

NEKTAR THERAPEUTICS  
Form 10-Q  
November 09, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2012

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)

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

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

**455 Mission Bay Boulevard South**  
**San Francisco, California 94158**  
(Address of principal executive offices)

**415-482-5300**  
(Registrant's telephone number, including area code)

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

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes  No

The number of outstanding shares of the registrant's Common Stock, \$0.0001 par value, was 115,168,858 on November 5, 2012.

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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 Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). All statements other than statements of historical fact are forward-looking statements for purposes of this quarterly report on Form 10-Q, including any projections of earnings, revenue or other financial items, any statements of the plans and objectives of management for future operations (including, but not limited to, pre-clinical development, clinical trials and manufacturing), statements related to our financial condition and future working capital needs, any statements concerning proposed drug candidates, any statements regarding future economic conditions or performance, any statements regarding the success of our collaboration arrangements or future payments that may come due to us under these arrangements, any statements regarding our plans and objectives to initiate clinical trials, and any statements of assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as may, will, expects, plans, anticipates, estimates, potential or continue, negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, such expectations or any of the forward-looking statements may prove to be incorrect and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including, but not limited to, the risk factors set forth in Part II, Item 1A Risk Factors below and for the reasons described elsewhere in this quarterly report on Form 10-Q. All forward-looking statements and reasons why results may differ included in this report are made as of the date hereof and we do not intend to update any forward-looking statements except as required by law or applicable regulations. Except where the context otherwise requires, in this quarterly report on Form 10-Q, the Company, Nektar, we, us, and our refer to Nektar Therapeutics, a Delaware corporation, and, where appropriate, its subsidiaries.

### **Trademarks**

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

**Table of Contents****PART I: FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements Unaudited:  
NEKTAR THERAPEUTICS****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except par value)**

	September 30, 2012	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 10,338	\$ 15,312
Short-term investments	308,939	225,856
Accounts receivable	3,911	4,938
Inventory	16,754	12,656
Other current assets	7,003	17,944
Total current assets	346,945	276,706
Restricted cash and long-term investments	35,022	173,768
Property and equipment, net	73,256	78,576
Goodwill	76,501	76,501
Other assets	9,728	999
Total assets	\$ 541,452	\$ 606,550
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,624	\$ 3,019
Accrued compensation	12,687	12,807
Accrued expenses	6,450	6,669
Accrued clinical trial expenses	13,200	11,953
Deferred revenue, current portion	22,639	19,643
Convertible subordinated notes		214,955
Other current liabilities	11,870	6,486
Total current liabilities	69,470	275,532
Capital lease obligations, less current portion	12,414	14,582
Senior secured notes	125,000	
Liability related to sale of future royalties, less current portion	126,746	
Deferred revenue, less current portion	101,762	108,188
Other long-term liabilities	10,728	10,437
Total liabilities	446,120	408,739
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, 10,000 shares authorized, \$0.0001 par value; 3,100 shares designated Series A and no shares issued or outstanding at December 31, 2011; no shares designated, issued or outstanding at September 30, 2012		
Common stock, \$0.0001 par value; 300,000 authorized; 115,073 shares and 114,485 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	11	11

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Capital in excess of par value	1,612,620	1,597,428
Accumulated other comprehensive income (loss)	155	(1,103)
Accumulated deficit	(1,517,454)	(1,398,525)
<b>Total stockholders' equity</b>	<b>95,332</b>	<b>197,811</b>
Total liabilities and stockholders' equity	\$ 541,452	\$ 606,550

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

**Table of Contents****NEKTAR THERAPEUTICS****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share information)****(Unaudited)**

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>Revenue:</b>				
Product sales and royalties	\$ 12,280	\$ 10,222	\$ 35,855	\$ 26,023
License, collaboration and other	6,132	16,846	24,190	29,675
<b>Total revenue</b>	<b>18,412</b>	<b>27,068</b>	<b>60,045</b>	<b>55,698</b>
<b>Operating costs and expenses:</b>				
Cost of goods sold	7,228	5,038	23,138	16,441
Research and development	34,016	31,018	102,302	93,464
General and administrative	10,068	12,350	30,750	35,262
Impairment of long-lived assets			1,675	
<b>Total operating costs and expenses</b>	<b>51,312</b>	<b>48,406</b>	<b>157,865</b>	<b>145,167</b>
<b>Loss from operations</b>	<b>(32,900)</b>	<b>(21,338)</b>	<b>(97,820)</b>	<b>(89,469)</b>
<b>Non-operating income (expense):</b>				
Interest income	603	622	1,865	1,583
Interest expense	(11,184)	(2,543)	(23,448)	(7,698)
Other income (expense), net	156	(717)	913	(599)
<b>Total non-operating expense, net</b>	<b>(10,425)</b>	<b>(2,638)</b>	<b>(20,670)</b>	<b>(6,714)</b>
<b>Loss before provision for income taxes</b>	<b>(43,325)</b>	<b>(23,976)</b>	<b>(118,490)</b>	<b>(96,183)</b>
Provision for income taxes	222	92	439	300
<b>Net loss</b>	<b>\$ (43,547)</b>	<b>\$ (24,068)</b>	<b>\$ (118,929)</b>	<b>\$ (96,483)</b>
<b>Basic and diluted net loss per share</b>	<b>\$ (0.38)</b>	<b>\$ (0.21)</b>	<b>\$ (1.04)</b>	<b>\$ (0.86)</b>
<b>Weighted average shares outstanding used in computing basic and diluted net loss per share</b>	<b>114,915</b>	<b>114,413</b>	<b>114,699</b>	<b>112,435</b>

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS****(In thousands)****(Unaudited)****Three months ended  
September 30,****Nine months ended  
September 30,**

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	2012	2011	2012	2011
Comprehensive loss	\$ (42,772)	\$ (25,821)	\$ (117,671)	\$ (98,438)

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



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	<b>Nine months ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (118,929)	\$ (96,483)
Adjustments to reconcile net loss to net cash used in operating activities:		
Non-cash interest expense on liability related to sale of future royalties	12,856	
Non-cash royalty revenue related to sale of future royalties	(6,895)	
Stock-based compensation	12,015	14,501
Depreciation and amortization	10,595	11,424
Impairment of long-lived assets	1,675	
Other non-cash transactions	641	967
Changes in operating assets and liabilities:		
Accounts receivable	1,027	12,188
Inventory	(4,098)	(3,388)
Other assets	10,593	(1,750)
Accounts payable	(401)	(4,200)
Accrued compensation	(120)	2,508
Accrued expenses	(465)	6,238
Accrued clinical trial expenses	1,247	1,468
Deferred revenue	(3,430)	(12,320)
Other liabilities	1,309	(2,681)
Net cash used in operating activities	(82,380)	(71,528)
<b>Cash flows from investing activities:</b>		
Purchases of investments	(126,609)	(627,529)
Restricted cash	(25,000)	
Maturities of investments	202,768	290,810
Sales of investments	5,378	218,660
Purchases of property and equipment	(5,744)	(8,294)
Net cash provided by (used in) investing activities	50,793	(126,353)
<b>Cash flows from financing activities:</b>		
Payments of loan and capital lease obligations	(1,773)	(1,431)
Proceeds from issuance of senior secured notes, net of \$4.4 million of issuance costs	78,006	
Repayment of convertible subordinated notes	(172,407)	
Proceeds from sale of future royalties, net of \$4.4 million of transaction costs	119,588	
Issuance of common stock, net of issuance costs	3,177	224,072
Net cash provided by financing activities	26,591	222,641
Effect of exchange rates on cash and cash equivalents	22	493
Net (decrease) increase in cash and cash equivalents	(4,974)	25,253

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Cash and cash equivalents at beginning of period	15,312	17,755
Cash and cash equivalents at end of period	\$ 10,338	\$ 43,008
<b>Supplemental disclosure of cash flows information:</b>		
Cash paid for interest	\$ 9,010	\$ 9,592
Retirement of convertible subordinate notes in exchange for senior secured notes	\$ 42,548	\$

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

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2012**

**(Unaudited)**

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

***Organization***

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

Our research and development activities have required significant resources to date and are expected to continue to require significant resources. As a result, we expect to continue to incur substantial losses and negative cash flows from operations in the future. We have financed our operations primarily through cash from licensing, collaboration and manufacturing agreements and financing transactions. At September 30, 2012, we had approximately \$354.3 million in cash, cash equivalents, and investments in marketable securities and \$152.0 million in indebtedness. The indebtedness includes \$125.0 million in aggregate principal amount of 12.0% senior secured notes due July 15, 2017 which we issued during the three months ended September 30, 2012, but excludes our long-term liability relating to the sale of future royalties. As is further described in Note 5, this royalty obligation liability will not be settled in cash, but we may be required to make a payment of up to \$7.0 million in 2014 if certain performance targets are not met. During the three months ended September 30, 2012, we retired \$215.0 million in aggregate principal amount of our previously outstanding convertible subordinated notes.

***Basis of Presentation and Principles of Consolidation***

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

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

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

On January 1, 2012, we were required to adopt new accounting guidance related to the presentation of comprehensive income that prohibits the presentation of other comprehensive income (OCI) in the statement of stockholders' equity and instead, provides the option of presenting OCI in a continuous statement of comprehensive income or as two separate consecutive statements. Our comprehensive loss consists of our net loss plus our foreign currency translation gains and losses and unrealized holding gains and losses on available-for-sale securities, neither of which were significant during the three and nine months ended September 30, 2012 and 2011. This change had no impact on our financial position or results of operations.

The accompanying Condensed Consolidated Financial Statements are unaudited. The Condensed Consolidated Balance Sheet data as of December 31, 2011 was derived from the audited consolidated financial statements which are included in our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the SEC on February 29, 2012. The information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and the accompanying notes to those financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011.

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Revenue, expenses, assets, and liabilities can vary during each quarter of the year. The results and trends in these interim Condensed Consolidated Financial Statements are not necessarily indicative of the results to be expected for the full year or any other periods.

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### ***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. On an ongoing basis, we evaluate our estimates, including those related to deferred revenue recognition periods, inventories, the impairment of investments, the impairment of goodwill and long-lived assets, contingencies, estimated interest expense from our liability related to our sale of future royalties, stock-based compensation, and ongoing litigation, among other estimates. We base our estimates on historical experience and on other assumptions that management believes are reasonable under the circumstances. These estimates form the basis for making judgments about the carrying values of assets and liabilities when these values are not readily apparent from other sources.

### ***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 revenue, operating loss or net loss or total assets, liabilities or stockholders' equity.

### ***Segment Information***

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

### ***Significant Concentrations***

Our customers are primarily pharmaceutical and biotechnology companies that are located in the U.S. and Europe. Our accounts receivable balance contains billed and unbilled trade receivables from product sales and royalties, as well as time and materials based billings from collaborative research and development agreements. We provide for an allowance for doubtful accounts by reserving for specifically identified doubtful accounts. We generally do not require collateral from our customers. We perform a regular review of our customers' payment histories and associated credit risk. We have not experienced significant credit losses from our accounts receivable and our allowance for doubtful accounts was not significant at either September 30, 2012 or December 31, 2011.

We are dependent on our suppliers and contract manufacturers to provide raw materials, drugs and devices of appropriate quality and reliability and to meet applicable contract and regulatory requirements. In certain cases, we rely on single sources of supply of one or more critical materials. Consequently, in the event that supplies are delayed or interrupted for any reason, our ability to develop and produce our drug candidates or our ability to meet our supply obligations could be significantly impaired, which could have a material adverse effect on our business, financial condition and results of operations.

### ***Revenue***

We enter into arrangements with pharmaceutical and biotechnology collaboration partners that may involve multiple deliverables. Our arrangements may contain one or more of the following elements: upfront fees, contract research and development, milestone payments, manufacturing and supply payments, royalties, and license fees. Each deliverable in the arrangement is evaluated to determine whether it meets the criteria to be accounted for as a separate unit of accounting or whether it should be combined with other deliverables. Revenue is recognized separately for each element.

At the inception of each new multiple-element arrangement or the material modification of an existing multiple-element arrangement, we allocate all consideration received under multiple-element arrangements to all units of accounting based on the relative selling price method, generally based on our best estimate of selling price (ESP). The objective of ESP is to determine the price at which we would transact a sale if the product or service was sold on a stand-alone basis. We determine ESP for the elements in our collaboration arrangements by considering multiple factors including, but not limited to, technical complexity of the performance obligation and similarity of elements to those performed under previous arrangements. Since we apply significant judgment in arriving at the ESPs, any material change in our estimates would significantly affect the allocation of the total consideration to the different elements of a multiple element arrangement.



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### *Product sales and royalties*

Product sales are primarily derived from cost-plus and fixed price manufacturing and supply agreements with our collaboration partners and revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed or determinable, and collection is reasonably assured. We have not experienced any significant returns from our customers.

Generally, we are entitled to royalties from our partners based on the net sales of their approved drugs that are marketed and sold in one or more countries where we hold royalty rights. We recognize royalty revenue when the cash is received or when the royalty amount to be received is estimable and collection is reasonably assured. With respect to the non-cash royalties from our liability related to sale of future royalties described at Note 5, revenues are recognized during the period in which the related royalty report is received, which occurs in the quarter after the applicable product sales are made.

### *License, collaboration and other*

Upfront fees received by us in collaboration arrangements that include future obligations, such as manufacturing and supply obligations, under our license and collaborative agreements are recognized ratably over our expected performance period under each respective collaboration arrangement. We make our best estimate of the period over which we expect to fulfill our performance obligations, which may include technology transfer assistance, research activities, clinical development activities, and manufacturing activities from development through the commercialization of the product. Given the uncertainties of these collaboration arrangements, significant judgment is required to determine the duration of the performance period.

Contingent consideration received from the achievement of a substantive milestone is recognized in its entirety in the period in which the milestone is achieved, which we believe is consistent with the substance of our performance under our various license and collaboration agreements. A milestone is defined as an event (i) that can only be achieved based in whole or in part either on the entity's performance or on the occurrence of a specific outcome resulting from the entity's performance, (ii) for which there is substantive uncertainty at the date the arrangement is entered into that the event will be achieved, and (iii) that would result in additional payments being due to the entity. A milestone is substantive if the consideration earned from the achievement of the milestone is consistent with our performance required to achieve the milestone or the increase in value to the collaboration resulting from our performance, relates solely to our past performance, and is reasonable relative to all of the other deliverables and payments within the arrangement.

