incurred litigation costs as a result of such litigation and may incur substantial future costs and potential indemnity claims from Pfizer associated with the litigation. These and other disputes may have a material impact on our business, results of operation and financial condition.

From time to time, we may be involved in lawsuits, claims, investigations and proceedings, consisting of intellectual property, commercial, employment and other matters, which arise in the ordinary course of business. In accordance with the SFAS No. 5, *Accounting for*

Contingencies, we make a provision for a liability when it is both probable that a liability has

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been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, ruling, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. If any unfavorable ruling were to occur in any specific period, there exists the possibility of a material adverse impact on the results of operations of that period or on our cash flows and liquidity.

Collaboration Agreements for Pulmonary Products

As part of our collaboration agreements with our partners for the development, manufacture and supply of products based on our Pulmonary Technology, we generally agree to defend, indemnify and hold harmless our partners from and against third party liabilities arising out of the 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.

To date we have not incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the obligated amount under these agreements is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. No liabilities have been recorded for these obligations on our Condensed Consolidated Balance Sheets as of June 30, 2007 or December 31, 2006.

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

As part of our license, manufacturing and supply agreements with our partners for the development or manufacture and supply of PEG reagents based on our PEGylation Technology, we generally agree to defend, indemnify and hold harmless our partners from and against third party liabilities arising out of the 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 in our Condensed Consolidated Balance Sheets as of June 30, 2007 or December 31, 2006.

Note 8 Stock-Based Compensation

Total stock-based compensation costs were recorded in the following income statement and balance sheet lines items of our Condensed Consolidated Financial Statements:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Cost of goods sold	$ 485	$ 653	$ 1,010	$ 907
Research and development expense	2,187	3,354	5,299	5,669
General and administrative expense	1,745	10,485	4,414	14,819
Total stock-based compensation expense	4,417	14,492	10,723	21,395
Net Inventory Change	(9)	(96)	57	204
Total stock-based compensation costs	$ 4,408	$ 14,396	$ 10,780	$ 21,599

During 2006, we issued performance based RSU awards totaling approximately 1,010,000 shares of our common stock to certain employees. These awards vest based upon achieving three per-determined performance milestones. During the three month-period ended June 30, 2007, one of the three milestones was achieved and approximately 174,000 shares were fully vested and released.

The total unrecognized expense related to unvested stock-based compensation arrangements under the Option Plans is expected to be recognized as follows:

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Fiscal Year	(in thousands)
2007 (remaining 6 months)	$ 7,357
2008	11,754
2009	8,775
2010	5,862
2011 and thereafter	2,387
	$ 36,135

Note 9 Net Loss Per Share

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

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Convertible debentures and notes	15,958	16,897	16,155	16,897
Stock options and restricted stock units	10,768	6,287	10,271	6,369
Warrants		20		20
Total	26,726	23,204	26,426	23,286

Note 10 Comprehensive Loss

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

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Net loss, as reported	$ (27,510)	$ (62,831)	$ (53,183)	$ (96,302)
Change in net unrealized gains on available-for-sale securities	92	219	347	252
Currency translation adjustment	72	106	58	46
Total comprehensive loss	$ (27,346)	$ (62,506)	$ (52,778)	$ (96,004)

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

	June 30, 2007	December 31, 2006
Unrealized losses on available-for-sale securities	$ (152)	$ (499)
Translation adjustment	619	561
Total accumulated other comprehensive income	$ 467	$ 62

Note 11 Subsequent Events

On August 1, 2007, we entered into a Co-Development, License and Co-Promotion Agreement (the Agreement) with Bayer Healthcare LLC, with regard to further development and commercialization of NKTR-061 (inhaled amikacin). Under the terms of the Agreement, we will co-promote the Amikacin Product Candidate in the United States with Bayer and we have granted Bayer an exclusive, royalty-bearing license for the Amikacin Product Candidate in all other countries of the world. As part of this agreement, we will receive milestone payments of up to $175 million associated with the successful development and commercialization of NKTR-061. This includes an upfront payment of $50 million.

