NEKTAR®

2006 ANNUAL REPORT

NEKTAR®

Nektar Therapeutics is a leader in translating advanced PEGylation and pulmonary delivery technologies into therapies that transform patient care and outcomes. We are the science and development expertise behind blockbuster products that make a positive difference in the lives of patients. We are a public company with a deep commitment to creating value for our shareholders and making them proud of the scientific and medical advances that their support enables.

To meet our commitments to patients, physicians and shareholders, we are moving our company in a new direction. Starting from a position of strength made possible by our previous achievements, we are moving toward greater efficiency, productivity and value creation by reorganizing into specific business units and focusing on advancing our proprietary pipeline. Never before have we believed so strongly in our ability to succeed. Come see what the excitement at Nektar is all about.

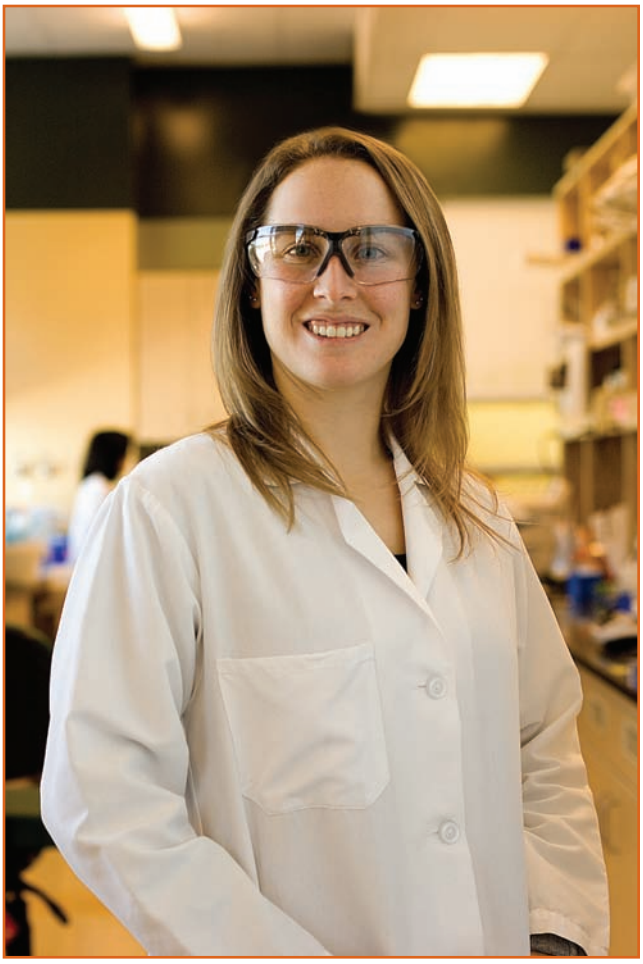
Table of Contents

WE MAKE MEDICINES better for patients

Nektar's Platform Technologies

ADVANCED PEGYLATION When attached to a drug, polyethylene glycol (PEG) polymer chains can sustain bioavailability by protecting the drug molecules from immune responses and other clearance mechanisms. In the body, the chain-like PEG attracts water molecules that act like a shield, protecting the active drug molecule from degradation by antibodies or enzymes. The water molecules also significantly increase the PEG's original size, thereby slowing the drug clearance from the kidneys, which allows the drug to stay in the body longer. The end result: medicine with prolonged and enhanced therapeutic benefits. Most importantly, Nektar scientists are demonstrating through the use of various structures that "PEGylation" technology can be applied to small molecules.

ADVANCED PULMONARY DELIVERY Pulmonary delivery offers opportunities for improved and innovative drug delivery and greater patient compliance. In addition, pulmonary delivery offers rapid onset of action and more efficient and targeted treatment of lung disorders. Nektar Advanced Pulmonary Delivery combines innovations in dry powder and liquid pulmonary technology with state-of-the-art devices that deliver both large and small molecules to the lung for systemic and local drug administration.



11 MARKETED OR FILED PRODUCTS

PRODUCT	PARTNER	STATUS
Exubera® for diabetes	Pfizer	Marketed
Neulasta® for neutropenia	Amgen	Marketed
Macugen® for macular degeneration	OSI Pharmaceuticals	Marketed
Somavert® for acromegaly	Pfizer	Marketed
PEGASYS® for hepatitis C	Roche	Marketed
PEG-INTRON® for hepatitis C	Schering	Marketed
Definity® for cardiac imaging	Bristol-Myers Squibb	Marketed
SprayGel™ for post-surgical adhesions	Confluent	Marketed
DuraSeal™ for cranial dural sealant	Confluent	Marketed
Cimzia™ for Crohn's disease	UCB Pharma	Filed
Mircera™ for renal anemia	Roche	Filed

ANTICIPATED 2007 VALUE DRIVERS

Proprietary Programs

- NKTR-061 (inhaled amikacin) Phase 2a data by year-end
- NKTR-102 (PEG-irinotecan) Commence Phase 2 by year-end
- NKTR-118 (oral PEG-naloxol) Commence Phase 2 by year-end