Our license and collaboration agreements with our partners provide for payments to us upon the achievement of development milestones, such as the completion of clinical trials or regulatory submissions, approvals by health authorities, and commercial launches of drugs. Given the challenges inherent in developing and obtaining regulatory approval for drug products and in achieving commercial launches, there was substantial uncertainty whether any such milestones would be achieved at the time of execution of these licensing and collaboration agreements. In addition, we evaluated whether the development milestones meet the remaining criteria to be considered substantive. As a result of our analysis, we consider our remaining development milestones under all of our license and collaboration agreements to be substantive and, accordingly, we expect to recognize as revenue future payments received from such milestones only if and as each milestone is achieved.

Our license and collaboration agreements with certain partners also provide for contingent payments to us based solely upon the performance of the respective partner. For such contingent amounts we expect to recognize the payments as revenue when earned under the applicable contract, provided that collection is reasonably assured.

Our license and collaboration agreements with our partners also provide for payments to us upon the achievement of specified sales volumes of approved drugs. We consider these payments to be similar to royalty payments and we will recognize such sales-based payments upon achievement of such sales volumes, provided that collection is reasonably assured.

### *Income Taxes*

We account for income taxes under the liability method; 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. We record a valuation allowance against deferred tax assets to reduce their carrying value to an amount that is more likely than not to be realized. When we establish or reduce the valuation allowance related to the deferred tax assets, our provision for income taxes will increase or decrease, respectively, in the period such determination is made.

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For the three and nine months ended September 30, 2012 and 2011, we recorded an income tax provision for our Nektar India operations at an effective tax rate of approximately 32% for each period. The U.S. federal deferred tax assets generated from our net operating losses have been fully reserved as we believe it is not more likely than not that the benefit will be realized.



**Table of Contents****Note 2 Cash, Cash Equivalents, and Available-For-Sale Investments**

Cash, cash equivalents, and available-for-sale investments are as follows (in thousands). Included in our restricted cash and long-term investments balance on our Condensed Consolidated Balance Sheet at September 30, 2012 is \$25.0 million of restricted cash required to be maintained in a separate reserve account until July 1, 2015 under the terms of our senior secured notes issued in July 2012.

	Estimated Fair Value at	
	September 30, 2012	December 31, 2011
Cash and cash equivalents	\$ 10,338	\$ 15,312
Short-term investments	308,939	225,856
Restricted cash and long-term investments	35,022	173,768
Total cash, cash equivalents, and available-for-sale investments	\$ 354,299	\$ 414,936

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

	Estimated Fair Value at	
	September 30, 2012	December 31, 2011
Corporate notes and bonds	\$ 299,457	\$ 344,427
U.S. corporate commercial paper	12,998	9,464
Obligations of U.S. government agencies	5,001	44,230
Obligations of U.S. states and municipalities	1,505	1,503
Available-for-sale investments	318,961	399,624
Cash and money market funds	35,338	15,312
Total cash, cash equivalents, and available-for-sale investments	\$ 354,299	\$ 414,936

The following table summarizes our portfolio of available-for-sale investments reported as short-term and long-term investments by contractual maturity (in thousands):

	Estimated Fair Value at	
	September 30, 2012	December 31, 2011
Less than one year	\$ 308,939	\$ 213,386
Greater than one year but less than two years	10,022	186,238
Total available-for-sale investments	\$ 318,961	\$ 399,624

We invest in liquid, high quality debt securities. Our investments in debt securities are subject to interest rate risk. To minimize the exposure due to an adverse shift in interest rates, we invest in securities with maturities of two years or less and maintain a weighted average maturity of one year or less. Investments in securities with remaining maturities of less than one year, or where our intent is to use the investments to fund current operations or to make them available for current operations, are classified as short-term investments.

Gross unrealized gains and losses were not significant at either September 30, 2012 or December 31, 2011. During the nine month periods ended September 30, 2012 and 2011, we sold available-for-sale securities totaling \$5.4 million and \$218.7 million, respectively, and realized gains and losses were not significant in any of the three and nine month periods ended September 30, 2012 and 2011. The cost of securities sold is based

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on the specific identification method.

All of our investments are categorized as Level 1 or Level 2, as explained in the table below. We use a market approach to value our Level 2 investments. The disclosed fair value related to our investments is based primarily on the reported fair values in our period-end brokerage statements, which are based on market prices from a variety of industry standard data providers and generally represent quoted prices for similar assets in active markets or have been derived from observable market data. We independently validate these fair values using available market quotes and other information. During the three and nine month periods ended September 30, 2012 and 2011, there were no transfers between Level 1 and Level 2 of the fair value hierarchy.

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The following table represents the fair value hierarchy for our financial assets measured at fair value on a recurring basis as of September 30, 2012 and December 31, 2011 (in thousands):

<b>As of September 30, 2012:</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money market funds	\$ 8,992	\$	\$	\$ 8,992
U.S. corporate commercial paper		12,998		12,998
Corporate notes and bonds		299,457		299,457
Obligations of U.S. government agencies		5,001		5,001
Obligations of U.S. states and municipalities		1,505		1,505
Cash equivalents and available-for-sale investments	\$ 8,992	\$ 318,961	\$	\$ 327,953
Cash, including restricted cash				26,346
Cash, cash equivalents, and available-for-sale investments				\$ 354,299
<b>As of December 31, 2011:</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money market funds	\$ 13,950	\$	\$	\$ 13,950
U.S. corporate commercial paper		9,464		9,464
Corporate notes and bonds		344,427		344,427
Obligations of U.S. government agencies		44,230		44,230
Obligations of U.S. states and municipalities		1,503		1,503
Cash equivalents and available-for-sale investments	\$ 13,950	\$ 399,624	\$	\$ 413,574
Cash				1,362
Cash, cash equivalents, and available-for-sale investments				\$ 414,936

*Level 1* Quoted prices in active markets for identical assets or liabilities.

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

*Level 3* Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

**Note 3 Inventory**

Inventory consists of the following (in thousands):

	<b>September 30, 2012</b>	<b>December 31, 2011</b>
Raw materials	\$ 12,083	\$ 9,754
Work-in-process	3,586	1,219
Finished goods	1,085	1,683
Total	\$ 16,754	\$ 12,656

Inventory is generally manufactured upon receipt of firm purchase orders from our collaboration partners. Inventory includes direct materials, direct labor, and manufacturing overhead and is determined on a first-in, first-out basis. Raw materials include manufactured intermediate

materials which are subsequently combined with other materials to make work-in-process and finished goods inventory. Inventory is stated at the lower of cost or market and is net of reserves determined using specific identification plus an estimated reserve for defective or excess inventory based on historical experience or projected usage.

**Note 4 Senior Secured Notes Due July 2017**

On July 11, 2012, we issued \$125.0 million in aggregate principal amount of senior secured notes (Senior Notes) with the entire principal amount due on July 15, 2017. The Senior Notes bear interest at 12.0% per annum payable in cash semi-annually in arrears on January 15 and July 15 of each year, beginning January 15, 2013. The Senior Notes are secured by a first-priority lien on substantially all of our assets. In connection with this transaction, we retired \$42.5 million of principal amount of our convertible subordinated notes in exchange for the same principal amount of Senior Notes. As a result of these transactions, we received cash of \$82.5 million, less approximately \$4.4 million in transaction costs, of which \$25.0 million is required to be maintained in a restricted account until July 1, 2015 and which is included in restricted cash and long-term investments on our Condensed Consolidated Balance Sheet at September 30, 2012. Given that the Senior Notes were recently issued in July 2012, we believe the carrying amount of the Senior Notes is consistent with its fair value at September 30, 2012.

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The Senior Notes contain customary covenants, including covenants that limit or restrict our ability to incur liens, incur indebtedness, and make certain restricted payments, but do not contain covenants related to future financial performance. The Senior Notes are callable by us at any time, subject to certain prepayment premiums and conditions. If we experience certain change of control events, the holders of the Senior Notes will have the right to require us to purchase all or a portion of the Senior Notes at a purchase price in cash equal to 101% of the principal amount thereof, plus accrued and unpaid interest to the date of purchase. In addition, upon certain asset sales, we may be required to offer to use the net proceeds thereof to purchase some of the Senior Notes at 100% of the principal amount thereof, plus accrued and unpaid interest to the date of purchase.

We used the proceeds from the issuance of the Senior Notes and our existing cash to repay the remaining \$172.4 million in principal amount of our convertible subordinated notes in full at maturity on September 28, 2012.

**Note 5 Liability Related to Sale of Future Royalties**

On February 24, 2012, we entered into a Purchase and Sale Agreement (the Purchase and Sale Agreement) with RPI Finance Trust (RPI), an affiliate of Royalty Pharma, pursuant to which we sold, and RPI purchased, our right to receive royalty payments (the Royalty Entitlement) arising from the worldwide net sales, from and after January 1, 2012, of (a) CIMZIA<sup>®</sup>, under Nektar's license, manufacturing and supply agreement with UCB Pharma (UCB), and (b) MIRCERA<sup>®</sup>, under Nektar's license, manufacturing and supply agreement with F. Hoffmann-La Roche Ltd and Hoffmann-La Roche Inc. (together referred to as Roche). We received an aggregate cash purchase price for the Royalty Entitlement of \$124.0 million. As part of this sale, we incurred approximately \$4.4 million in transaction costs, which will be amortized to interest expense over the estimated life of the Purchase and Sale Agreement. As a result of our ongoing manufacturing and supply obligations related to the generation of these royalties and as is further described below, although we sold all of our rights to receive royalties from the CIMZIA<sup>®</sup> and MIRCERA<sup>®</sup> products, we will continue to account for these royalties as revenue and recorded the \$124.0 million in proceeds from this transaction as a liability.

The following table shows the activity within the liability account:

	Nine months ended September 30, 2012
Liability related to sale of future royalties - beginning balance	\$
Proceeds from sale of future royalties	124,000
Non-cash interest expense	12,641
CIMZIA <sup>®</sup> and MIRCERA <sup>®</sup> royalties	(6,895)
<b>Total liability related to sale of future royalties</b>	<b>129,746</b>
Less: current portion	(3,000)
<b>Liability related to sale of future royalties, non-current portion:</b>	<b>\$ 126,746</b>

We determined that we have significant continuing involvement in the generation of the future royalty payments to be received by RPI related to CIMZIA<sup>®</sup> and MIRCERA<sup>®</sup> through our ongoing manufacturing and supply obligations related to these products. As a result, we recorded the \$124.0 million as a long-term liability (Royalty Obligation) on our Condensed Consolidated Balance Sheet that will be amortized using the interest method over the estimated life of the Purchase and Sale Agreement. The discounted cash flow model used to estimate the fair value of the rights sold to RPI requires us to make estimates regarding, among other things, the assumptions market participants would make regarding the timing, probability and amount of future royalties, as well as the appropriate financial discount rates. We consider the assumptions and estimates used in this analysis to fall within Level 3 of the fair value hierarchy. We believe the carrying amount of the Royalty Obligation is consistent with its fair value at September 30, 2012.

As a result of this liability accounting, even though the royalties from UCB and Roche are remitted directly to RPI starting in the second quarter of 2012 for royalties arising from product sales in the first quarter of 2012, we will continue to record revenue



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for these royalties. We recognize royalties from net sales of CIMZIA® and MIRCERA® upon notification of the actual royalty amount, which occurs in the quarter after those sales are made. During the nine months ended September 30, 2012, we recognized \$9.6 million in aggregate royalties from net sales of CIMZIA® and MIRCERA®, of which the \$2.7 million recognized in the three months ended March 31, 2012 was retained by us as these amounts resulted from royalties on product sales in the fourth quarter of 2011 and the \$6.9 million recognized in the six month period ended September 30, 2012 was remitted by UCB and Roche directly to RPI as these amounts resulted from product sales in the first and second quarters of 2012.

As royalties are remitted to RPI from Roche and UCB, the balance of the Royalty Obligation will be effectively repaid over the life of the agreement. In order to determine the amortization of the Royalty Obligation, we are required to estimate the total amount of future royalty payments to be received by RPI and payments we are required to make to RPI as noted below, if any, over the life of the agreement. The sum of these amounts less the \$124.0 million proceeds we received will be recorded as interest expense over the life of the Royalty Obligation. Since inception, our estimate of this total interest expense resulted in an effective annual interest rate of approximately 17%. We will periodically assess the estimated royalty payments to RPI from UCB and Roche and to the extent such payments are greater or less than our initial estimates, or the timing of such payments is materially different than our original estimates, we will adjust the amortization of the Royalty Obligation. There are a number of factors that could materially affect the amount and timing of royalty payments from CIMZIA® and MIRCERA®, most of which are not within our control. Such factors include, but are not limited to, changing standards of care, the introduction of competing products, manufacturing or other delays, biosimilar competition, intellectual property matters, adverse events that result in governmental health authority imposed restrictions on the use of the drug products, and other events or circumstances that could result in reduced royalty payments from CIMZIA® and MIRCERA®, all of which would result in a reduction of non-cash royalty revenues and the non-cash interest expense over the life of the Royalty Obligation. Conversely, if sales of CIMZIA® and MIRCERA® are more than expected, the non-cash royalty revenues and the non-cash interest expense recorded by us would be greater over the term of the Royalty Obligation.

Pursuant to the Purchase and Sale Agreement, we are required to pay to RPI (a) \$3.0 million if certain worldwide net sales thresholds of MIRCERA® for the 12 month period ending on December 31, 2012 are not achieved and (b) up to an additional \$7.0 million if certain worldwide net sales thresholds of MIRCERA® for the 12 month period ending on December 31, 2013 are not achieved. The Purchase and Sale Agreement grants RPI the right to receive certain reports and other information relating to the Royalty Entitlement and contains other representations and warranties, covenants and indemnification obligations that are customary for a transaction of this nature. In particular, if we breach our obligations under the Purchase and Sale Agreement, we could be required to pay damages to RPI that are not limited to the purchase price we received in the sale transaction. As of September 30, 2012, we have concluded that it is probable that the minimum 2012 MIRCERA® net sales threshold will not be met and, therefore, we expect to make the \$3.0 million payment to RPI described above in early 2013. The liability for this expected \$3.0 million payment is included in other current liabilities on our Condensed Consolidated Balance Sheet at September 30, 2012.