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Bayer will fund all clinical development of the Amikacin Product Candidate following the completion of the ongoing Phase II clinical studies that we are currently conducting (other than $10 million of Phase III clinical trial costs to be reimbursed by Nektar following the payment by Bayer of a $10 million development milestone), all world-wide regulatory filings, approvals and related activities, further development of formulated Amikacin, and final product packaging. We will fund the ongoing clinical development of the Amikacin Product Candidate through the completion of current ongoing Phase II clinical studies and the further development of the nebulizer device through the completion of the Phase III clinical trials.

For more details regarding the terms and conditions of our agreement with Bayer, please refer to the Current Report on Form 8-K filed with the Securities and Exchange Commission on August 6, 2007.

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

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

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. Ten products using these technology platforms have received regulatory approval in the U.S. or the EU.

We create or enable potential 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 programs. Our proprietary programs are designed to target serious diseases in novel ways. We believe our proprietary product candidates and development programs 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.

We continue to make significant investments in our proprietary product development programs which comprise a substantial portion of our research and development spending. Our strategy is to develop a portfolio of proprietary product candidates that is intended to address critical unmet medical needs by exploiting our know-how and technology in combination with established medicines. We intend to develop some of these programs in partnership with pharmaceutical and biotechnology companies in various stages of their development in an effort to help fund the investment of our proprietary development programs. Our decision as to when to seek partners for our proprietary product development programs will be made on an individual program basis and such decisions will have an important impact on our future revenues, research and development spending, and financial position.

We will continue to seek collaborative arrangements with pharmaceutical and biotechnology companies, where appropriate. We believe our partnering strategy enables us to develop a large and diversified pipeline of products and development programs using our technologies. To date the revenues we have received from the sales of our partner products have been insufficient to meet our operating and other expenses. We do not anticipate receiving sufficient amounts of revenue from other partner product sales or royalties in the near future to meet our operating expenses.

We currently depend on sales to Pfizer for a significant portion of our revenues primarily from the manufacture and sale of Exubera inhalers and inhalation powder. Total revenue from Pfizer, including Exubera commercial products and contract research revenue, was approximately $43.7 million and $108.4 million, representing 66% and 72% of total revenue, during the three-month and six-month periods ended June 30, 2007, respectively. Pfizer s commercialization of Exubera has proceeded slower than planned with Pfizer commencing direct-to-consumer advertising just recently in July 2007. Exubera sales to end-users have not been significant to date, and because Pfizer is responsible for all Exubera sales and marketing, it is very difficult for us to predict the level of future Exubera sales to end-users. There are substantial risks and uncertainties with respect to the commercial success of Exubera, including physician and patient education and experiences, the overall effectiveness of Pfizer s sales and marketing efforts, third party payor reimbursement, country specific pricing approvals, manufacturing and supply execution,

and other risks and uncertainties identified in this report.

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We are currently the exclusive supplier of Exubera inhalers and inhalation powder and we receive revenues for these manufacturing activities from Pfizer on a cost-plus basis. We have been manufacturing Exubera inhalation powder and inhalers at commercial scale since early 2006. Because the commercial launch and sales levels of Exubera by Pfizer has been much slower than originally planned, Pfizer has built substantial Exubera inventory. As a result, we have worked with Pfizer to reduce Exubera manufacturing volumes in the second half of 2007 to address the current inventory and demand imbalance while maintaining sufficient future Exubera manufacturing capacity. We currently expect that this lower level of manufacturing activity will continue throughout 2008 and beyond depending on the future level of Pfizer s Exubera sales.

To fund the 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 June 30, 2007, we had approximately $410.3 million in indebtedness. Our ability to meet the repayment obligations of this debt is dependent upon our and our partners ability to develop, obtain regulatory approvals, and successfully commercialize products. Even if we are successful in this regard, we may require additional capital to repay our debt obligations as they become due.

In the second quarter of 2007, as part of an overall effort to reduce ongoing operating costs and improve the organizational structure, efficiency and productivity of Nektar, we commenced the implementation of a plan to reduce our work force by approximately 25%. The total cost of the Plan is expected to be approximately $8.5 million, comprised of cash payments for severance, medical insurance and outplacement services. For additional information, please refer to Note 4 of the Notes to Condensed Consolidated Financial Statements. We will continue to evaluate our ongoing spending levels and explore ways to reduce operating costs.