Partnering

- One pulmonary and one PEG product deal with significant economics

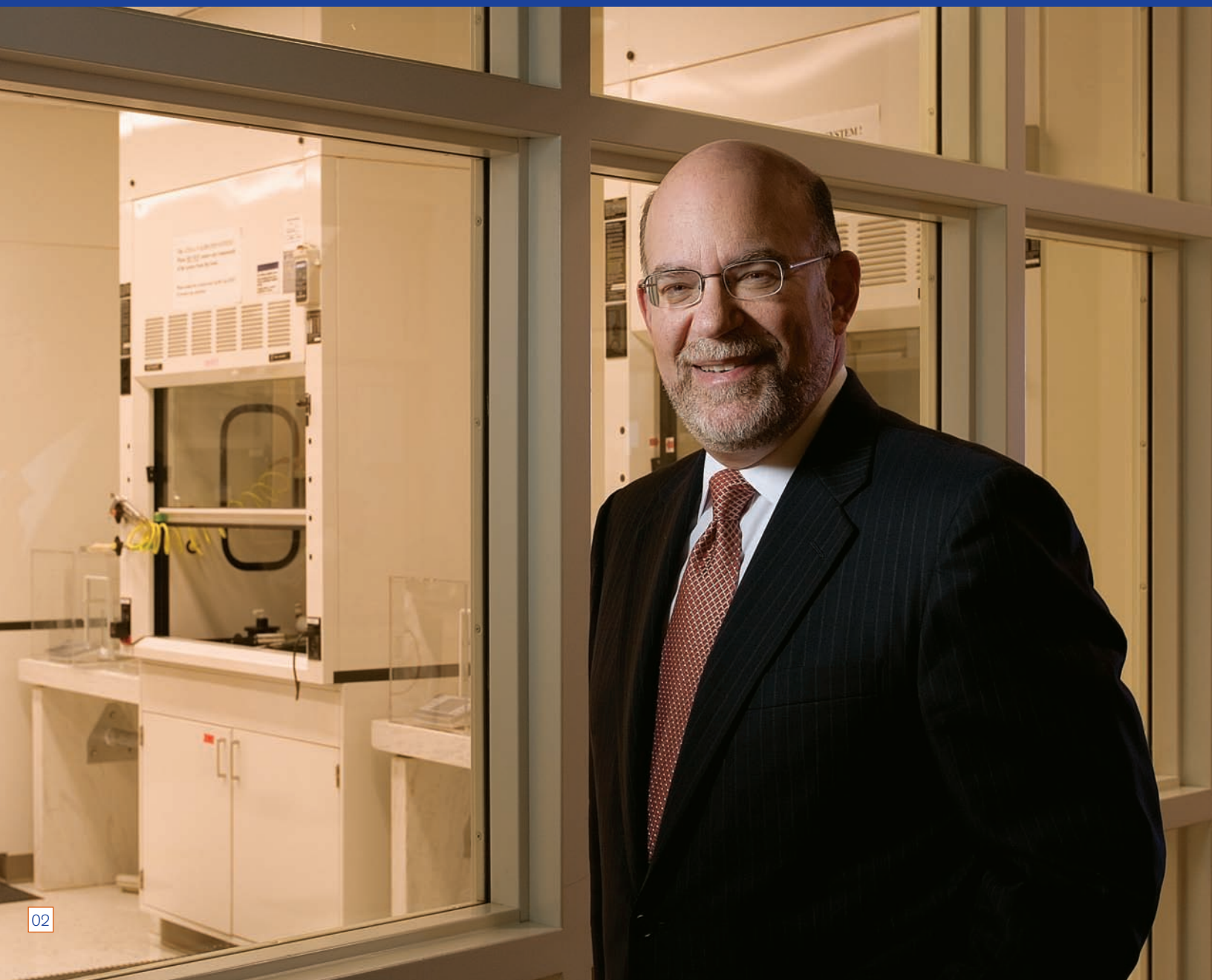
Revenue and Product Approvals

- Revenue from full launch of Exubera
- Roche's Mircera approval in US (renal anemia)
- UCB's Cimzia™ approval in US and EU (Crohn's disease)

Focus The Business

- Improve productivity and efficiency
- Significantly reduce cash burn

The anticipated value drivers and certain other statements in this letter are forward-looking statements and actual results could differ materially based on a number of risks and uncertainties including those contained under the heading "Risk Factors" in Nektar's most recent annual report on Form 10-K and quarterly report on Form 10-Q filed with the SEC.



TO OUR SHAREHOLDERS

Nektar Therapeutics is widely regarded in the biopharmaceutical industry as a technology and commercial pioneer in the pulmonary delivery and PEGylation of medicines. We have leveraged this expertise to transform approved products—many of which serve large and lucrative commercial markets—into significantly safer, more effective, and more convenient therapeutics for patients. The most recent example of our pioneering efforts to improve therapeutics is Exubera®, which has been approved in the U.S. and Europe, the world's two most important pharmaceutical markets.

Exubera matters

Exubera is the world's first inhaled insulin product to be approved for the treatment of adults with type 1 and type 2 diabetes. This drug has the potential to revolutionize the way diabetes—one of this generation's greatest health problems—is treated. The sales and marketing of Exubera, which under our collaboration agreement is the responsibility of Pfizer, has been the focus of great concern to investors and analysts.

We believe that Exubera's regrettably slow start is a poor indication of its true potential in a multibillion-dollar market that has gone underserved for more than a generation. We are, therefore, working closely with the new management team at Pfizer, and the new Exubera marketing team, in particular, to ensure that this breakthrough product reaches its potential. Pfizer is equally committed to Exubera's success and it is putting in place a sales and marketing program that is designed to succeed where the previous program came up short.

Advancing our proprietary pipeline

Make no mistake, Exubera prescriptions matter. However, there are a number of proprietary products in development at Nektar with enormous therapeutic and commercial potential that have unfortunately been overlooked and overshadowed in recent years by Exubera and our other pulmonary-based programs.

When the market and medical community gain more clarity about our proprietary pipeline, particularly our PEGylated small molecule programs, they will understand why we are so excited about these prospects.

The vast majority of medicines on the market today are small molecules. PEGylating these molecules is far from simple, but we are the PEGylation experts. All of the PEGylated therapeutics approved over the past 10 years have been enabled by Nektar. We are producing data and filing patents to prove that with the right chemistry, the hurdles to PEGylating small molecules are not insurmountable.

One of the programs we are accelerating is NKTR-102 (PEG-irinotecan). Irinotecan is a top-selling chemotherapy for colon cancer and other solid tumors which is a tremendously important product for oncologists. However, irinotecan has severe limitations: the drug causes diarrhea and neutropenia. These are dose-limiting side effects that can seriously complicate treatment. Our preclinical data indicate that PEGylation of irinotecan has the potential to significantly mediate these two side effects and, therefore, greatly improve the quality of care for cancer patients taking this drug.

We are also accelerating the development of NKTR-118 (oral PEG-naloxol) for opioid-induced constipation. In preclinical studies, NKTR-118 alleviated constipation without diminishing the analgesic impact of the opioid; it did not enter the central nervous system as a result of our proprietary PEGylation chemistry.

In addition to NKTR-102 and NKTR-118, Nektar is developing a number of other proprietary programs including PEG-Factor IX for hemophilia, NKTR-203 (basal insulin for diabetes), NKTR-024 (inhaled amphotericin B) for the prevention of invasive pulmonary fungal infections and NKTR-061 (inhaled amikacin) for pneumonia.

What it takes

Elevating the importance of our proprietary pipeline is just one of many sweeping changes underway at Nektar to better leverage our pulmonary and PEGylated drug development platforms. We will continue to partner our products when the economics add significantly to shareholder value, however, in general we will focus more upon proprietary drug development.

Nektar has two remarkable platform technologies which can be broadly applied to make medicines more therapeutically and commercially valuable, and to develop novel therapeutics. We have only begun to prove what we are capable of producing for shareholders and patients alike.

Sincerely,

Howard W. Robin
President and Chief Executive Officer

OPPORTUNITIES THROUGH INNOVATION

All of the PEGylated medicines approved over the past 10 years were enabled by Nektar. Our scientific ingenuity is the engine behind our expanding portfolio of robust PEGylated product opportunities.