**Note 6 Commitments and Contingencies*****Legal Matters***

From time to time, we are involved in lawsuits, arbitrations, claims, investigations and proceedings, consisting of intellectual property, commercial, employment and other matters, which arise in the ordinary course of business. We make provisions for liabilities when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Such provisions are reviewed at least quarterly and adjusted to reflect the impact of settlement negotiations, judicial and administrative 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 or on our cash flows and liquidity.

On November 18, 2009, the Research Foundation of the State University of New York (SUNY) filed an action against Nektar in the United States District Court for the Northern District of New York. SUNY seeks to recover amounts it alleges it is owed pursuant to a technology licensing contract between Nektar and SUNY. We dispute SUNY's claims. Discovery in the matter has closed and cross motions for summary judgment (including Nektar's motion for summary judgment dismissing the action) were filed in October 2012. The motions are fully briefed and are currently *sub judice*. In the event the action survives Nektar's motion, we expect that a trial would be scheduled in the first half of 2013. We believe that SUNY's claims are without merit. No reasonable estimate of the possible loss or range of loss can be made at this time and no liabilities have been recorded for this matter on our Consolidated Balance Sheets as of September 30, 2012 or December 31, 2011.

***Indemnifications in Connection with Commercial Agreements***

As part of our collaboration agreements with our partners related to the license, development, manufacture and supply of drugs based on our proprietary technologies, we generally agree to defend, indemnify and hold harmless our partners from and against third party liabilities arising out of the agreement, including product liability (with respect to our activities) and infringement of intellectual property to the extent the

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intellectual property is developed by us and licensed to our partners. The term of these indemnification obligations is generally perpetual any time after execution of the agreement. There is generally no limitation on the potential amount of future payments we could be required to make under these indemnification obligations.



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As part of the sale of our royalty interest in the CIMZIA® and MIRCERA® products, we and RPI made representations and warranties and entered into certain covenants and ancillary agreements which are supported by indemnity obligations. Additionally, as part of our pulmonary asset sale to Novartis, we and Novartis made representations and warranties and entered into certain covenants and ancillary agreements which are supported by an indemnity obligation. In the event it were determined that we breached certain of the representations and warranties or covenants and agreements made by us in any such agreements, we could incur substantial indemnification liabilities depending on the timing, nature, and amount of any such claims.

To date we have not incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the aggregate amount of any potential indemnification obligation is not a stated amount, the overall maximum amount of any such obligations cannot be reasonably estimated. No liabilities have been recorded for these obligations on our Condensed Consolidated Balance Sheets at either September 30, 2012 or December 31, 2011.

**Note 7 License and Collaboration Agreements**

We have entered into various license agreements and collaborative research, development and commercialization agreements with pharmaceutical and biotechnology companies. Under these arrangements, we are entitled to receive license fees, upfront payments, milestone payments, royalties, sales milestones, payment for the manufacture and supply of our proprietary PEGylation materials and/or reimbursement for research and development activities. All of our collaboration agreements are generally cancelable by our partners without significant financial penalty. Our costs of performing these services are generally included in research and development expense, however, costs for product sales to our collaboration partners are included in cost of goods sold.

In accordance with these agreements, we recognized license, collaboration and other revenue as follows (in thousands):

Partner	Drug or Drug Candidate	Three months ended		Nine months ended	
		September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Baxter Healthcare	Hemophilia	\$ 741	\$ 3,556	\$ 5,794	\$ 4,486
Roche	PEGASYS® and MIRCERA®	2,011	1,283	5,134	3,849
Amgen, Inc.	Neulasta®	1,250	1,250	3,750	3,750
Affymax, Inc.	Omontys®	198	2,440	2,610	3,343
Bayer Healthcare LLC	BAY41-6551 (Amikacin Inhale)	714	750	2,257	2,250
Other		1,218	7,567	4,645	11,997
License, collaboration, and other revenue		\$ 6,132	\$ 16,846	\$ 24,190	\$ 29,675

As of September 30, 2012, our collaboration agreements with partners included potential future amounts payable to us for development milestones totaling approximately \$161.1 million, including amounts from our agreements with Bayer and Baxter described below. In addition, we are entitled to receive up to \$235.0 million and \$75.0 million of contingent payments described below related to NKTR-118 and NKTR-119, respectively, based on development and regulatory events to be pursued and completed solely by AstraZeneca.

***Baxter Healthcare: Hemophilia***

In September 2005, we entered into an exclusive research, development, license and manufacturing and supply agreement with Baxter Healthcare SA and Baxter Healthcare Corporation (together referred to as Baxter) to develop products designed to improve therapies for Hemophilia A patients using our PEGylation technology. In December 2007, we expanded our agreement with Baxter to include the license of our PEGylation technology with the potential to improve any future products Baxter may develop for Hemophilia B patients. Under the terms of the agreement, we are entitled to research and development funding and are responsible for supplying Baxter with its requirements for our proprietary materials. Baxter is responsible for all clinical development, regulatory, and commercialization expenses. The agreement is terminable by the parties under customary conditions.

As of September 30, 2012, we are entitled to up to \$28.0 million of development milestones related to Hemophilia A upon achievement of certain development objectives, as well as sales milestones upon achievement of annual sales targets and royalties based on annual worldwide net sales of products resulting from this agreement. This Hemophilia A program includes BAX-855, which is currently in Phase 1/2 development and which Baxter has targeted to start Phase 3 development by the end of 2012. In prior years, we received upfront payments under

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the Baxter agreement totaling \$4.0 million and \$5.0 million related to Hemophilia A and Hemophilia B programs, respectively. As of September 30, 2012, we have deferred revenue of \$1.4 million relating to the Hemophilia A program, which we expect to recognize through September 2016, the estimated end of our obligations under this agreement.

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In May 2012, Baxter notified us that they intended to cease all future research activities under our agreement related to Hemophilia B. As a result, in the three months ended June 30, 2012, we recognized the remaining \$3.9 million deferred revenue balance related to the Hemophilia B program since we have no ongoing or additional performance obligations.

***Roche: PEGASYS® and MIRCERA®***

In February 1997, we entered into a license, manufacturing and supply agreement with Roche, under which we granted Roche a worldwide, exclusive license to certain intellectual property related to our proprietary PEGylation materials used in the manufacture and commercialization of PEGASYS®. As a result of Roche exercising a license extension option in December 2009, Roche has the right to manufacture all of its requirements for our proprietary PEGylation materials for PEGASYS® and we perform additional manufacturing, if any, only on an as-requested basis. In connection with Roche's exercise of the license extension option in December 2009, we received a payment of \$31.0 million. As of September 30, 2012, we have deferred revenue of approximately \$16.7 million related to this agreement, which we expect to recognize through December 2015, the period through which we are required to provide back-up manufacturing and supply services related to PEGASYS®.

In February 2012, we entered into a toll-manufacturing agreement with Roche under which we will manufacture the proprietary PEGylation material used by Roche to produce MIRCERA®. Roche entered into the toll-manufacturing agreement with the objective of establishing us as a secondary back-up source on a non-exclusive basis. Under the terms of the toll-manufacturing agreement, Roche agreed to pay us an upfront payment of \$5.0 million and will pay a total of up to \$22.0 million in performance-based milestone payments upon our achievement of certain manufacturing readiness, validation and production milestones, including the delivery of specified quantities of PEGylation materials, all of which are scheduled to be completed by the end of January 2013. Roche will also pay us additional consideration for any future orders of the PEGylation materials for MIRCERA® beyond the initial quantities scheduled to be manufactured through January 2013. Roche may terminate the toll-manufacturing agreement due to an uncured material default by us. As of September 30, 2012, we have received \$16.0 million in upfront and milestone payments under this agreement. There is a risk that we will not achieve the remaining \$11.0 million milestone on a timely basis or at all, however we currently expect that we will be able to successfully complete it.

We analyzed the milestone payments under the agreement and determined that they did not meet the criteria for revenue recognition under the milestone method as a result of our continuing manufacturing obligations. We have identified our back-up manufacturing obligation through December 2016 and the delivery of PEGylation materials specified in the agreement in 2012 and early 2013 as the units of accounting in the arrangement. We made our best estimate of the selling prices for these deliverables and have allocated the expected \$27.0 million consideration to these items based on the relative selling price method. As of September 30, 2012, we have recognized revenue of \$2.3 million related to this agreement. As of September 30, 2012, we have deferred revenue of approximately \$13.7 million, which we expect to recognize through December 2016, the estimated end of our obligations under this agreement.

***Amgen, Inc.: Neulasta®***

In October 2010, we amended and restated an existing supply and license agreement by entering into a supply, dedicated suite and manufacturing guarantee agreement (the amended and restated agreement) and a license agreement with Amgen Inc. and Amgen Manufacturing, Limited (together referred to as Amgen). Under the terms of the amended and restated agreement, we guarantee the manufacture and supply of our proprietary PEGylation materials (Polymer Materials) to Amgen in an existing manufacturing suite to be used exclusively for the manufacture of Polymer Materials for Amgen (the Manufacturing Suite) in our manufacturing facility in Huntsville, Alabama (Facility). This supply arrangement is on a non-exclusive basis (other than the use of the Manufacturing Suite and certain equipment) whereby Nektar is free to manufacture and supply the Polymer Materials to any other third party and Amgen is free to procure the Polymer Materials from any other third party. Under the terms of the amended and restated agreement, we received a \$50.0 million payment in the fourth quarter of 2010 in return for our guaranteeing the supply of certain quantities of Polymer Materials to Amgen including without limitation the Additional Rights described below and manufacturing fees that are calculated based on fixed and variable components applicable to the Polymer Materials ordered by Amgen and delivered by us. Amgen has no minimum purchase commitments. If quantities of the Polymer Materials ordered by Amgen exceed specified quantities, significant additional payments become payable to us in return for our guaranteeing the supply of additional quantities of the Polymer Materials.

The term of the amended and restated agreement ends on October 29, 2020. In the event we become subject to a bankruptcy or insolvency proceeding, we cease to own or control the Facility, we fail to manufacture and supply or certain other events, Amgen or its designated third party will have the right to elect, among certain other options, to take title to the dedicated equipment and access the Facility to operate the Manufacturing Suite solely for the purpose of manufacturing the Polymer Materials (the Additional Rights). Amgen may terminate the amended and restated agreement for convenience or due to an uncured material default by us. Our research facility in Huntsville, Alabama that we propose to sell is a different building and location from that of the Facility as described here.



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As of September 30, 2012, we have deferred revenue of approximately \$40.4 million related to this agreement, which we expect to recognize through October 2020, the estimated end of our obligations under this agreement.

***Affymax, Inc.: OMONTYS®***

In April 2004, we entered into a license, manufacturing and supply agreement with Affymax, Inc. (Affymax) under which we provided Affymax with a worldwide, non-exclusive license under certain of our proprietary PEGylation technology to develop, manufacture and commercialize OMONTYS® (peginesatide). On March 27, 2012, the U.S. Food and Drug Administration (FDA) approved OMONTYS® to treat anemia in patients with chronic kidney disease on dialysis and OMONTYS® sales were initiated in the second quarter of 2012. Under our agreement, Affymax is obligated to purchase its entire requirements of the proprietary PEGylation materials required to manufacture OMONTYS® exclusively from Nektar. Affymax is responsible for all clinical development, regulatory and commercialization expenses. We are entitled to royalties based on annual worldwide net sales of OMONTYS®. For a certain period of time, we will share a portion of our future royalty payments with Enzon Pharmaceuticals, Inc.

In addition, as a result of the FDA's approval of OMONTYS®, we earned a \$2.0 million milestone payment. Under our milestone method revenue recognition policy, this substantive milestone was recognized in its entirety upon achievement in March 2012. We have previously received other milestone and related payments under our agreement with Affymax and, as of September 30, 2012, we have deferred revenue of approximately \$7.3 million, which we expect to recognize through March 2022, the estimated period through which we are required to provide manufacturing and supply services.

***Bayer Healthcare LLC: BAY41-6551 (Amikacin Inhale)***

In August 2007, we entered into a co-development, license and co-promotion agreement with Bayer Healthcare LLC (Bayer) to develop a specially-formulated inhaled Amikacin. We are responsible for development and manufacturing and supply of the nebulizer device included in the Amikacin product. Bayer is responsible for most future clinical development and commercialization costs, all activities to support worldwide regulatory filings, approvals and related activities, further development of Amikacin Inhale and final product packaging and distribution. We received an upfront payment of \$40.0 million in 2007 and performance milestone payments of \$20.0 million, of which \$10.0 million will be used to reimburse Bayer for Phase 3 clinical trial costs. We are entitled to up to \$60.0 million of development milestones upon achievement of certain development objectives, as well as sales milestones upon achievement of annual sales targets and royalties based on annual worldwide net sales of Amikacin Inhale. As of September 30, 2012, we have deferred revenue of approximately \$25.2 million related to this agreement, which we expect to recognize through July 2021, the estimated end of our obligations under this agreement.

***AstraZeneca AB: NKTR-118 and NKTR-119***

In September 2009, we entered into a license agreement with AstraZeneca AB (AstraZeneca), under which we granted AstraZeneca a worldwide, exclusive, perpetual, royalty-bearing, and sublicensable license under our patents and other intellectual property to develop, market, and sell NKTR-118 and NKTR-119. AstraZeneca is responsible for all costs associated with research, development and commercialization and is responsible for all drug development and commercialization decisions for NKTR-118 and NKTR-119. AstraZeneca paid us an upfront payment of \$125.0 million, which we received in the fourth quarter of 2009 and which was fully recognized as of December 31, 2010. We are entitled to receive up to \$235.0 million and \$75.0 million of contingent payments related to NKTR-118 and NKTR-119, respectively, based on development events to be pursued and completed solely by AstraZeneca. In particular, if AstraZeneca files for regulatory approval of NKTR-118 with the FDA and the European Medicines Agency (EMA), Nektar will be entitled to \$95.0 million of these payments. We will be entitled to the remaining \$140.0 million of these payments if NKTR-118 is approved by the FDA and EMA and commercial launch is achieved in the U.S. and one major country in the European Union. In addition, we are also entitled to sales milestone payments and royalties based on annual worldwide net sales of NKTR-118 and NKTR-119 products. During the three and nine months ended September 30, 2012 and 2011, we did not earn significant revenues from this arrangement.