Recent Developments

On August 1, 2007, we entered into an agreement with Bayer Healthcare LLC to develop and commercialize NKTR-061 (inhaled amikacin). NKTR-061 is under development for adjunctive treatment of Gram-negative pneumonias that often lead to significant morbidity and mortality. This therapy utilizes our proprietary Pulmonary Technology to deliver a specially-formulated amikacin, an aminoglycoside antibiotic, for inhalation deep into the lung.

Bayer will fund all clinical development of the Amikacin Product Candidate following the completion of the ongoing Phase II clinical studies that we are currently conducting (other than $10 million of Phase III clinical trial costs to be reimbursed by Nektar following the payment by Bayer of a $10 million development milestone), all world-wide regulatory filings, approvals and related activities, further development of formulated Amikacin, and final product packaging. We will fund the ongoing clinical development of the Amikacin Product Candidate through the completion of current ongoing Phase II clinical studies and the further development of the nebulizer device through the completion of the Phase III clinical trials.

As part of this agreement, we will receive milestone payments of up to $175 million associated with the successful development and commercialization of NKTR-061. This includes an upfront payment of $50 million. Subsequent to the successful clinical and regulatory development of the product, we have agreed to co-promote the product with Bayer Healthcare in the United States and to share profits. For sales outside the United States, we will receive tiered performance royalties up to a maximum of 30%.

Research and Development Activities

Our product pipeline includes both partnered and proprietary development programs. We have ongoing collaborations or licensing arrangements with more than thirty biotechnology and pharmaceutical companies to provide our technologies and development expertise. Our technologies are currently being used in ten approved products in the US or EU or both, in two partner programs that have been filed with the FDA and twelve development programs in human clinical trials.

The length of time that a development program is in a given phase varies substantially according to factors relating to the development program, such as the type and intended use of the product candidate, the clinical trial design, and the ability to enroll suitable patients. Generally, for partnered programs, 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 portfolio of development programs is based on our Pulmonary Technology and PEGylation Technology platforms. Within each major category, we have both partnered and proprietary development programs. The estimated completion dates and costs for our programs are not reasonably certain. Please refer to the Risk Factors for discussion of the risks associated with our partnered and proprietary development programs.

In connection with our research and development for partner products and development programs, we earned $16.6 million and $28.6 million in contract research revenue for the three-month and six-month periods ended June 30, 2007, respectively, and $13.1 million and $29.1 million in contract research revenue for the three-month and six-month periods ended June 30, 2006, respectively.

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The costs incurred in connection with these programs, including allocations of facilities, cGMP quality programs and other shared costs, is as follows (in millions):

Molecule	Status as of June 30, 2007 (1)	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Pulmonary					
Partnered Products and Development Programs					
Next generation inhaled insulin (NGI)(2)	Pre-Clinical	$ 8.0	$ 5.0	$ 16.5	$ 7.4
Tobramycin inhalation powder (TIP) (3)	Phase 3	4.3	3.3	8.2	6.2
Exubera® (insulin human [rDNA origin]) Inhalation Powder (2)	Approved in US, EU, Brazil, and Mexico	1.7	5.6	6.4	10.9
Other partnered product candidates	Various	3.2	3.5	7.0	7.5
Proprietary Development Programs					
NKTR-061 (inhaled amikacin)	Phase 2	4.4	3.4	6.8	6.7
NKTR-024 (amphotericin B inhalation powder)(4)	Phase 1 (pre-pivotal)	0.3	6.7	4.2	11.0
Other proprietary product candidates	Various	1.9	2.9	3.8	3.2
Technology platform	Various	3.3	3.0	5.9	6.5
Total Pulmonary		$ 27.1	$ 33.4	$ 58.8	$ 59.4
PEGylation					
Partnered Products and Development Programs	Various	$ 1.7	$ 0.2	$ 3.4	$ 1.5
Proprietary Development Programs					
NKTR-118 (oral PEG-naloxol)	Phase 1	3.3	0.7	3.8	1.3
NKTR-102 (PEG-irinotecan)	Phase 1	1.5	1.6	2.5	2.2
Other proprietary product candidates	Various	2.2	3.1	4.8	4.4
Total PEGylation		$ 8.7	$ 5.6	$ 14.5	$ 9.4