Our PEGylation technologies improve the performance and tolerability of drugs used to treat chronic ailments and life-threatening illnesses.

Nektar's PEGylation franchise is based on complex technology, but its impact on therapeutics–and its value to the biopharmaceutical industry–are quite simple to grasp. All of the PEGylated therapeutics approved over the past 10 years were enabled by Nektar. Many of these therapeutics have become mainstays in cancer care, infectious diseases and other serious medical conditions.

A Robust Technology

The process of PEGylation adds polymers of polyethylene glycol (PEG) to a drug. Binding of water molecules to the chain-like PEG molecules leads to the effective expansion and motion of the polymer, which reduces the interaction between the PEGylated drug and other molecules within the body. By reducing interactions between the drug and the immune system and clearance mechanisms, the addition of PEG can reduce a drug's immunogenicity and may substantially improve a drug's half-life. Compared to unmodified drugs, PEGylated molecules often result in improved clinical benefits such as: efficacy, safety and less frequent administration.

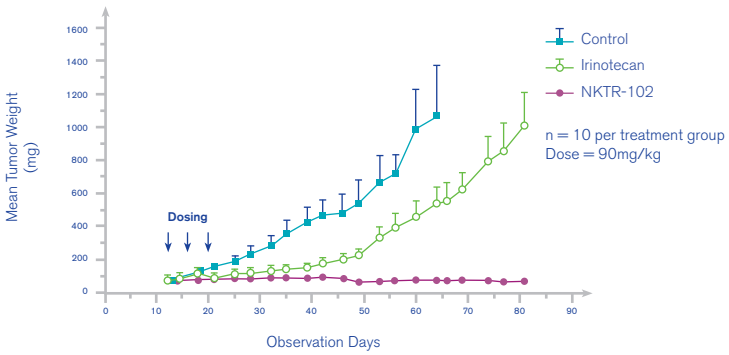
In the past, Nektar's R&D efforts have been focused on PEGylating large molecules for partners. With an eye on the future, and far larger market opportunities, we are pioneering efforts to PEGylate small molecules. Small molecule medicines represent the vast majority of prescription drugs on the market and in development today. Traditional PEGylation technology is not conducive to small molecules, so we invented new approaches and structures that allow us to attach a PEG to a small molecule. This novel approach improves the therapeutic profile of the small molecule and avoids blood-brain-barrier and first-pass metabolism effects. The end result is a small molecule that stays in the body longer, prolonging the drug's therapeutic effects, and can avoid central nervous system uptake.

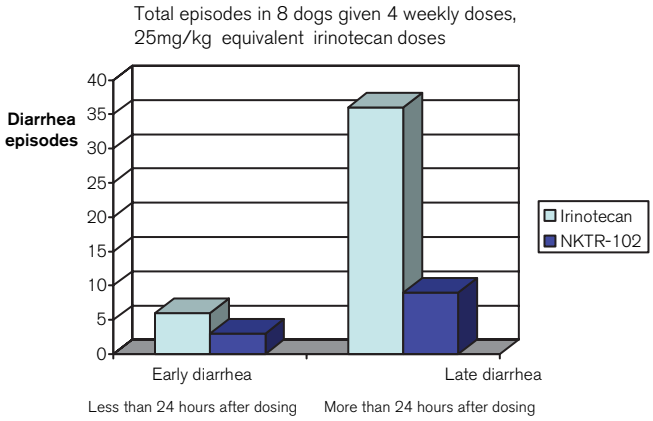
Nektar's Most Advanced Proprietary PEGylation Programs

NKTR-102 (PEG-irinotecan) is a PEGylated formulation of irinotecan, a drug with demonstrated efficacy in the treatment of colorectal cancer and other solid tumors. Irinotecan is a remarkable drug, but it causes neutropenia and severe diarrhea, which exacerbates the misery experienced by cancer patients undergoing irinotecan chemotherapy. Preclinical studies suggest that NKTR-102 may significantly reduce the neutropenia and severe diarrhea associated with irinotecan.

NKTR-118 (oral PEG-naloxol) is an oral PEGylated formulation of an analog of naloxone. This drug is designed to relieve the constipation that chronic and acute pain sufferers experience when taking opioids for pain relief. Phase 1 data suggest that NKTR-118 has the potential to significantly improve the quality of life for these patients by alleviating their constipation. NKTR-118 does not enter the central nervous system where it could interfere with the opioid analgesia.

Preclinical data suggest that NKTR-102 (PEG-irinotecan) can potentially produce dramatically better results than irinotecan





APPLYING PROVEN SCIENCE

Nektar's advanced pulmonary delivery technologies are improving the lives of patients with diabetes, infectious diseases and other life-threatening conditions by improving the therapeutic performance of their medicines.

A Breakthrough In Treatment

EXUBERA®
(insulin human [rDNA origin])
Inhalation Powder

Nektar developed and licensed to Pfizer the world's first inhaled insulin product–and this breakthrough product is bringing new hope for diabetics. As Pfizer notes, "The fear of injections has prevented or delayed far, far too many patients from accepting this appropriate treatment to control their blood sugar levels. Exubera® (insulin human [rDNA origin]) Inhalation Powder is a major advance in insulin delivery to help patients accept insulin early for better glycemic control … 'Taking Exubera is a welcome alternative. The device is small enough to fit into my coat pocket, and I can carry it with me everywhere I go. Using Exubera helps me to control my diabetes,' said a 62-year-old Exubera user with type 2 diabetes. … Pfizer is moving forward to effectively establish Exubera and serve the million of diabetics still uncontrolled on current therapy."

Nektar is turning the challenges of pulmonary delivery into opportunities for success in the clinic and in the marketplace.

For patients with lung disorders, pulmonary delivery offers rapid, efficient and targeted treatment of disease that is superior to what can be achieved with oral or systemic administration. We are building a diverse pipeline of inhaled anti-infective agents to treat a variety of life-threatening pulmonary infections.

Transforming Disease Management

Our pulmonary delivery technology is transforming the treatment of diseases that are managed today with injected therapies. Exubera,® approved for the treatment of type 1 and type 2 diabetes, is the first example of this approach in action. Exubera is an effective new approach to managing diabetes, one of the biggest problems in public health today.