**Note 8 Impairment of Long Lived Assets**

In an effort to reduce ongoing operating costs and improve our organizational structure, efficiency and productivity, in March 2012, we announced a plan to consolidate our U.S.-based research activities at our existing San Francisco location and to cease the use of and sell one of our buildings located in Huntsville, Alabama that was dedicated to research activities. As a result, we performed a preliminary analysis of the fair value of the land, building and related improvements based primarily on available market data. Based upon this analysis, we concluded that the combined carrying value of the land and building exceeded fair value and we recorded an impairment loss of \$1.7 million in March 2012. No further impairment losses were recorded in the quarters ended June 30, 2012 and September 30, 2012, however, until we dispose of these assets, we will update our analysis of their fair value on a regular basis and such updates could result in further impairment charges in future periods.



**Table of Contents****Note 9 Stock-Based Compensation**

Total stock-based compensation expense was recognized in our Condensed Consolidated Financial Statements as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Cost of goods sold	\$ 353	\$ 295	\$ 1,121	\$ 957
Research and development expense	1,670	2,020	5,296	6,109
General and administrative expense	1,957	2,504	5,598	7,435
Total stock-based compensation	\$ 3,980	\$ 4,819	\$ 12,015	\$ 14,501

During the three months ended September 30, 2012 and 2011, we granted 434,060 and 331,480 stock options, respectively. The weighted average grant-date fair value of options granted during the three months ended September 30, 2012 and 2011 was \$4.78 per share and \$2.79 per share, respectively.

During the nine months ended September 30, 2012 and 2011, we granted 3,416,780 and 2,723,445 stock options, respectively. The weighted average grant-date fair value of options granted during the nine months ended September 30, 2012 and 2011 was \$3.91 per share and \$5.30 per share, respectively.

As a result of stock issuances under our equity compensation plans, during the three months ended September 30, 2012 and 2011, we issued 292,485 and 121,705 common shares, respectively, and during the nine months ended September 30, 2012 and 2011, we issued 587,421 and 909,181 common shares, respectively.

**Note 10 Net Loss Per Share**

Basic net loss per share is calculated based on the weighted-average number of common shares outstanding during the periods presented. For all periods presented in the accompanying 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. During the three months ended September 30, 2012, we retired our \$215.0 million in principal amount of convertible subordinated notes in full. As a result, there are no potentially dilutive convertible notes outstanding as of September 30, 2012. The weighted average of these potentially dilutive securities has been excluded from the diluted net loss per share calculation and is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Stock options	14,301	14,471	13,836	11,423

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

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

*Overview**Strategic Direction of Our Business*

We are a clinical-stage biopharmaceutical company developing a pipeline of drug candidates that utilize our PEGylation and advanced polymer conjugate technology platforms, which are designed to improve the benefits of drugs for patients. Our current proprietary pipeline is comprised of drug candidates across a number of therapeutic areas including oncology, pain, anti-infectives, anti-viral and immunology. Our research and development activities involve small molecule drugs, peptides and other potential biologic drug candidates. We create our innovative drug candidates by using our proprietary advanced polymer conjugate technologies and expertise to modify the chemical structure of drugs to create new molecular entities. Polymer chemistry is a science focused on the synthesis or bonding of polymer architectures with drug molecules to alter the properties of a molecule when it is bonded with polymers. Additionally, we may utilize established pharmacologic targets to engineer a new drug candidate relying on a combination of the known properties of these targets and our proprietary polymer chemistry technology and expertise. Our drug candidates are designed to improve the pharmacokinetics, pharmacodynamics, half-life, bioavailability, metabolism or distribution of drugs and improve the overall benefits and use of a drug for the patient. Our objective is to apply our advanced polymer conjugate technology platform to create new drug candidates in multiple therapeutic areas that address large potential markets.

Our most advanced proprietary product candidate, naloxegol (NKTR-118), is a peripheral opioid antagonist that is currently being evaluated in Phase 3 clinical studies for the treatment of opioid-induced constipation (OIC). We are a party to an exclusive worldwide license agreement with AstraZeneca for the global development and commercialization of naloxegol and NKTR-119. NKTR-119 is an early stage research and development program that is designed to combine various opioids with naloxegol. The core Phase 3 clinical development program for naloxegol, which AstraZeneca calls the KODIAC program, is comprised of four clinical trials which are designed to investigate the safety and efficacy of naloxegol for the treatment of OIC in patients with non-cancer related pain. The outcome and timing of the naloxegol development program will have a substantial impact on our financial condition as we are entitled to up to \$235.0 million in regulatory filing and commercial launch milestones. In the event AstraZeneca submits regulatory approval filings with the U.S. Food and Drug Administration (FDA) and the European Medicines Agency (EMA), we would be entitled to \$95.0 million in milestone payments. We would be entitled to the remaining \$140.0 million of milestone payments if naloxegol is approved by the FDA and EMA and commercial launch is achieved in the U.S. and one major country in the European Union (EU). Following the commercial launch of naloxegol, we are entitled to significant and escalating double-digit royalties varying by country of sale and based on the level of annual net sales. As a result, the outcome of the KODIAC program and AstraZeneca's future advancement of the naloxegol program is critical to our business prospects and financial position.

Our second most advanced proprietary drug candidate, etirinotecan pegol (NKTR-102), is a next-generation topoisomerase I inhibitor. NKTR-102 is currently being evaluated as a single-agent therapy in a Phase 3 open-label, randomized, multicenter clinical study in patients with metastatic breast cancer. This Phase 3 clinical study, which we call the BEACON study (BrEAst Cancer Outcomes with NKTR-102), is scheduled to enroll approximately 840 patients with metastatic breast cancer that have previously received treatment with an anthracycline, a taxane, and capecitabine. The BEACON study will require a substantial investment over the next two and one-half years. In November 2012, NKTR-102 was designated by the FDA as a Fast Track development program for the treatment of patients with locally recurrent or metastatic breast cancer progressing after treatment with an anthracycline, a taxane, and capecitabine. We are also in the process of completing an expanded Phase 2 clinical study for NKTR-102 in patients with platinum-resistant ovarian cancer. We are currently in the process of continuing patient follow-up activities as well as compiling and performing verification procedures on the data we have to date. Final results from this study and communication with government health authorities in both the United States and EU will guide our future development and regulatory strategy for NKTR-102 in ovarian cancer. In addition, a Phase 2 clinical study for NKTR-102 in patients with metastatic colorectal cancer is still enrolling patients.

We also have a significant collaboration with Bayer Healthcare LLC (Bayer) for Amikacin Inhale, an inhaled solution of amikacin, an aminoglycoside antibiotic, that has completed Phase 2 development. Preparations for a Phase 3 clinical study are continuing. This program is significantly behind schedule due to our plan with Bayer to finalize the design of the nebulizer device for commercial manufacturing prior to initiating Phase 3 clinical development, with the objective of commencing a Phase 3 clinical study as soon as possible following completion of this work. Bayer has selected a third party contract research organization for this study and preparation activities are underway. If we can successfully complete the remaining clinical manufacturing and related stability testing activities, we and Bayer currently expect the Phase 3 clinical study to start in the first quarter of 2013. We expect to continue to make significant investments over the next two years to establish the clinical and commercial manufacturing capability for the Amikacin Inhale nebulizer device.





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While the late stage clinical development programs described above are key elements of the future success of our company, we believe it is critically important that we continue to make substantial investments in our earlier-stage drug candidate pipeline. For example, in April 2012 we advanced NKTR-192, our short-acting opioid drug candidate, into Phase 1 clinical studies and in July 2012 we advanced NKTR-181 into a Phase 2 clinical study. In May 2012, NKTR-181 was designated by the FDA as a Fast Track development program for the treatment of moderate to severe chronic pain. While we believe that our substantial investment in research and development has the potential to create significant value if one or more of our drug candidates demonstrates positive clinical results and/or receives regulatory approval in one or more major markets, drug research and development is an inherently uncertain process and there is a high risk of failure at every stage prior to approval and the timing and outcome of clinical trial results is extremely difficult to predict. Clinical development successes and failures can have a disproportionate positive or negative impact on our scientific and medical prospects, financial prospects, financial condition, and market value.

Historically, we have entered into a number of license and supply contracts under which we manufactured and supplied our proprietary PEGylation reagents on a cost-plus or fixed price basis. Our current strategy is to manufacture and supply PEGylation reagents to support our proprietary drug candidates or our third party collaborators where we have a strategic development and commercialization relationship or where we derive substantial economic benefit. As a result, whenever possible, we are renegotiating or not seeking renewal of legacy manufacturing supply arrangements that do not include a strategic development or commercialization component. For example, in October 2010, we entered into a supply, dedicated suite and manufacturing guarantee agreement with Amgen, Inc. and Amgen Manufacturing, Limited, which has significantly amended economic and other terms in the non-exclusive supply and license agreement we previously entered into with Amgen in 1995. In addition, in December 2010, we entered into an amended manufacturing and supply agreement with Merck (through its acquisition of Schering-Plough Corporation) to provide for transfer to an alternative manufacturer and revised economics for an interim supply arrangement until that transition is completed.

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

At September 30, 2012, we had approximately \$354.3 million in cash, cash equivalents, and investments in marketable securities and \$152.0 million in indebtedness. The indebtedness includes \$125.0 million in aggregate principal amount of 12.0% senior secured notes due July 15, 2017 which we issued during the three months ended September 30, 2012, but excludes our long-term liability relating to the sale of future royalties. As is further described in Note 5, this royalty obligation liability will not be settled in cash, but we may be required to make a payment of up to \$7.0 million in 2014 if certain performance targets are not met. During the three months ended September 30, 2012, we retired \$215.0 million in aggregate principal amount of our previously outstanding convertible subordinated notes. As of September 30, 2012, we had at least twelve months of working capital to fund our current business plans. We expect the clinical development of our proprietary drug candidates including NKTR-102, NKTR-061, NKTR-181, and NKTR-192 will require significant investment in order to continue to advance in clinical development with the objective of entering into a collaboration partnership or obtaining regulatory approval. However, we have no credit facility or any other sources of committed capital. In addition, while in the past we have received a number of significant payments from license and collaboration agreements and other significant transactions, we do not currently anticipate completing new transactions with substantial upfront payments in the near-term. Our current business plan is also subject to significant uncertainties and risks as a result of, among other factors, expenses being higher than anticipated, unplanned expenses, cash receipts being lower than anticipated, and the need to satisfy contingent liabilities including litigation matters and indemnification obligations.

The availability and terms of various financing alternatives substantially depend on the success or failure of our drug development programs including naloxegol (NKTR-118), BAX-855, Amikacin Inhale, NKTR-102, NKTR-181, and NKTR-192. The availability and terms of financing alternatives and any future significant payments from existing or new collaborations all depend on the positive outcome of ongoing or planned clinical studies, whether we or our partners are successful in obtaining health authority approvals in major markets, and if approved, the commercial success of these drugs. In particular, we are entitled to up to \$235.0 million of regulatory and commercial launch milestones under our license agreement with AstraZeneca, \$95.0 million of which is related to AstraZeneca submitting regulatory approval filings for naloxegol with the FDA and EMA. In the event we do not enter into any new collaboration partnerships with significant up-front payments or do not receive the naloxegol regulatory milestones in 2013, we could be required to reduce spending and delay or curtail some of our research and development programs or pursue financing alternatives. In the event we determine to explore financing alternatives, our objective would be to first pursue financing alternatives that are not dilutive to the ownership of our common stock security holders. However, if non-dilutive financing alternatives are not available to us on commercially reasonable terms or at all, we could be required to pursue dilutive equity-based financing alternatives such as an offering of convertible debt or common stock.

**Table of Contents****Results of Operations**

Three and Nine Months Ended September 30, 2012 and 2011

Revenue (in thousands, except percentages)

	Three months ended September 30, 2012	Three months ended September 30, 2011	Increase / (Decrease) 2012 vs. 2011	Percentage Increase / (Decrease) 2012 vs. 2011
Product sales and royalties	\$ 12,280	\$ 10,222	\$ 2,058	20%
License, collaboration and other	6,132	16,846	(10,714)	(64)%
<b>Total revenue</b>	<b>\$ 18,412</b>	<b>\$ 27,068</b>	<b>\$ (8,656)</b>	<b>(32)%</b>

	Nine months ended September 30, 2012	Nine months ended September 30, 2011	Increase / (Decrease) 2012 vs. 2011	Percentage Increase / (Decrease) 2012 vs. 2011
Product sales and royalties	\$ 35,855	\$ 26,023	\$ 9,832	38%
License, collaboration and other	24,190	29,675	(5,485)	(18)%
<b>Total revenue</b>	<b>\$ 60,045</b>	<b>\$ 55,698</b>	<b>\$ 4,347</b>	<b>8%</b>

Our revenue is derived from our collaboration agreements, under which we may receive product sales revenue, royalties, license fees, milestone payments or contract research payments. Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed or determinable, and collection is reasonably assured. The amount of upfront fees received under our license and collaboration agreements allocated to continuing obligations, such as manufacturing and supply commitments, are recognized ratably over our expected performance period under the arrangement. As a result, there may be significant variations in the timing of receipt of cash payments and our recognition of revenue. We make our best estimate of the period over which we expect to fulfill our performance obligations. Given the uncertainties in research and development collaborations, significant judgment is required by us to determine the performance periods.

**Product sales and royalties**

Product sales include cost-plus and fixed price manufacturing and supply agreements with our collaboration partners. The timing of product shipments is based on the demand and requirements of our collaboration partners and is not ratably throughout the year. We recognize royalty revenue from certain of our collaboration partners based on their net sales of commercial products.

Product sales and royalties increased during the three and nine months ended September 30, 2012 compared to the three and nine months ended September 30, 2011 primarily due to a \$0.7 million and \$6.2 million increase in product sales, respectively, as a result of increased product demand from our collaboration partners and a \$1.4 million and \$3.6 million increase in royalties, respectively, as a result of the increase in royalties received from UCB Pharma's CIMZIA<sup>®</sup> and Roche's MIRCERA<sup>®</sup> product sales.

In February 2012, we sold all of our rights to receive future royalty payments on CIMZIA<sup>®</sup> and MIRCERA<sup>®</sup>. As described in Note 5 to our Condensed Consolidated Financial Statements, this royalty sale transaction has been recorded as a liability that amortizes over the estimated royalty payment period. As a result of this liability accounting, even though the royalties from UCB and Roche are remitted directly to the purchaser of these royalty interests starting in the second quarter of 2012 for royalties arising from product sales in the first quarter of 2012, we will continue to record revenue for these royalties. During the three and nine months ended September 30, 2012, we recognized \$3.4 million and \$9.6 million in aggregate royalties from net sales of CIMZIA<sup>®</sup> and MIRCERA<sup>®</sup>, of which the \$2.7 million recognized in the three months ended March 31, 2012 was retained by us as these amounts resulted from product sales in the fourth quarter of 2011 and the \$6.9 million recognized in the six months ended September 30, 2012 was remitted directly to RPI as these amounts resulted from product sales in the first two quarters of 2012. During the three and nine months ended September 30, 2011, we recognized \$2.1 million and \$5.7 million in aggregate royalties from net

sales of CIMZIA<sup>®</sup> and MIRCERA<sup>®</sup>. We expect royalties to increase throughout 2012 as compared to 2011.

***License, Collaboration and Other***

License, collaboration and other revenue includes amortization of upfront payments and milestone payments received in connection with our license and collaboration agreements and reimbursed research and development expenses. The level of license, collaboration and other revenue depends in part upon the estimated amortization period of the upfront payments, the achievement of milestones, the continuation of existing collaborations, the amount of reimbursed research and development work, and entering into new collaboration agreements, if any.

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License, collaboration and other revenue for the three months ended September 30, 2012 decreased compared to the three months ended September 30, 2011 primarily due to the recognition in the three months ended September 30, 2011 of a \$5.0 million license fee from a license agreement signed in September 2011 and \$4.5 million in development milestones achieved under two existing collaboration agreements.

License, collaboration and other revenue for the nine months ended September 30, 2012 decreased compared to the nine months ended September 30, 2011 primarily due to the recognition in the nine months ended September 30, 2011 of the \$5.0 million license fee and \$4.5 million in development milestones noted above partially offset by the recognition in the nine months ended September 30, 2012 of the remaining \$3.9 million deferred revenue balance as a result of Baxter's decision to cease all activities under our collaboration agreement related to their Hemophilia B program.

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

	Three months ended September 30, 2012	Three months ended September 30, 2011	Increase / (Decrease) 2012 vs. 2011	Percentage Increase / (Decrease) 2012 vs. 2011
Cost of goods sold	\$ 7,228	\$ 5,038	\$ 2,190	43%
Product gross profit	\$ 5,052	\$ 5,184	\$ (132)	(3)%
Product gross margin	41%	51%		

	Nine months ended September 30, 2012	Nine months ended September 30, 2011	Increase / (Decrease) 2012 vs. 2011	Percentage Increase / (Decrease) 2012 vs. 2011
Cost of goods sold	\$ 23,138	\$ 16,441	\$ 6,697	41%
Product gross profit	\$ 12,717	\$ 9,582	\$ 3,135	33%
Product gross margin	35%	37%		

Cost of goods sold increased during the three and nine months ended September 30, 2012 compared to the three and nine months ended September 30, 2011 primarily due to a \$0.7 million and \$6.2 million increase in product sales in the three and nine months ended September 30, 2012 compared to the three and nine months ended September 30, 2011, respectively.

Product gross profit and product gross margin include revenue from product sales and royalties. Product gross profit in the three months ended September 30, 2012 is consistent with that in the three months ended September 30, 2011. The increase in product gross profit during the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011 is primarily attributable to the increase in royalties. Product gross margin decreased in the three and nine months ended September 30, 2012 compared to the three and nine months ended September 30, 2011 primarily due to the mix of products sold.

We expect product gross margin to fluctuate in future periods depending on the level and mix of manufacturing orders from our customers due to the fixed cost base associated with our manufacturing activities.

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

	Three months ended September 30, 2012	Three months ended September 30, 2011	Increase / (Decrease) 2012 vs. 2011	Percentage Increase / (Decrease) 2012 vs. 2011
Research and development expense	\$ 34,016	\$ 31,018	\$ 2,998	10%

  

	Nine months ended September 30, 2012	Nine months ended September 30, 2011	Increase / (Decrease) 2012 vs. 2011	Percentage Increase / (Decrease) 2012 vs.

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2011

Research and development expense	\$	102,302	\$	93,464	\$	8,838	9%
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Research and development expense consists primarily of personnel costs (including salaries, benefits, and stock-based compensation), clinical study costs, direct costs of outside research, materials, supplies, licenses and fees. Research and development expense also includes certain overhead allocations consisting of various support and facilities related costs. Research and development expense is not expected to be ratable over the four quarters of the year. We expect research and development expense to increase throughout the remainder of 2012 compared to 2011 as we continue to advance our pipeline of drug candidates. In particular, we expect to incur significant costs on the NKTR-102 Phase 3 BEACON study as well as on the NKTR-181 Phase 2 clinical study that we initiated in July 2012.

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Research and development expense increased during the three and nine months ended September 30, 2012 compared to the three and nine months ended September 30, 2011 primarily due to our NKTR-102 Phase 3 BEACON study initiated in December 2011.

Other than as described in the Overview section above, there have been no material changes to the status of clinical programs in the nine months ended September 30, 2012 from the activities discussed in our Annual Report on Form 10-K for the year ended December 31, 2011 on file with the Securities and Exchange Commission.

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

	Three months ended September 30, 2012	Three months ended September 30, 2011	Increase / (Decrease) 2012 vs. 2011	Percentage Increase / (Decrease) 2012 vs. 2011
General and administrative expense	\$ 10,068	\$ 12,350	\$ (2,282)	(18)%

	Nine months ended September 30, 2012	Nine months ended September 30, 2011	Increase / (Decrease) 2012 vs. 2011	Percentage Increase / (Decrease) 2012 vs. 2011
General and administrative expense	\$ 30,750	\$ 35,262	\$ (4,512)	(13)%

General and administrative expense includes the cost of administrative staffing, business development, marketing, finance and legal activities. General and administrative expense decreased during the three and nine months ended September 30, 2012 compared to the three and nine months ended September 30, 2011 primarily as a result of a payment obligation incurred in the three months ended September 30, 2011 related to the settlement of a commercial litigation matter as well as decreases in non-cash stock-based compensation expense.

**Interest Expense (in thousands, except percentages)**

	Three months ended September 30, 2012	Three months ended September 30, 2011	Increase / (Decrease) 2012 vs. 2011	Percentage Increase / (Decrease) 2012 vs. 2011
Interest expense on notes and capital leases	\$ 5,605	\$ 2,543	\$ 3,062	>100%
Non-cash interest expense on liability related to sale of future royalties	5,579		5,579	>100%
Total interest expense	\$ 11,184	\$ 2,543	\$ 8,641	>100%

	Nine months ended September 30, 2012	Nine months ended September 30, 2011	Increase / (Decrease) 2012 vs. 2011	Percentage Increase / (Decrease) 2012 vs. 2011
Interest expense on notes and capital leases	\$ 10,592	\$ 7,698	\$ 2,894	38%
Non-cash interest expense on liability related to sale of future royalties	12,856		12,856	>100%
Total interest expense	\$ 23,448	\$ 7,698	\$ 15,750	>100%

The increase in interest expense for the three and nine months ended September 30, 2012 compared to the three and nine months ended September 30, 2011 is attributable to the interest expense recorded for the royalty sale transaction and the senior secured notes. On February 24, 2012, we sold all of our rights to receive future royalty payments on CIMZIA® and MIRCERA® in exchange for \$124.0 million. As described in

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Note 5 to our Condensed Consolidated Financial Statements, this royalty sale transaction has been recorded as a liability that amortizes over the estimated royalty payment period as CIMZIA® and MIRCERA® royalties are remitted directly to the purchaser. We impute interest on the transaction and record interest expense at the effective interest rate, which we currently estimate to be approximately 17%. There are a number of factors that could materially affect the estimated interest rate and we will assess this estimate on a periodic basis.



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On July 11, 2012, we issued \$125.0 million of 12% senior secured notes maturing on July 15, 2017. In connection with this transaction, we retired a principal amount of \$42.5 million of our \$215.0 million in aggregate principal amount of 3.25% convertible subordinated notes in exchange for \$42.5 million in principal amount of senior secured notes. We repaid the remaining \$172.4 million in principal amount of convertible subordinated notes in full at maturity on September 28, 2012.

As a result of the royalty sale transaction and the issuance of the senior secured notes, we expect interest expense in 2012 to increase significantly from 2011.

***Liquidity and Capital Resources***

At September 30, 2012, we had approximately \$354.3 million in cash, cash equivalents, and investments in marketable securities and \$152.0 million in indebtedness. The indebtedness includes \$125.0 million in aggregate principal amount of 12.0% senior secured notes due July 15, 2017, but excludes our long-term liability relating to the sale of future royalties. As is further described in Note 5 to our Condensed Consolidated Financial Statements, this royalty obligation liability will not be settled in cash, but we may be required to make a payment of up to \$7.0 million in 2014 if certain performance targets are not met. On July 11, 2012, we issued \$125.0 million in aggregate principal amount of senior secured notes. In connection with this transaction, we retired a principal amount of \$42.5 million of our \$215.0 million in aggregate principal amount of 3.25% convertible subordinated notes in exchange for \$42.5 million in principal amount of senior secured notes. As a result of these transactions, we received cash of \$82.5 million, less approximately \$4.4 million in transaction costs, of which \$25.0 million is required to be maintained in a restricted reserve account until July 1, 2015. On September 28, 2012, we repaid the remaining \$172.4 million in principal amount on the convertible subordinated notes.

As of September 30, 2012, we had at least twelve months of working capital to fund our current business plans. We expect the clinical development of our proprietary drug candidates including NKTR-102, NKTR-061, NKTR-181, and NKTR-192 will require significant investment in order to continue to advance in clinical development with the objective of entering into a collaboration partnership or obtaining regulatory approval. However, we have no credit facility or any other sources of committed capital. In addition, while in the past we have received a number of significant payments from license and collaboration agreements and other significant transactions, we do not currently anticipate completing new transactions with substantial upfront payments in the near-term. Our current business plan is also subject to significant uncertainties and risks as a result of, among other factors, expenses being higher than anticipated, unplanned expenses, cash receipts being lower than anticipated, and the need to satisfy contingent liabilities including litigation matters and indemnification obligations.

The availability and terms of various financing alternatives substantially depend on the success or failure of our drug development programs including naloxegol (NKTR-118), BAX-855, Amikacin Inhale, NKTR-102, NKTR-181, and NKTR-192. The availability and terms of financing alternatives and any future significant payments from existing or new collaborations all depend on the positive outcome of ongoing or planned clinical studies, whether we or our partners are successful in obtaining health authority approvals in major markets, and if approved, the commercial success of these drugs. In particular, we are entitled to up to \$235.0 million of regulatory and commercial launch milestones under our license agreement with AstraZeneca, \$95.0 million of which is related to AstraZeneca submitting regulatory approval filings for naloxegol with the FDA and EMA. In the event we do not enter into any new collaboration partnerships with significant up-front payments or do not receive the naloxegol regulatory milestones in 2013, we could be required to reduce spending and delay or curtail some of our research and development programs or pursue financing alternatives. In the event we determine to explore financing alternatives, our objective would be to first pursue financing alternatives that are not dilutive to the ownership of our common stock security holders. However, if non-dilutive financing alternatives are not available to us on commercially reasonable terms or at all, we could be required to pursue dilutive equity-based financing alternatives such as an offering of convertible debt or common stock.

Due to the potential for continued uncertainty in the credit markets in 2012 and thereafter, we may experience reduced liquidity with respect to some of our investments in marketable securities. These investments are generally held to maturity, which is less than two years. However, if the need arises to liquidate such securities before maturity, we may experience losses on liquidation. At September 30, 2012, the average time to maturity of the investments held in our portfolio was approximately five months and the maturity of any single investment did not exceed twenty-four months. To date we have not experienced any liquidity issues with respect to these securities, but if such issues arise, we may be required to hold some, or all, of these securities until maturity. We believe that, even allowing for potential liquidity issues with respect to these securities, our remaining cash, cash equivalents, and investments will be sufficient to meet our anticipated cash needs for at least the next twelve months.

***Cash flows from operating activities***

Cash flows used in operating activities for the nine months ended September 30, 2012 totaled \$82.4 million, which includes \$100.9 million of net operating cash uses, including \$6.7 million for interest payments on our convertible subordinated notes, partially offset by the receipt of \$18.5 million from collaboration agreements. Because of the nature and timing of certain cash receipts and payments, net cash utilization is not

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expected to be ratable over the four quarters of the year. We expect cash flows used in operating activities, excluding upfront payments received, if any, will increase throughout the remainder of 2012 compared to the same period in 2011 as a result of increased spending on our research and development programs.

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Cash flows used in operating activities for the nine months ended September 30, 2011 totaled \$71.5 million, which includes \$96.0 million of net operating cash uses, including \$7.0 million for a semi-annual interest payment on our convertible subordinated notes, partially offset by the receipt of \$24.5 million from collaboration agreements executed in prior years, of which \$16.5 million was included in accounts receivable at December 31, 2010 resulting from an upfront payment obligation arising from an amendment to one of our manufacturing and supply agreements to extend the supply term and provide for a manufacturing transition.

### *Cash flows from investing activities*

We purchased \$5.7 million and \$8.3 million of property and equipment in the nine months ended September 30, 2012 and 2011, respectively.

Under the terms of our issuance of senior secured notes in July 2012, \$25.0 million of the proceeds from this transaction is required to be maintained in a separate reserve account until July 1, 2015.