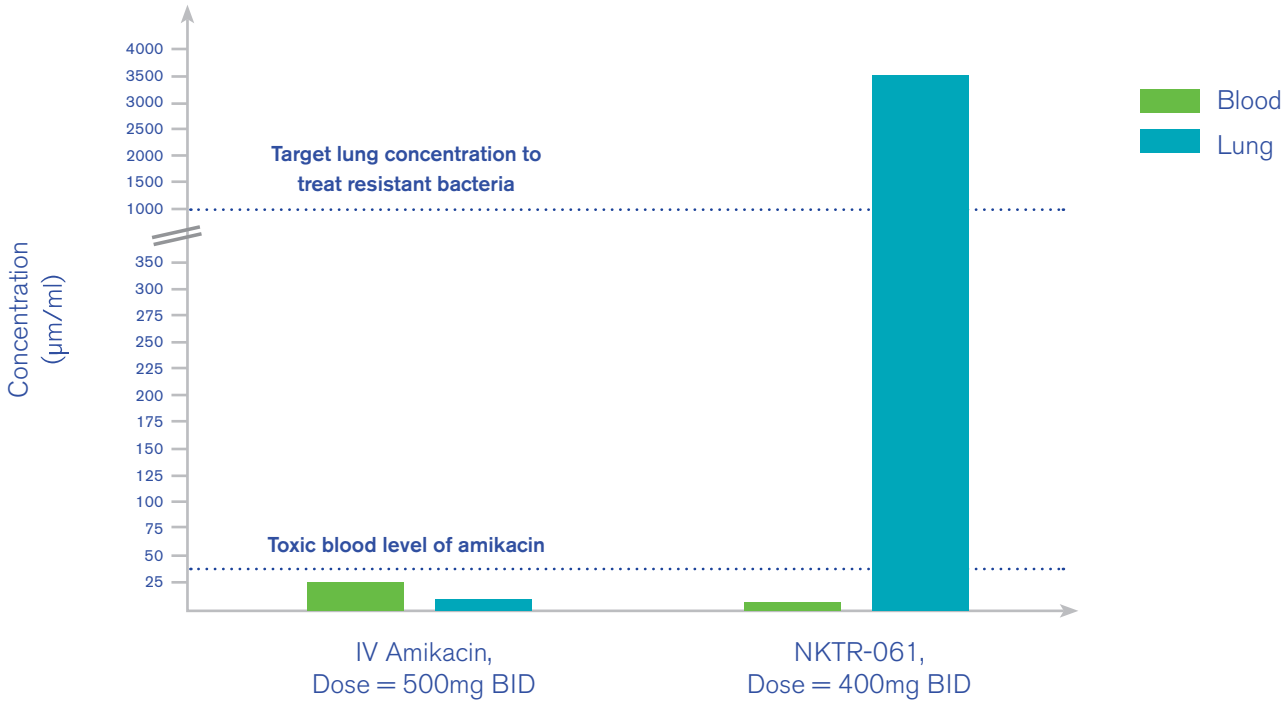
Nektar's Most Advanced Pulmonary Delivery Program

NKTR-061 (inhaled amikacin). Patients with hospital-acquired pneumonia who need mechanical ventilation, as well as patients on ventilators who contract ventilator-associated pneumonia have high morbidity and mortality rates, in spite of available broad spectrum intravenous antibiotics.

It is estimated that 3.5 million patients in U.S. hospitals are diagnosed with pneumonia each year. Of these cases, up to 250,000 are on mechanical ventilators.

Our Inhaled antibiotics program is designed to treat pneumonias in this ventilated patient population. Our easy-to-use micropump technology ensures that NKTR-061 (inhaled amikacin) has the potential to deliver a target lung concentration sufficient to treat resistant bacteria without producing the systemic toxicity commonly found with high doses of intravenous antibiotics.

NKTR-061 (inhaled amikacin) has the potential to effectively target the lung without systemic toxicity



A PIPELINE WITH BLOCKBUSTER POTENTIAL

Nektar is committed to developing a portfolio of products that will improve patient care and create value for our investors.

11 PRODUCT CANDIDATES IN THE CLINIC

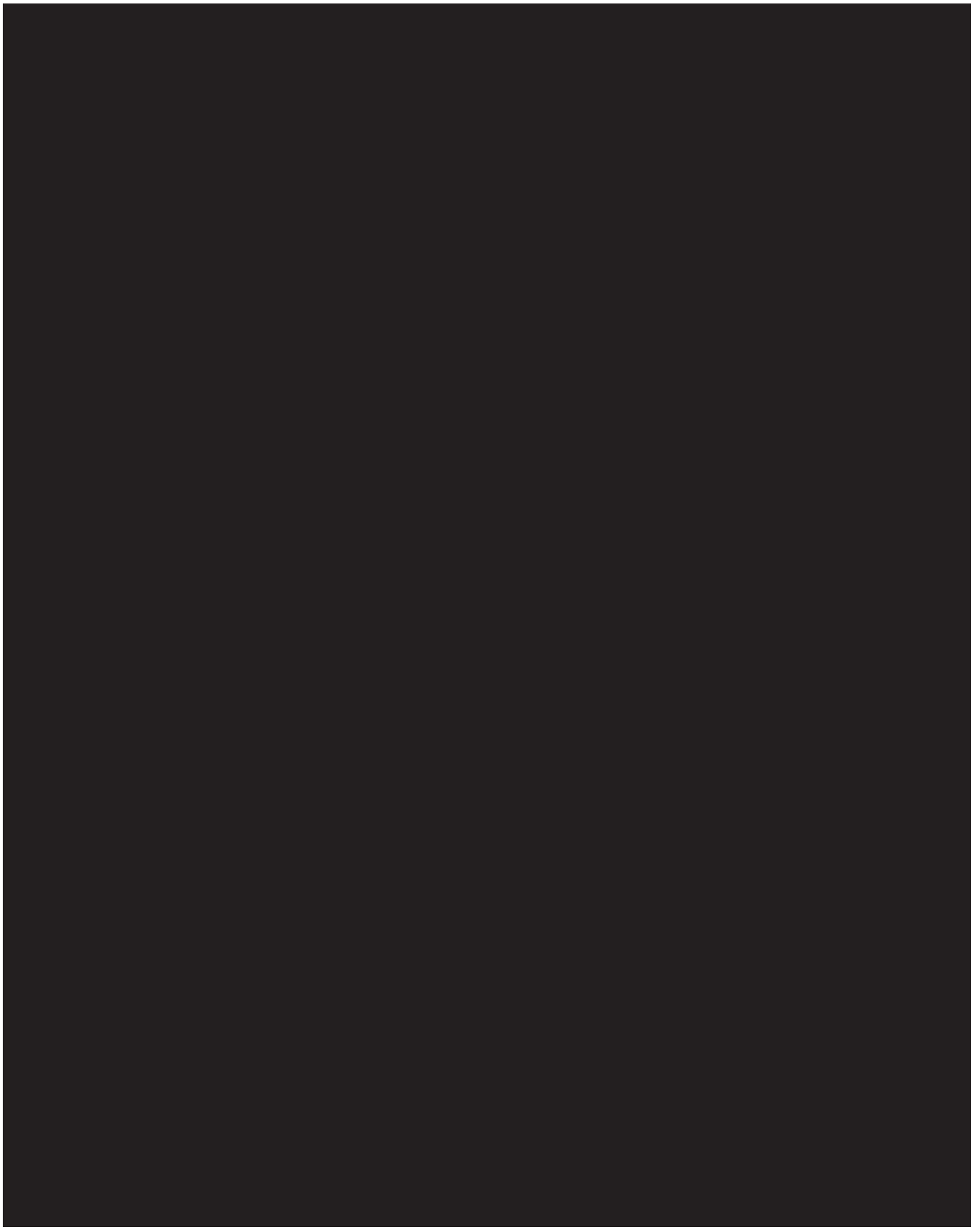
PRODUCT	PARTNER	STATUS
Tobramycin Inhalation Powder (TIP™) for lung infection	Novartis	Phase 3
PEG-Anti-GFR antibody fragment for cancer (CDP 791)	UCB Pharma	Phase 2
Inhaled-Dronabinol for migraine	Solvay	Phase 2
PEG-human growth hormone for growth deficiency (hGH)	Pfizer	Phase 2
PEG-Hematide™ for anemia	Affymax	Phase 2
Ciprofloxacin Inhalation Powder (CIP) for lung infection	Bayer	Phase 1
Ostabolin-C™ Inhalation Powder (OCIP) for osteoporosis	Zelos Therapeutics	Phase 1
NKTR-061 (inhaled amikacin) for pneumonia		Phase 2
NKTR-024 (inhaled amphotericin B) for prevention of invasive pulmonary fungal infections		Phase 1
NKTR-102 (PEG-irinotecan) for solid tumors		Phase 1
NKTR-118 (oral PEG-naloxol) for opioid-induced constipation		Phase 1