### *Cash flows from financing activities*

On February 24, 2012, we sold all of our rights to receive future royalty payments on CIMZIA® and MIRCERA® in exchange for \$124.0 million. As part of this sale, we incurred approximately \$4.4 million in transaction costs.

On July 11, 2012, we issued \$125.0 million of senior secured notes maturing on July 15, 2017. As part of this transaction, we incurred approximately \$4.4 million in issuance costs. In connection with this transaction, we retired the principal amount of \$42.5 million of our \$215.0 million in aggregate principal amount of convertible subordinated notes in exchange for \$42.5 million in principal amount of the senior secured notes. On September 28, 2012, we repaid the remaining \$172.4 million in principal amount of the convertible subordinated notes.

On January 24, 2011, we completed a public offering of our common stock with gross proceeds of approximately \$220.4 million. As part of the public offering, we incurred approximately \$0.6 million in legal and accounting fees, filing fees, and other offering expenses.

We received \$3.2 million and \$4.3 million, respectively, from issuances of common stock to employees during the nine months ended September 30, 2012 and 2011.

### ***Contractual Obligations***

There were no material changes during the nine months ended September 30, 2012 to the summary of contractual obligations included in our Annual Report on Form 10-K for the year ended December 31, 2011 on file with the Securities and Exchange Commission other than the Purchase and Sale Agreement entered into on February 24, 2012, with respect to the sale of our royalty interests in CIMZIA® and MIRCERA® as described in Note 5 to our Condensed Consolidated Financial Statements, and the senior secured notes issued in July 2012 and the convertible subordinated notes retired in the three months ended September 30, 2012 as described in Note 4 to our Condensed Consolidated Financial Statements.

### ***Off-Balance Sheet Arrangements***

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

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. We evaluate our estimates on an ongoing basis. Actual results may differ from those estimates under different assumptions or conditions. With the exception of the updates to the following critical accounting policies and estimates, there have been no material changes to our critical accounting policies and estimates discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

### ***Revenue***

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On January 1, 2011, we adopted on a prospective basis Accounting Standards Update (ASU) 2009-13, which amends the criteria to identify separate units of accounting within Subtopic 605-25, Revenue Recognition-Multiple-Element Arrangements. In the nine months ended September 30, 2012, we entered into our first arrangement that requires accounting under this guidance. Under this

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guidance, at the inception of each new multiple-element arrangement or the material modification of an existing multiple-element arrangement, we allocate arrangement consideration to all units of accounting based on the relative selling price method, generally based on our best estimate of selling price (ESP). The objective of ESP is to determine the price at which we would transact a sale if the product or service was sold on a stand-alone basis. We determine ESP for the elements in our collaboration arrangements by considering multiple factors including, but not limited to, technical complexity of the performance obligation and similarity of elements to those performed under previous arrangements. Since we apply significant judgment in arriving at the ESPs, any material changes would significantly affect the allocation of the total consideration to the different elements of a multiple element arrangement.

***Non-cash Interest Expense on Liability Related to Sale of Future Royalties***

In February 2012, we sold all of our rights to receive future royalty payments on CIMZIA® and MIRCERA®. Although we are required to make payments to the purchaser of these royalty interests only in certain situations, including the event of our breach of a representation, warranty or covenant in the Purchase and Sale Agreement that gives rise to a liability in accordance with the terms and conditions of such agreement, this royalty sale transaction was recorded as a liability (Royalty Obligation) that we will amortize using the interest method over the estimated life of the Purchase and Sale Agreement. As a result, we impute interest on the transaction and record interest expense at the estimated interest rate. Our estimate of the interest rate under the agreement is based on the amount of royalty payments to be received by RPI over the life of the arrangement and payments we may be required to make to RPI under the agreement, if any. We will periodically assess the expected royalty payments to RPI from UCB and Roche using a combination of historical results and forecasts from market data sources. To the extent such payments are greater or less than our initial estimates, or the timing of such payments is materially different than our original estimates, we will adjust the amortization of the Royalty Obligation. There are a number of factors that could materially affect the amount and timing of royalty payments from CIMZIA® and MIRCERA®, most of which are not within our control. Such factors include, but are not limited to, changing standards of care, the introduction of competing products, manufacturing or other delays, biosimilar competition, intellectual property matters, adverse events that result in governmental health authority imposed restrictions on the use of the drug products, and other events or circumstances that result in reduced royalty payments from CIMZIA® and MIRCERA®, all of which would result in a reduction of non-cash royalty revenues and non-cash interest expense over the life of the Royalty Obligation. Conversely, if sales of CIMZIA® and MIRCERA® are higher than expected, non-cash royalty revenues and non-cash interest expense would also be greater over the term of the Royalty Obligation.

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

Our market risks at September 30, 2012 have not changed significantly from those discussed in Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2011 on file with the Securities and Exchange Commission.

**Item 4. Controls and Procedures*****Disclosure Controls and Procedures***

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934 (Exchange Act) reports is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

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

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

We continuously seek to improve the efficiency and effectiveness of our internal controls. This results in refinements to processes throughout the Company. However, there was no change in our internal control over financial reporting that occurred in the three months ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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

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

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**Table of Contents****PART II: OTHER INFORMATION****Item 1. Legal Proceedings**

Reference is hereby made to our disclosures in "Legal Matters" under Note 6 of the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q and the information under the heading "Legal Matters" is incorporated by reference herein.

**Item 1A. Risk Factors**

Investors in Nektar Therapeutics should carefully consider the risks described below before making an investment decision. The risks described below may not be the only ones relating to our company. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011. Additional risks that we currently believe are immaterial may also impair our business operations. Our business, results of operations, financial condition, cash flows and future prospects and the trading price of our common stock and our abilities to repay our senior secured notes could be harmed as a result of any of these risks, and investors may lose all or part of their investment. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2011, including our consolidated financial statements and related notes, and our other filings made from time to time with the Securities and Exchange Commission (SEC).

**Risks Related to Our Business*****Drug development is a long and inherently uncertain process with a high risk of failure at every stage of development.***

We have a number of proprietary drug candidates and partnered drug candidates in research and development ranging from the early discovery research phase through preclinical testing and clinical trials. Preclinical testing and clinical studies are long, expensive and highly uncertain processes. It will take us, or our collaborative partners, several years to complete clinical studies. The start or end of a clinical study is often delayed or halted due to changing regulatory requirements, manufacturing challenges, required clinical trial administrative actions, slower than anticipated patient enrollment, changing standards of care, availability or prevalence of use of a comparator drug or required prior therapy, clinical outcomes, or our and our partners' financial constraints.

Drug development is a highly uncertain scientific and medical endeavor, and failure can unexpectedly occur at any stage of clinical development. Typically, there is a high rate of attrition for drug candidates in preclinical and clinical trials due to scientific feasibility, safety, efficacy, changing standards of medical care and other variables. The risk of failure increases for our drug candidates that are based on new technologies, such as the application of our advanced polymer conjugate technology to small molecules, including NKTR-118, NKTR-119, NKTR-102, NKTR-181, NKTR-192 and other drug candidates currently in discovery research or preclinical development. The failure of one or more of our drug candidates could have a material adverse effect on our business, financial condition and results of operations.

***Even with success in preclinical testing and previously completed clinical trials, the risk of clinical failure for any drug candidate remains high prior to regulatory approval.***

A number of companies have suffered significant unforeseen failures in late stage clinical studies due to factors such as inconclusive efficacy results and adverse medical events, even after achieving positive results in earlier clinical studies that were satisfactory both to them and to reviewing government health authorities. While the NKTR-118, NKTR-102, and Amikacin Inhale drug candidates have each demonstrated positive results from Phase 2 clinical studies, there is a substantial risk that Phase 3 clinical study outcomes from these drug candidates from larger patient populations will not demonstrate positive efficacy, safety or other clinical outcomes sufficient to support regulatory filings and achieve regulatory approval. Phase 3 clinical study outcomes remain very unpredictable and it is possible that one or more of these Phase 3 clinical studies could fail at any time due to efficacy, safety or other important clinical findings or regulatory requirements. If one or more of these drug candidates fail in Phase 3 clinical studies, it would have a material adverse effect on our business, financial condition and results of operations.

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

We or our partners may not obtain regulatory approval for drug candidates on a timely basis, or at all, or the terms of any approval (which in some countries includes pricing approval) may impose significant restrictions or limitations on use. Drug candidates must undergo rigorous animal and human testing and an extensive FDA mandated or equivalent foreign government health authority review process for safety and efficacy. The drug development process generally takes a number of years and requires the expenditure of substantial resources. The time required for completing testing and obtaining approvals is uncertain, and the FDA and other U.S. and foreign regulatory agencies have substantial discretion, at any phase of development, to terminate clinical studies, require additional clinical development or other testing, delay or withhold registration and marketing approval and mandate product withdrawals, including recalls. In addition, undesirable side effects caused by our drug candidates could cause us or regulatory authorities to interrupt, delay or halt clinical trials and could result in a more restricted label or the delay or denial of regulatory approval by regulatory authorities. For example, we understand that the FDA is exploring whether there is any evidence of a potential cardiovascular class effect related to opioid withdrawal associated with mu-opioid antagonists and naloxegol is a mu-opioid antagonist. Although AstraZeneca is conducting comprehensive safety studies for naloxegol as part of the KODIAC development program, the health authorities retain significant discretion over regulatory requirements which remain very uncertain and difficult to predict prior to obtaining approval.

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

***We have substantial future capital requirements and there is a risk we may not have access to sufficient capital to meet our current business plan. If we do not receive substantial milestone payments from our existing collaboration agreements, execute new high value collaborations or other arrangements, or are unable to raise additional capital in one or more financing transactions, we would be unable to continue our current level of investment in research and development.***

As of September 30, 2012, we had cash, cash equivalents, and investments in marketable securities valued at approximately \$354.3 million and indebtedness of approximately \$152.0 million, including approximately \$125.0 million in senior secured notes due July 2017, \$15.2 million in capital lease obligations, and \$11.8 million of other liabilities. In addition, at September 30, 2012, we had a \$126.7 million liability related to the sale of future royalties. While this royalty obligation liability will not be settled in cash, we may be required to make a payment of up to \$7.0 million in 2014 if certain performance targets are not met. While we believe that our cash position will be sufficient to meet our liquidity requirements through at least the next 12 months, our future capital requirements will depend upon numerous unpredictable factors, including:

the cost, timing and outcomes of clinical studies and regulatory reviews of our proprietary drug candidates that we have licensed to our collaboration partners (e.g. naloxegol licensed to AstraZeneca);

if and when we receive potential milestone payments and royalties from our existing collaborations if the drug candidates subject to those collaborations achieve clinical, regulatory or commercial success, in particular, if the KODIAC development program is successful and AstraZeneca submits regulatory filings with the FDA and the European Medicines Agency for naloxegol, we will be entitled to \$95.0 million in milestone payments;

the progress, timing, cost and results of our clinical development programs in particular our Phase 3 BEACON study for NKTR-102 and our Phase 2 clinical study for NKTR-181;

the success, progress, timing and costs of our efforts to implement new collaborations, licenses and other transactions that increase our current net cash, such as the sale of additional royalty interests held by us, term loan or other debt arrangements, and the issuance of securities;



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the outcome of the regulatory review process and commercial success of drug products for which we are entitled to receive royalties (e.g., Map Pharmaceutical's Levade<sup>®</sup>);

the number of patients, enrollment criteria, primary and secondary endpoints, and the number of clinical studies required by the government health authorities in order to consider for approval our drug candidates and those of our collaboration partners;

our general and administrative expenses, capital expenditures and other uses of cash; and

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disputes concerning patents, proprietary rights, or license and collaboration agreements that negatively impact our receipt of milestone payments or royalties or require us to make significant payments arising from licenses, settlements, adverse judgments or ongoing royalties.

A significant multi-year capital commitment is required to advance our drug candidates through the various stages of research and development in order to generate sufficient data to enable high value collaboration partnerships with significant up-front payments or to successfully achieve regulatory approval. If sufficient capital is not available to us or is not available on commercially reasonable terms, it could require us to delay or reduce one or more of our research and development programs. If we are unable to sufficiently advance our research and development programs, it could substantially impair the value of such programs and result in a material adverse effect on our business, financial condition and results of operations.

***The results from the expanded Phase 2 clinical study for NKTR-102 in women with platinum-resistant/refractory ovarian cancer are unlikely to result in a review or an approval of a new drug application (NDA) by the United States Food and Drug Administration (FDA), and the future results from this trial are difficult to predict.***

We expanded the NKTR-102 Phase 2 study by 110 patients in women with platinum-resistant/refractory ovarian cancer that had received prior Doxil® therapy with the potential for us to consider an early NDA submission after we evaluate these expanded study results. We are currently in the process of continuing patient follow-up activities as well as compiling and performing verification procedures on the data we have to date. Acceptance and approval of an NDA by the FDA almost always requires the sponsor to conduct comparative Phase 3 clinical studies prior to acceptance for review or approval of an NDA. As a result, acceptance for review or approval of an accelerated NDA submitted to the FDA based on overall response rate from our single-arm Phase 2 study in platinum-resistant/refractory ovarian cancer would be unusual and is highly unlikely. Therefore we do not expect the FDA to accept or approve an accelerated NDA based on this Phase 2 clinical study. The FDA has significant discretion to determine what constitutes a high unmet medical need, what therapies should be considered available to patients regardless of which therapies are approved or typically prescribed in a particular setting, the relevance of certain efficacy end points (e.g. overall response rate, progression free survival, overall survival), and the number of patients required to be studied to demonstrate sufficient therapeutic benefit and safety profile. One or more of such judgments and determinations by the FDA could impair our ability to submit an accelerated NDA for platinum resistant/refractory ovarian cancer patients, and even if submitted, whether the FDA would accept it for review and/or approve the NDA.

Further, this expansion of our Phase 2 study in platinum resistant/refractory ovarian cancer will necessarily change the final efficacy (e.g., overall response rates, progression-free survival, overall survival) and safety (i.e., frequency and severity of serious adverse events) results, and, accordingly, the final results in this study remain subject to substantial change and could be materially and adversely different from previously announced results. If the clinical studies for NKTR-102 ovarian cancer are not successful, it could significantly harm our business, results of operations and financial condition.

***While we have conducted numerous experiments using laboratory and home-based chemistry techniques that have not been able to convert NKTR-181 into a rapid-acting and more abusable opioid, there is a risk that in the future a technique could be discovered to convert NKTR-181 into a rapid-acting and more abusable opioid which would significantly diminish the value of this drug candidate.***

An important objective of our NKTR-181 drug development program is to create a unique opioid molecule that does not rapidly enter a patient's central nervous system and therefore has the potential to be less susceptible to abuse than alternative opioid therapies. To date, we have conducted numerous experiments using laboratory and home-based chemistry techniques that have been unable to convert NKTR-181 into a rapidly-acting, more abusable form of opioid. In the future, an alternative chemistry technique, process or method of administration, or combination thereof, may be discovered to enable the conversion of NKTR-181 into a more abusable opioid which could significantly and negatively impact the potential of NKTR-181.

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

We intend to continue to seek partnerships with pharmaceutical and biotechnology partners to fund a portion of our research and development capital requirements. The timing of new collaboration partnerships is difficult to predict due to availability of clinical data, the outcomes from our clinical studies, the number of potential partners that need to complete due diligence and approval processes, the definitive agreement negotiation process and numerous other unpredictable factors that can delay, impede or prevent significant transactions. If we are unable to find suitable partners or to negotiate collaboration arrangements with favorable commercial terms with respect to our existing and future drug candidates or the licensing of our intellectual property, or if any arrangements we negotiate, or have negotiated, are terminated, it could have a material adverse effect on our business, financial condition and results of operations.



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***Preliminary and interim data from our clinical studies that we announce or publish from time to time is subject to audit and verification procedures that could result in material changes in the final data and may change as more patient data becomes available.***

From time to time, we publish preliminary or interim data from our clinical studies. For example, on April 16, 2012, we announced preliminary tumor response rate data from our expanded Phase 2 clinical study for NKTR-102 in platinum resistant/refractory ovarian cancer. Preliminary data remains subject to audit confirmation and verification procedures that may result in the final data being materially different from the preliminary data we previously published. Interim data is also subject to the risk that one or more of the clinical outcomes may materially change as patient enrollment continues and more patient data becomes available. As a result, preliminary and interim data should be viewed with caution until the final data are available. Material adverse changes in the final data could significantly harm our business prospects.

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

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

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

Numerous pending and issued U.S. and foreign patent rights and other proprietary rights owned by third parties relate to pharmaceutical compositions, methods of preparation and manufacturing, and methods of use and administration. We cannot predict with any certainty which, if any, patent references will be considered relevant to our or our collaboration partners' technology or drug candidates 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. In certain cases, we have existing licenses or cross-licenses with third parties, however the scope and adequacy of these licenses is very uncertain and can change substantially during long development and commercialization cycles for biotechnology and pharmaceutical products. There can be no assurance that we can obtain a license to any technology that we determine we need on reasonable terms, if at all, or that we could develop or otherwise obtain alternate technology. If we are required to enter into a license with a third party, our potential economic benefit for the products subject to the license will be diminished. If a license is not available on commercially reasonable terms or at all, we may be prevented from developing and selling the drug, which could significantly harm our business, results of operations, and financial condition.

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

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

clinical development and commercialization obligations that are based on certain commercial reasonableness performance standards that can often be difficult to enforce if disputes arise as to adequacy of performance;

research and development performance and reimbursement obligations for our personnel and other resources allocated to partnered drug candidate development programs;

clinical and commercial manufacturing agreements, some of which are priced on an actual cost basis for products supplied by us to our partners with complicated cost allocation formulas and methodologies;

intellectual property ownership allocation between us and our partners for improvements and new inventions developed during the course of the collaboration;

royalties on drug sales based on a number of complex variables, including net sales calculations, geography, scope of patent claim coverage, patent life, generic competitors, bundled pricing and other factors; and

indemnity obligations for intellectual property infringement, product liability and certain other claims.

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We are a party to certain significant agreements including an asset purchase agreement with Novartis pursuant to which we sold a significant portion of our pulmonary business at the end of 2008, the worldwide exclusive license agreement with AstraZeneca related to the further development and commercialization of naloxegol and NKTR-119, and the purchase and sale agreement related to the sale of our royalty interests in UCB's CIMZIA and Roche's MIRCERA that we completed in February 2012. Each of these agreements contains complex representations and warranties, covenants and indemnification obligations that could result in substantial future liability and harm our financial condition if we breach any of our agreements with AstraZeneca or Novartis or any third party agreements impacted by these complex transactions.

From time to time, we have informal dispute resolution discussions with third parties regarding the appropriate interpretation of the complex commercial terms contained in our agreements. One or more disputes may arise or escalate in the future regarding our collaboration agreements, transaction documents, or third-party license agreements that may ultimately result in costly litigation and unfavorable interpretation of contract terms, which would have a material adverse effect on our business, financial condition and results of operations.

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

From time to time, third parties have asserted, and may in the future assert, that we or our partners infringe their proprietary rights, such as patents and trade secrets, or have otherwise breached our obligations to them. The third party often bases its assertions on a claim that its patents cover our technology platform or drug candidates or that we have misappropriated its confidential or proprietary information. Similar assertions of infringement could be based on future patents that may issue to third parties. In certain of our agreements with our partners, we are obligated to indemnify and hold harmless our collaboration partners from intellectual property infringement, product liability and certain other claims, which could cause us to incur substantial costs and liability if we are called upon to defend ourselves and our partners against any claims. If a third party obtains injunctive or other equitable relief against us or our partners, they could effectively prevent us, or our partners, from developing or commercializing, or deriving revenue from, certain drugs or drug candidates in the U.S. and abroad.

For instance, F. Hoffmann-La Roche Ltd, to which we license our proprietary PEGylation reagent intellectual property for use in the MIRCERA<sup>®</sup> product, was a party to a significant patent infringement lawsuit brought by Amgen Inc. related to Roche's proposed marketing and sale of MIRCERA<sup>®</sup> to treat chemotherapy anemia in the U.S. In October 2008, a federal court ruled in favor of Amgen, issuing a permanent injunction preventing Roche from marketing or selling MIRCERA<sup>®</sup> in the U.S. Roche and Amgen subsequently entered into a settlement and limited license agreement which allows Roche to begin selling MIRCERA<sup>®</sup> in the U.S. in July 2014.

Currently, the Research Foundation of the State University of New York (SUNY) seeks to recover amounts it alleges it is owed pursuant to a technology licensing contract between SUNY and us. SUNY has filed an action in the United States District Court for the Northern District of New York. We dispute SUNY's claims. However, we cannot predict with certainty the eventual outcome of any pending or future litigation. Costs associated with such litigation, substantial damage claims, indemnification claims or royalties paid for licenses from third parties could have a material adverse effect on our business, financial condition and results of operations.

Third-party claims involving proprietary rights or other matters could also result in substantial settlement payments or substantial damages to be paid by us. For instance, a settlement might require us to enter a license agreement under which we would pay substantial royalties or other compensation to a third party, diminishing our future economic returns from the related drug. In October 2011, we entered into a settlement related to a trade secret and breach of contract litigation where we agreed to make an upfront payment of \$2.7 million and a future contingent payment of \$3.0 million if a certain drug candidate receives FDA approval. In 2006, we entered into a litigation settlement related to an intellectual property dispute with the University of Alabama in Huntsville pursuant to which we paid \$11.0 million and agreed to pay an additional \$10.0 million in equal \$1.0 million installments over ten years ending with the last payment due on July 1, 2016.

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

The patent positions of pharmaceutical and biotechnology companies, such as ours, are uncertain and involve complex legal and factual issues. We own greater than 120 U.S. and 420 foreign patents and a number of pending patent applications that cover various aspects of our technologies. We have filed patent applications, and plan to file additional patent applications, covering various aspects of our PEGylation and advanced polymer conjugate technologies and our proprietary product candidates. There can be no assurance that patents that have issued will be valid and enforceable or that patents for which we apply will issue with broad coverage, if at all. The coverage claimed in a patent application can be significantly reduced before the patent is issued and, as a consequence, our patent applications may result in patents with narrow coverage that may not prevent competition from similar drugs. The scope of our patent claim coverage can be critical to our right to receive royalties from our collaboration partnerships. Since publication of discoveries in scientific or patent literature often lags behind the date of such discoveries, we cannot be certain that we were the first inventor of inventions covered by our patents or patent applications. As part of the patent application process, we may have to participate in



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interference proceedings declared by the U.S. Patent and Trademark Office, which could result in substantial cost to us, even if the eventual outcome is favorable. Further, an issued patent may undergo further proceedings to limit its scope so as not to provide meaningful protection and any claims that have issued, or that eventually issue, may be circumvented or otherwise invalidated. Any attempt to enforce our patents or patent application rights could be time consuming and costly. An adverse outcome could subject us to significant liabilities to third parties, require disputed rights to be licensed from or to third parties or require us to cease using the technology in dispute. Even if a patent is issued and enforceable, because development and commercialization of pharmaceutical products can be subject to substantial delays, patents may expire early and provide only a short period of protection, if any, following commercialization of related products.

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

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

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

***If we or our contract manufacturers are not able to manufacture drugs or drug substances in sufficient quantities that meet applicable quality standards, it could delay clinical studies, result in reduced sales or constitute a breach of our contractual obligations, any of which could significantly harm our business, financial condition and results of operations.***

If we or our contract manufacturers are not able to manufacture and supply sufficient drug quantities meeting applicable quality standards required to support large clinical studies or commercial manufacturing in a timely manner, we risk delaying our clinical studies or those of our collaboration partners, reducing drug sales by our collaboration partners or breaching contractual obligations. As a result, we could incur substantial costs and damages, and reduce or even eliminate product or royalty revenue. In some cases, we rely on contract manufacturing organizations to manufacture and supply drug product for our clinical studies and those of our collaboration partners. Pharmaceutical manufacturing involves significant risks and uncertainties related to the demonstration of adequate stability, sufficient purification of the drug substance and drug product, the identification and elimination of impurities, optimal formulations, process validation, and challenges in controlling for all of these variables. We have faced and may in the future face significant difficulties, delays and unexpected expenses as we validate third party contract manufacturers required for drug supply to support our clinical studies and the clinical studies and products of our collaboration partners. Failure by us or our contract manufacturers to supply drug product in sufficient quantities that meet all applicable quality requirements could result in supply shortages for our clinical studies or the clinical studies and commercial activities of our collaboration partners. Such failures could significantly and materially delay clinical trials and regulatory submissions or result in reduced sales, any of which could significantly harm our business prospects, results of operations and financial condition.

Failures in device manufacturing have similar effects. For instance, we entered a service agreement with Novartis pursuant to which we subcontract to Novartis certain important services to be performed in relation to our partnered program for Amikacin Inhale with Bayer Healthcare LLC. If our subcontractors do not dedicate adequate resources to our programs, we risk breach of our obligations to our partners. Building and validating large scale clinical or commercial-scale manufacturing facilities and processes,





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recruiting and training qualified personnel and obtaining necessary regulatory approvals is complex, expensive and time consuming. In the past we have encountered challenges in scaling up manufacturing to meet the requirements of large scale clinical trials without making modifications to the drug formulation, which may cause significant delays in clinical development. We have experienced repeated significant delays in starting the Phase 3 clinical development program for Amikacin Inhale as we seek to finalize and validate the device design with a demonstrated capability to be manufactured at commercial scale. This work is ongoing and there remains significant risk in finalizing, validating, and producing the device at sufficient quantities meeting applicable quality requirements until this work is completed. Drug/device combination products are particularly complex, expensive and time-consuming to develop due to the number of variables involved in the final product design, including ease of patient/doctor use, maintenance of clinical efficacy, reliability and cost of manufacturing, regulatory approval requirements and standards and other important factors. There continues to be substantial and unpredictable risk and uncertainty related to manufacturing and supply until such time as the commercial supply chain is validated and proven.

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

Our revenue is derived from our collaboration agreements from which we receive contract research payments, milestone payments based on clinical progress, regulatory progress or net sales achievements, royalties and manufacturing revenue. Significant variations in the timing of receipt of cash payments and our recognition of revenue can result from significant milestone payments based on the execution of new collaboration agreements, the timing of clinical outcomes, regulatory approval, commercial launch and the achievement of certain annual sales thresholds. The amount of our revenue derived from collaboration agreements in any given period will depend on a number of unpredictable factors, including our ability to find and maintain suitable collaboration partners, the timing of the negotiation and conclusion of collaboration agreements with such partners, whether and when we or our collaboration partners achieve clinical, regulatory and sales milestones, the timing of regulatory approvals in one or more major markets, reimbursement levels by private and government payers, and the market introduction of new drugs or generic versions of the approved drug, as well as other factors.

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

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

design and conduct large scale clinical studies;

prepare and file documents necessary to obtain government approvals to sell a given drug candidate; and/or

market and sell the drugs when and if they are approved.

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

we may be unable to control whether, and the extent to which, our partners devote sufficient resources to the development programs or commercial marketing and sales efforts;

disputes may arise or escalate in the future with respect to the ownership of rights to technology or intellectual property developed with partners;

disagreements with partners could lead to delays in, or termination of, the research, development or commercialization of product candidates or to litigation or arbitration proceedings;

contracts with our partners may fail to provide us with significant protection, or to be effectively enforced, in the event one of our partners fails to perform;

partners have considerable discretion in electing whether to pursue the development of any additional product candidates and may pursue alternative technologies or products either on their own or in collaboration with our competitors;

partners with marketing rights may choose to devote fewer resources to the marketing of our partnered products than they do to products of their own development or products in-licensed from other third parties;

the timing and level of resources that our partners dedicate to the development program will affect the timing and amount of revenue we receive;

we do not have the ability to unilaterally terminate agreements (or partners may have extension or renewal rights) that we believe are not on commercially reasonable terms or consistent with our current business strategy;

partners may be unable to pay us as expected; and

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partners may terminate their agreements with us unilaterally for any or no reason, in some cases with the payment of a termination fee penalty and in other cases with no termination fee penalty.