4 PRECLINICAL DEVELOPMENT PROGRAMS

PRODUCT	PARTNER	STATUS
PEG-Factor VIII for hemophilia	Baxter	Pre-clinical
PEG-Factor IX for hemophilia		Pre-clinical
Next Generation Inhaled Insulin for diabetes	Pfizer	Pre-clinical
NKTR-203 Basal Insulin for diabetes		Pre-clinical

Nektar proprietary products

2006 FINANCIAL REVIEW



Selected Financial Information

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

(In thousands, except per share information)

Years ended December 31,	**2006**	2005	2004	2003	2002
STATEMENTS OF OPERATIONS DATA:					
Revenue:					
Product sales and royalties [1]	**$ 153,556**	$ 29,366	$ 25,085	$ 27,295	$ 18,465
Contract research	**56,303**	81,602	89,185	78,962	76,380
Exubera commercialization readiness	**7,859**	15,311	–	–	–
Total revenue	**217,718**	126,279	114,270	106,257	94,845
Total operating costs and expenses [2]	**376,948**	308,912	188,212	171,012	193,658
Loss from operations [2]	**(159,230)**	(182,633)	(73,942)	(64,755)	(98,813)
Gain (loss) on debt extinguishment	**–**	(303)	(9,258)	12,018	–
Interest and other income (expense), net	**5,297**	(2,312)	(18,849)	(12,984)	(8,655)
(Provision) Benefit for income taxes	**(828)**	137	163	(169)	–
Net loss	**$ (154,761)**	$ (185,111)	$ (101,886)	$ (65,890)	$ (107,468)
Basic and diluted net loss per share [3]	**$ (1.72)**	$ (2.15)	$ (1.30)	$ (1.18)	$ (1.94)
Shares used in computing basic and diluted net loss per share [3]	**89,789**	85,915	78,461	55,821	55,282

Years ended December 31,	**2006**	2005	2004	2003	2002
BALANCE SHEET DATA:					
Cash, cash equivalents and investments	**$ 466,977**	$ 566,423	$ 418,740	$ 298,409	$ 293,969
Working capital	**$ 369,725**	$ 450,248	$ 223,880	$ 223,971	$ 136,424
Total assets	**$ 768,177**	$ 858,554	$ 744,921	$ 616,788	$ 606,638
Convertible subordinated notes [4]	**$ 417,653**	$ 417,653	$ 173,949	$ 359,988	$ 299,149
Other long term liabilities	**$ 29,457**	$ 27,598	$ 36,250	$ 46,742	$ 37,553
Accumulated deficit	**$ (1,056,993)**	$ (902,232)	$ (717,121)	$ (615,235)	$ (549,345)
Total stockholders' equity	**$ 227,060**	$ 326,811	$ 467,342	$ 164,191	$ 206,770

1 2006 Product sales and royalties include commercial manufacturing revenue from Exubera Inhalation Powder and Exubera Inhalers.

2 We changed our method of accounting for stock based compensation on January 1, 2006 in connection with the adoption of SFAS No. 123R, Accounting for Share-Based Payment.

3 Basic and diluted net loss per share is based upon the weighted average number of common shares outstanding.

4 We repaid $36.0 million of the 5% Convertible Subordinated Notes on February 7, 2007.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed here. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this section as well as in Item 1A of Part I of the Annual Report on Form 10-K filed with the Securities and Exchange Commission under the heading "Risk Factors."

OVERVIEW

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

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

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

The commercial success of Exubera will be a critical factor in us achieving our profitability objective and for us to be able to fund the key elements of our business strategy. We expect our future revenues to come increasingly from the manufacture and sale of Exubera Inhalation Powder and Inhalers and royalties from sales of Exubera by Pfizer. Like any product in the early stages of commercial launch, there are substantial risks and uncertainties with respect to the commercial success of Exubera, including the timing and success of the commercialization of Exubera by Pfizer in various markets, physician and patient education and experiences, third party payor reimbursement, country specific pricing approvals, manufacturing and supply execution, and other risks and uncertainties identified in this report. In addition, under our collaboration agreement with Pfizer, we do not participate in the marketing and sales activity for Exubera.

Our manufacturing revenues received from Pfizer for Exubera Inhalation Powder and Inhalers are calculated on a cost-plus basis. Exubera royalty revenue levels will depend on the level of Exubera product sales to end users and Pfizer's cost of goods sold for Exubera. Pfizer is taking a phased approach to the Exubera commercial launch. In the second half of 2006, the early phase of the Exubera launch focused on manufacturing scale-up activities and the education of diabetes specialists. In 2007, Pfizer initiated the next phase of the launch expanding the education, marketing and sales efforts more broadly to primary care physicians. Because the Exubera commercial roll-out is in its early phases, we cannot predict the level of Exubera end user product sales or expected royalty revenues for this or subsequent years.

Currently, we are the exclusive manufacturer of the Exubera Inhalation Powder. Under our collaboration agreement, Pfizer can manufacture up to one-half of the Exubera Inhalation Powder and also has responsibility for the automated filling of all insulin blister packs for the Exubera Inhaler and packaging of the Exubera product. Pfizer has an Exubera Inhalation Powder manufacturing facility and will likely manufacture a portion of the Exubera Inhalation Powder in the future. In the second half of 2006, Pfizer experienced scale-up challenges with highly automated, specially engineered Pfizer equipment, although Pfizer has said they made significant progress in addressing these challenges. Any failure, delay or inability to address these challenges and scale-up Pfizer's portion of the manufacturing, filling, and packaging processes could impede Exubera sales and would significantly and adversely impact our revenues, results of operations, and financial condition. Although we have been successful at meeting our Exubera Inhalation Powder and Inhaler manufacturing objectives to date, it is critical that we continue to meet our manufacturing commitments in 2007 to support Pfizer's requirements. Commercial scale manufacturing execution by both Nektar and Pfizer remains an important factor in meeting anticipated Exubera market demand and meeting our financial objectives.

We continue to make significant investments in our proprietary development programs which comprise a substantial portion of our research and development spending. Our current strategy is to develop a portfolio of proprietary programs that is intended to address critical unmet medical needs by exploiting our know-how and technology in combination with established medicines. We intend to continue our strategy of partnering these development programs with pharmaceutical and biotechnology companies in various stages of their development in an effort to help fund the investment of our proprietary development programs. Our decision as to when to seek partners for our proprietary development programs will be made on an individual program basis and such decisions will have an important impact on our future revenues, research and development spending, and financial position. In this regard, we are currently seeking collaboration partners for two of our proprietary development programs and the success and timing of these partnering efforts will affect our research and development expense levels and revenues in 2007 and beyond.

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

To fund the expense related to our research and development activities, we have raised significant amounts of capital through the sale of our equity and convertible debt securities. As of December 31, 2006, we had approximately $447.9 million in long-term debt. Our ability to meet the repayment obligations of this debt is dependent upon our and our partners' ability to develop, obtain regulatory approvals, and successfully commercialize products. Even if we are successful in this regard, we may require additional capital to repay our debt obligations.

RESEARCH AND DEVELOPMENT ACTIVITIES

Our product pipeline includes both partnered and proprietary development programs. We have ongoing collaborations or licensing arrangements with more than 30 biotechnology and pharmaceutical companies to provide our technologies. Our technologies are currently being used in nine approved products, in two partner programs that have been filed for with the FDA and twelve development programs in human clinical trials.

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

Our portfolio of development programs is focused on our Pulmonary Technology and PEGylation Technology platforms. Within each major category, we have both partnered and proprietary development programs. The estimated completion dates and costs for our programs are not reasonably certain. See Risk Factors for discussion of the risks associated with our partnered and proprietary research and development programs.

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

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

		Years ended December 31,		
MOLECULE	**STATUS[1]**	**2006**	2005	2004
Pulmonary				
Partnered Products and Development Programs				
Exubera® (insulin human [rDNA origin]) Inhalation Powder	Approved in U.S., EU, Brazil, and Mexico	**$ 22.1**	$ 51.4	$ 68.4
Tobramycin inhalation powder (TIP)	Phase 3	**12.8**	11.3	7.4
Other partner programs	Various	**14.3**	9.5	7.7
Proprietary Development Programs				
Next generation Exubera inhaler program	Pre-Clinical	**17.4**	6.5	2.7
Amphotericin B inhalation powder	Phase 1 (pre-pivotal)	**24.3**	16.7	8.3
Inhaled Antibiotics (Aerosolized amikacin)	Phase 2	**13.6**	9.1	2.5
Other proprietary products	Various	**9.1**	8.4	11.0
Technology platform	Various	**12.2**	16.9	11.1
TOTAL PULMONARY		**$ 125.8**	$ 129.8	$ 119.1
PEGylation				
Partnered products and development programs	Various	**$ 1.8**	$ 0.7	$ 1.5
Proprietary development programs				
PEG product (Oncology-related)	Pre-clinical	**5.5**	5.3	2.7
PEG product (Pain-related)	Pre-clinical	**2.7**	2.4	–
Other	Various	**10.6**	4.7	4.0
Total PEGylation		**$ 20.6**	$ 13.1	$ 8.2
Other	Various	**3.0**	8.8	6.2
Total Research and Development Expense		**$ 149.4**	$ 151.7	$ 133.5

1 Status definitions are included in the Form 10-K, December 31, 2006, Item 1: Business section

STOCK-BASED COMPENSATION

Effective January 1, 2006, we adopted the fair value method of accounting for stock-based compensation arrangements in accordance with SFAS No. 123R *Share-Based Payment*, using the modified prospective method of adoption. Our results of operations include $29.1 million of stock-based compensation expense for the year ended December 31, 2006.

Prior to January 1, 2006, we accounted for stock-based compensation using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25"). Under the modified prospective method of transition under SFAS No. 123R, we were not required to restate prior period financial statements to reflect expensing of stock-based compensation. Therefore, the results of operations for the years ended December 31, 2005 and 2004 are not directly comparable to December 31, 2006. In the discussions of cost of goods sold, research and development expenses and general and administrative expenses included within *Results of Operations* below, we have included the amount of stock-based compensation expense recognized during the year ended December 31, 2006 in order to explain the variations from December 31, 2005 and 2004.

Results of Operations

Years ended December 31, 2006, 2005 and 2004

Revenue (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Product Sales and Royalties	**$ 153,556**	$ 29,366	$ 25,085	$ 124,190	$ 4,281	100%	17%
Contract Research	**56,303**	81,602	89,185	(25,299)	(7,583)	(31%)	(9%)
Exubera Commercialization Readiness	**7,859**	15,311	–	(7,452)	15,311	(49%)	N/A
Total Revenue	**$ 217,718**	$ 126,279	$ 114,270	$ 91,439	$ 12,009	72%	11%

The increase in total revenue for the year ended December 31, 2006 as compared to the year ended December 31, 2005 was primarily due to an increase in Exubera product sales to Pfizer, partially offset by a decrease in contract research revenue from Pfizer. The increase in total revenue for the year ended December 31, 2005 as compared to the year ended December 31, 2004 was primarily due to Pfizer reimbursement of commercialization readiness costs.