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

***If we are unable either to create sales, marketing and distribution capabilities or to enter into agreements with third parties to perform these functions, we will be unable to commercialize our products successfully.***

We currently have no sales, marketing or distribution capabilities. To commercialize any of our drugs that receive regulatory approval for commercialization, we must either develop internal sales, marketing and distribution capabilities, which would be expensive and time consuming, or enter into collaboration arrangements with third parties to perform these services. If we decide to market our products directly, we must commit significant financial and managerial resources to develop a marketing and sales force with technical expertise and with supporting distribution, administration and compliance capabilities. Factors that may inhibit our efforts to commercialize our products directly or indirectly with our partners include:

our inability to recruit and retain adequate numbers of effective sales and marketing personnel;

the inability of sales personnel to obtain access to or persuade adequate numbers of physicians to use or prescribe our products;

the lack of complementary products or multiple product pricing arrangements may put us at a competitive disadvantage relative to companies with more extensive product lines; and

unforeseen costs and expenses associated with creating and sustaining an independent sales and marketing organization.

***If we, or our partners through our collaborations, are not successful in recruiting sales and marketing personnel or in building a sales and marketing infrastructure, we will have difficulty commercializing our products, which would adversely affect our business, results of operations and financial condition.***

To the extent we rely on other pharmaceutical or biotechnology companies with established sales, marketing and distribution systems to market our products, we will need to establish and maintain partnership arrangements, and we may not be able to enter into these arrangements on acceptable terms or at all. To the extent that we enter into co-promotion or other arrangements, any revenues we receive will depend upon the efforts of third parties, which may not be successful and are only partially in our control. In the event that we market our products without a partner, we would be required to build a sales and marketing organization and infrastructure, which would require a significant investment and we may not be successful in building this organization and infrastructure in a timely or efficient manner.

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

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

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

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

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

For the nine months ended September 30, 2012, we reported a net loss of \$118.9 million. If and when we achieve profitability depends upon a number of factors, including the timing and recognition of milestone payments and royalties received, the timing of revenue under our collaboration agreements, the amount of investments we make in our proprietary product candidates and the regulatory approval and market success of our product candidates. We may not be able to achieve and sustain profitability.

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

develop drugs utilizing our technologies, either independently or in collaboration with other pharmaceutical or biotech companies;

effectively estimate and manage clinical development costs, particularly the cost of the BEACON study and the Phase 2 clinical study for NKTR-181;

receive necessary regulatory and marketing approvals;

maintain or expand manufacturing at necessary levels;

achieve market acceptance of our partnered products;

receive royalties on products that have been approved, marketed or submitted for marketing approval with regulatory authorities; and

maintain sufficient funds to finance our activities.

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

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

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

We depend on independent clinical investigators, contract research organizations and other third-party service providers to conduct clinical trials for our proprietary product candidates. We rely heavily on these parties for successful execution of our clinical trials. Though we are ultimately responsible for the results of their activities, many aspects of their activities are beyond our control. For example, we are responsible for ensuring that each of our clinical trials is conducted in accordance with the general investigational plan and protocols for the trial, but the independent clinical investigators may prioritize other projects over ours or communicate issues regarding our products to us in an untimely

manner. Third parties may not complete activities on schedule or may not conduct our clinical trials in accordance with regulatory requirements or our stated protocols. The early termination of any of our clinical trial arrangements, the failure of third parties to comply with the regulations and requirements governing clinical trials or our reliance on results of trials that we have not directly conducted or monitored could hinder or delay the development, approval and commercialization of our product candidates and would adversely affect our business, results of operations and financial condition.

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

Our PEGylation and advanced polymer conjugate chemistry platforms and our partnered and proprietary products and product candidates compete with various pharmaceutical and biotechnology companies. Competitors of our PEGylation and polymer conjugate chemistry technologies include Dr. Reddy's Laboratories Ltd., Enzon Pharmaceuticals, Inc., SunBio Corporation, Mountain View Pharmaceuticals, Inc., Novo Nordisk A/S (formerly assets held by Neose Technologies, Inc.), and NOF Corporation. Several

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other chemical, biotechnology and pharmaceutical companies may also be developing PEGylation technologies or technologies that have similar impact on target drug molecules. Some of these companies license or provide the technology to other companies, while others are developing the technology for internal use.

There are several competitors for our proprietary product candidates currently in development. For Amikacin Inhale, the current standard of care includes several approved intravenous antibiotics for the treatment of either hospital-acquired pneumonia or ventilator-associated pneumonia in patients on mechanical ventilators. For naloxegol, there are currently several alternative therapies used to address opioid-induced constipation (OIC) and opioid-induced bowel dysfunction (OBD), including subcutaneous Relistor® (methylnaltrexone bromide) and oral and rectal over-the-counter laxatives and stool softeners such as docusate sodium, senna and milk of magnesia. In addition, there are a number of companies developing potential products which are in various stages of clinical development and are being evaluated for the treatment of OIC and OBD in different patient populations, including Adolor Corporation, Progenics Pharmaceuticals, Inc. in collaboration with Salix Pharmaceuticals, Ltd., Mundipharma Int. Limited, Sucampo Pharmaceuticals, and Takeda Pharmaceutical Company Limited. For NKTR-102, there are a number of chemotherapies and cancer therapies approved today and in various stages of clinical development for ovarian and breast cancers including but not limited to: Avastin® (bevacizumab), Camptosar® (irinotecan), Doxil® (doxorubicin HCl), Ellence® (epirubicin), Gemzar® (gemcitabine), Herceptin® (trastuzumab), Hycamtin® (topotecan), Iniparib, Paraplatin® (carboplatin), and Taxol® (paclitaxel). Major pharmaceutical or biotechnology companies with approved drugs or drugs in development for these cancers include Bristol-Meyers Squibb, Eli Lilly & Co., Roche, GlaxoSmithKline plc, Johnson and Johnson, Pfizer, Inc., Sanofi Aventis, and many others. There are approved therapies for the treatment of colorectal cancer, including Eloxatin® (oxaliplatin), Camptosar® (irinotecan), Avastin® (bevacizumab), Erbitux® (cetuximab), Vectibix® (panitumumab), Xeloda® (capecitabine), Adrucil® (fluorouracil), and Wellcovorin® (leucovorin). In addition, there are a number of drugs in various stages of preclinical and clinical development from companies exploring cancer therapies or improved chemotherapeutic agents to potentially treat colorectal cancer, including, but not limited to, products in development from Bristol-Myers Squibb Company, Pfizer, Inc., GlaxoSmithKline plc, Antigenics, Inc., F. Hoffmann-La Roche Ltd, Novartis AG, Cell Therapeutics, Inc., Neopharm Inc., Meditech Research Ltd, Alchemia Limited, Enzo Pharmaceuticals, Inc. and others.

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

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

The manufacture, clinical testing, marketing and sale of medical products involve inherent product liability risks. If product liability costs exceed our product liability insurance coverage, we may incur substantial liabilities that could have a severe negative impact on our financial position. Whether or not we are ultimately successful in any product liability litigation, such litigation would consume substantial amounts of our financial and managerial resources and might result in adverse publicity, all of which would impair our business. Additionally, we may not be able to maintain our clinical trial insurance or product liability insurance at an acceptable cost, if at all, and this insurance may not provide adequate coverage against potential claims or losses.

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

Our business strategy requires us to manage our business to provide for the continued development and potential commercialization of our proprietary and partnered drug candidates. Our strategy also calls for us to undertake increased research and development activities and to manage an increasing number of relationships with partners and other third parties, while simultaneously managing the capital necessary to support this strategy. Our decision to bear a majority or all of the clinical development costs of NKTR-102 substantially increases our future capital requirements. If we are unable to manage effectively our current operations and any growth we may experience, our business, financial condition and results of operations may be adversely affected. If we are unable to effectively manage our expenses, we may find it necessary to reduce our personnel-related costs through reductions in our workforce, which could harm our operations, employee morale and impair our ability to retain and recruit talent. Furthermore, if adequate funds are not available, we may be required to obtain funds through arrangements with partners or other sources that may require us to relinquish rights to certain of our technologies, products or future economic rights that we would not otherwise relinquish or require us to enter into other financing arrangements on unfavorable terms.

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



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Our success largely depends on the continued services of our executive officers and other key personnel. The loss of one or more members of our management team or other key employees could seriously harm our business, operating results and financial

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condition. The relationships that our key managers have cultivated within our industry make us particularly dependent upon their continued employment with us. We are also dependent on the continued services of our technical personnel because of the highly technical nature of our products and the regulatory approval process. Because our executive officers and key employees are not obligated to provide us with continued services, they could terminate their employment with us at any time without penalty. We do not have any post-employment noncompetition agreements with any of our employees and do not maintain key person life insurance policies on any of our executive officers or key employees.

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

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

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

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

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

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

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

lack of a provision for cumulative voting in the election of directors, which would otherwise allow less than a majority of stockholders to elect director candidates;

the ability of our board to authorize the issuance of blank check preferred stock to increase the number of outstanding shares and thwart a takeover attempt;

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, provisions of Delaware law relating to business combinations with interested stockholders may discourage, delay or prevent a third party from acquiring us. These provisions may also discourage, delay or prevent a third party from acquiring a large portion of our securities or initiating a tender offer or proxy contest, even if our stockholders might receive a premium for their shares in the acquisition over the then current market prices. We also have a change of control severance benefit plan which provides for

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certain cash severance, stock award acceleration and other benefits in the event our employees are terminated (or, in some cases, resign for specified reasons) following an acquisition. This severance plan could discourage a third party from acquiring us.

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

*The price of our common stock is expected to remain volatile.*

Our stock price is volatile. During the three months ended September 30, 2012, based on closing bid prices on The NASDAQ Global Select Market, our stock price ranged from \$7.99 to \$10.78 per share. 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:

announcements of data from, or material developments in, our clinical studies and those of our collaboration partners, including data regarding efficacy and safety, delays in clinical development, regulatory approval or commercial launch;

announcements by collaboration partners as to their plans or expectations related to drug candidates and approved drugs in which we have a substantial economic interest;

announcements regarding terminations or disputes under our collaboration agreements;

fluctuations in our results of operations;

developments in patent or other proprietary rights, including intellectual property litigation or entering into intellectual property license agreements and the costs associated with those arrangements;

announcements of technological innovations or new therapeutic products that may compete with our approved products or products under development;

announcements of changes in governmental regulation affecting us or our competitors;

litigation brought against us or third parties to whom we have indemnification obligations;

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

general market conditions.

*The indenture governing the senior secured notes imposes significant operating and financial restrictions on us and our subsidiaries that may prevent us from pursuing certain business opportunities and restrict our ability to operate our business.*

The indenture governing the senior secured notes contains covenants that restrict our and our subsidiaries' ability to take various actions, such as:

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incur or guarantee additional indebtedness or issue disqualified capital stock or cause certain of our subsidiaries to issue preferred stock;

pay dividends or distributions, redeem equity interests or subordinated indebtedness or make certain types of investments;

create or incur liens;

transfer, sell, lease or otherwise dispose of assets and issue or sell equity interests in certain of our subsidiaries;

incur restrictions on certain of our subsidiaries ability to pay dividends or other distributions to the Company or to make intercompany loans or asset transfers;

enter into transactions with affiliates;

engage in any business other than businesses which are the same, similar, ancillary or reasonably related to the our business as of July 11, 2012; and

consummate a merger, consolidation, reorganization or business combination, or sell, assign, transfer, lease or otherwise dispose of all or substantially all of our assets.

In addition, the indenture governing the senior secured notes contains a financial maintenance covenant requiring us to maintain a \$25.0 million segregated cash reserve account until July 1, 2015 to be applied to interest payments on the notes in the event of a default, subject to certain conditions. This indenture also requires us not to permit, thereafter and through the quarter ending June 30, 2017, the aggregate balance of our unrestricted cash and cash equivalents at the end of any two consecutive fiscal quarters to be less than \$25.0 million, subject to certain conditions. Our ability to comply with these covenants will likely be affected by many factors, including events beyond our control, and we may not satisfy those requirements. Our failure to comply with our debt-related obligations could result in an event of default under our other indebtedness and the acceleration of our other indebtedness, in whole or in part, could result in an event of default under the indenture governing the senior secured notes.

The restrictions contained in the indenture governing the senior secured notes could also limit our ability to plan for or react to market conditions, meet capital needs or otherwise restrict our activities or business plans and adversely affect our ability to finance our operations, enter into acquisitions or to engage in other business activities that would be in our interest.

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

None, including no purchases of any class of our equity securities by us or any affiliate pursuant to any publicly announced repurchase plan in the three months ended September 30, 2012.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

Except as so indicated in Exhibits 32.1 and 101, the following exhibits are filed as part of, or incorporated by reference into, this Quarterly Report on Form 10-Q.

Exhibit	Description of Documents
10.1(1)	Nektar Therapeutics 2012 Performance Incentive Plan.
31.1(2)	Certification of Nektar Therapeutics principal executive officer required by Rule 13a-14(a) or Rule 15d-14(a).
31.2(2)	Certification of Nektar Therapeutics principal financial officer required by Rule 13a-14(a) or Rule 15d-14(a).
32.1*	Section 1350 Certifications.
101**	The following materials from Nektar Therapeutics Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the unaudited Condensed Consolidated Balance Sheets, (ii) the unaudited Condensed Consolidated Statements of Operations, (iii) the unaudited Condensed Consolidated Statements of Comprehensive Loss, (iv) the unaudited Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements.

(1) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Current Report on Form 8-K filed on July 3, 2012.

(2) Filed herewith.

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

\*\* Exhibit 101 is being furnished and, in accordance with Rule 406T of Regulation S-T, shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability of that section, nor shall such exhibit be deemed to be incorporated by reference in any registration statement or other document filed under the Securities Act of 1933, as amended, or the Securities Exchange Act.



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**SIGNATURES**

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

By: /s/ JOHN NICHOLSON

**John Nicholson**

**Senior Vice President and Chief Financial Officer**

Date: November 9, 2012

By: /s/ JILLIAN B. THOMSEN

**Jillian B. Thomsen**

**Senior Vice President, Finance and Chief Accounting Officer**

Date: November 9, 2012



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