Pfizer represented 64%, 64% and 61% of our revenue for the years ended December 31, 2006, 2005 and 2004, respectively. No other single customer represented 10% or more of our total revenues for any of the three years ended December 31, 2006, 2005 or 2004.

Product Sales and Royalties

The increase in product sales and royalties for the year ended December 31, 2006 as compared to the year ended December 31, 2005 was primarily due to an increase in Exubera product sales to Pfizer after the approval of Exubera in January 2006. Also contributing to the increase was approximately $18.0 million from our PEGylation products.

The increase in product sales and royalty revenue for the year ended December 31, 2005 as compared to the year ended December 31, 2004, was due primarily to $5.0 million of royalty revenue received from OSI Pharmaceuticals (formerly Eyetech Pharmaceuticals) product sales of Macugen, $1.5 million of Exubera product sales, and $1.4 million of product sales for Aerogen products received in the year ended December 31, 2005. These product sales and royalty revenue increases were partially offset by decreases of $3.6 million of product sales from our PEGylation Technology customers.

We have not experienced any significant returns from our customers.

Royalty revenues were $9.0 million, $5.4 million and $0.5 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Contract Research

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

The decrease in contract research revenue in 2006 compared to 2005 was primarily due to a $34.8 million decrease in Pfizer contract research revenue after the FDA and EMEA approval of Exubera in January 2006, and the transition from contract research revenue and commercialization readiness revenue from Pfizer for the Exubera development program to Exubera product sales. The decrease in contract research revenue from Pfizer was partially offset by a $3.7 million increase in contract research revenues from Novartis Pharma AG (formerly Chiron Corporation) under our collaboration agreement to develop a dry powder inhaled formation of tobramycin using our Pulmonary Technology and a $3.4 million increase in contract research revenue from Baxter Healthcare, under our agreement to develop a product to extend the half-life of Hemophilia A proteins using our PEGylation Technology.

The decrease in contract research revenue for 2005 compared to 2004 was primarily due to approximately $7.4 million decrease in revenue from Pfizer related to the transition of the Exubera program from contract research and development to commercialization readiness. In addition, during the year ended December 31, 2004, we recognized $2.0 million in revenue from a one-time payment related to Aventis' termination of a collaborative program with us. Other decreases were primarily due to the expected fluctuations in contract research revenue and the timing of milestone payments.

The estimated completion dates and costs for our programs are not reasonably certain. See Risk Factors in Form 10-K for the fiscal year-ended December 31, 2006 for discussion of the risks associated with our partnered and proprietary research and development programs.

Cost of goods sold (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Cost of Goods Sold	**$ 113,921**	$ 23,728	$ 19,798	$ 90,193	$ 3,930	>100%	20%
Product gross margin	**39,635**	5,638	5,287	33,997	351	>100%	7%
Product gross margin %	**26%**	19%	21%				

The increase in cost of goods sold during the year ended December 31, 2006 as compared to the year ended December 31, 2005 is due to increased Exubera product sales. This resulted in an increase in gross margin percentage because the Exubera Inhalation Powder and Inhalers have a relatively higher margin than our other products. We expect the gross margin percentage to decline in future periods due to product mix and our cost-plus manufacturing arrangement.

Cost of sales for the years ended December 31, 2006, 2005 and 2004 includes $1.6 million, nil and nil, respectively, of stock-based compensation.

The decrease in product gross margin percentage for the year ended December 31, 2005, as compared to the year ended December 31, 2004, was primarily due to $1.5 million of Exubera product sales at zero margin.

Exubera commercialization readiness revenue and costs (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Exubera Commercialization Readiness revenue	**$ 7,859**	$ 15,311	$ –	$ (7,452)	$ 15,311	(49%)	N/A
Exubera commercialization readiness costs	**$ 4,168**	$ 12,268	$ –	$ (8,100)	$ 12,268	(66%)	N/A

Exubera commercialization readiness revenue represents reimbursement by Pfizer of certain agreed upon operating costs, plus a mark-up, relating to preparation for commercial production in our Exubera Inhalation Powder manufacturing facilities and our Exubera Inhaler third party contract manufacturing locations. The decrease in Exubera commercialization readiness revenue was primarily due to the transition from readiness preparation to commercial production in late 2005 and early 2006.

Exubera commercialization readiness costs are start up manufacturing costs we have incurred in our Exubera Inhalation Powder manufacturing facility and our Exubera Inhaler device third party contract manufacturing locations preparing for commercial scale manufacturing. We do not anticipate incurring any additional costs related to commercialization readiness. We expect that remaining commercialization readiness costs previously incurred will be amortized through October 2007.

Research and development (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Research and development	**$ 149,381**	$ 151,659	$ 133,523	$ (2,278)	$ 18,136	(2%)	14%
Purchased in-process research and development	**$ –**	$ 7,859	$ –	$ (7,859)	$ 7,859	N/A	N/A

The decrease in the research and development expense from the year ended December 31, 2006 compared to the year ended December 31, 2005, related to decreased spending in our inhaled insulin programs of $18.4 million and other programs of $1.1 million. These decreases were partially offset by $9.7 million of non-cash stock-based compensation expense attributable to the adoption of SFAS 123R and $7.5 million related to our PEGylation programs.

The increase in research and development expense for the year ended December 31, 2005 compared to the year ended December 31, 2004, was primarily attributable to an increase of $10.7 million for pulmonary programs, $4.9 million for PEGylation programs and $2.5 million in other programs.

During the year ended December 31, 2005, we recorded a charge of $7.9 million for purchased in-process research and development costs in connection with our acquisition of Aerogen. The purchased in-process research and development costs were expensed on the acquisition date because the acquired technology had not yet reached technological feasibility and had no future alternative use outside of these development programs. The in-process research and development primarily represents two programs in clinical development, Amikacin and Surfactant. Amikacin is used in our inhaled antibiotic program in an aerosolized form. We have completed one Phase 2 trial and are currently planning Phase 2 studies to examine the pharmacokinetics of the program.

General and administrative (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
General and Administrative	**$ 78,319**	$ 43,852	$ 30,967	$ 34,467	$ 12,885	79%	42%

General and administrative expenses are associated with administrative staffing, business development and marketing.

The increase in general and administrative expenses for the year ended December 31, 2006 as compared to the year ended December 31, 2005 was primarily due to the following:

- Increased salary and employee-benefit costs of $26.4 million, including $17.8 million of stock-based compensation expense, of which $10.9 million is related to executive severance; $6.9 million of cash compensation, of which $3.7 million is due to executive severance; and $1.7 million of employee health and welfare benefits.
- Increased professional fees of $4.9 million primarily due to legal services related to litigation support, audit and related services, and other consulting services.
- Increased lease termination costs of $1.0 million associated with the winding down of operations of Bradford UK. The increase from lease termination costs was partially offset by lack of general and administrative costs due to the wind down of our Bradford operations.

The increase in general and administrative expenses for the year ended December 31, 2005, as compared to the year ended December 31, 2004 was primarily due to the following:

- Increased accounting fees and expenses of approximately $2.0 million, primarily due to Sarbanes Oxley compliance requirements.
- Increased legal fees and expenses of approximately $3.0 million, primarily due to increased patent fees related to our proprietary development programs and derivative shareholder claims.
- Incremental head count and related expenses of $5.0 million to support our product planning and marketing efforts for our proprietary and partnered programs.
- Addition of approximately $1.0 million from Aerogen operations from the date of acquisition through December 31, 2005.

We expect general and administrative spending to increase over the next few years to support increased commercial activities.

Litigation settlement

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Litigation Settlement	**$ 17,710**	$ –	$ –	$ 17,710	$ –	>100%	N/A

On June 30, 2006, we, our subsidiary Nektar Therapeutics AL (Nektar AL), and a former officer, Milton Harris, entered into a Settlement Agreement and General Release (Settlement Agreement) with the University of Alabama Huntsville (UAH) related to an intellectual property dispute. Under the terms of the Settlement Agreement, the Company, Nektar AL, Mr. Harris and UAH agreed to full and complete satisfaction of all claims asserted in the litigation in exchange for $25 million in cash payments. We and Mr. Harris made an initial payment of $15.0 million on June 30, 2006, of which we paid $11.0 million and Mr. Harris paid $4.0 million. Beginning July 1, 2007, we will pay UAH 10 annual installment payments of $1.0 million each, representing an accrued liability of $7.0 million at December 31 2006, or the present value of the future payments using an 8% annual discount rate. We recorded a litigation settlement charge of $17.7 million during the year ended December 31, 2006 which reflects the net present value of the settlement payments.

Amortization of other intangible assets (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Amortization of Other Intangible Assets	**$ 4,039**	$ 4,206	$ 3,924	$ (167)	$ 282	(4)%	7%

Other intangible assets include proprietary technology, intellectual property, and supplier and customer relationships acquired from third parties or in business combinations. The majority of our other intangible assets were either impaired or fully amortized as of the year ending December 31, 2006.

As of December 31, 2006, the net book value of our other intangible assets is $3.6 million representing the unamortized portion of our supplier and customer relationships intangible asset. This will be amortized on a straight-line basis of approximately $0.9 million per year through October 2010. Accordingly, we expect our amortization of other intangible assets to decrease to $0.9 million per year in the future, absent additional business combinations.

Impairment of long-lived assets (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Impairment of Long-Lived Assets	**$ 9,410**	$ 65,340	$ –	$ (55,930)	$ 65,340	(86%)	N/A

For the year ending December 31, 2006, impairment of long-lived assets includes $5.5 million relating to the write-off of certain intangible assets relating to our Ireland operations. Additionally, as a result of a contract renegotiation with one of our collaboration partners, we determined that costs incurred relating to a construction-in-progress asset had no future value because the asset is no longer probable of being completed. Accordingly, we recorded an impairment charge of $2.7 million. Also, as a result of the winding down of our Bradford UK operations, we recorded an impairment charge of $1.2 million relating to the remaining laboratory and office equipment.

We performed our annual impairment test for goodwill in October 2005 and determined at that time that the undiscounted cash flow from our long-range forecast for each respective business unit exceeded the carrying amount of the respective goodwill. In December 2005, we were apprised of unfavorable results of clinical data related to programs from our Super Critical Fluids Technology program in Bradford UK, which provided an indication that the fair value of the respective business unit's goodwill was below the carrying value. Therefore, in connection with our year end close process, we re-performed the impairment analysis of goodwill and other long-lived assets for Bradford UK. We determined the fair value of the intangibles and other assets of Nektar UK based on a discounted cash flow model to be less than the carrying amount of goodwill and certain long-lived assets. Based on the above, we recorded an impairment charge to goodwill and long-lived assets in the year ended December 31, 2005 in the amount of $59.6 million and $5.7 million, respectively.

This charge is reflected in the Impairment of long-lived assets line item in our Consolidated Statements of Operations. See Note 13 for more information regarding the winding-down of the Bradford facility.

Interest Income (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Interest Income	**$ 23,450**	$ 13,022	$ 6,602	$ 10,428	$ 6,420	80%	97%

The increase in interest income for the year ended December 31, 2006 is primarily due to an increase in our balance of cash, cash equivalents, and investments in marketable securities resulting from our $315.0 million subordinated debt offering completed in late September 2005, and higher prevailing interest rates during 2006 compared to 2005.

The increase in interest income for the year ended December 31, 2005, as compared to the year ended December 31, 2004, was primarily due to increases in average daily cash balances as a result of net proceeds of approximately $315.0 million in convertible subordinated notes in September 2005, and higher prevailing interest rates during 2005 compared to 2004.

Interest expense (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Interest Expense	**$ 20,256**	$ 14,085	$ 25,747	$ 6,171	$ (11,662)	44%	(45)%

The increase in interest expense for the year ended December 31, 2006, as compared to the year ended December 31, 2005 was primarily due to a higher average balance of convertible subordinated debt outstanding resulting from our $315.0 million subordinated debt offering completed in September 2005.

For the year ended December 31, 2004, interest expense included a payment of approximately $12.7 million in interest made to certain holders of our outstanding 3.0% convertible subordinated notes due June 2010 which completed an exchange of $169.3 million in aggregate principal amount of the notes held by such holders for the issuance of approximately 14.9 million shares of our common stock. The net increase of $1.0 million was primarily due to the interest expense related to the issuance of $315.0 million of 3.25% convertible subordinated notes in September 2005 less the decrease in interest expense related to the retirement of $25.4 million and $45.9 million aggregate principal amount of our outstanding 5% and 3.5% convertible subordinated notes due February, 2007, and October, 2007, respectively, in September 2005.

Other income (expense), net (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Other Income (Expense), net	**$ 2,103**	$ (1,249)	$ 296	$ 3,352	$ (1,545)	>100%	>(100)%

During the year ended December 31, 2006, we recognized a $2.2 million gain from the sale of an equity investment in Confluent Technologies. We do not expect to realize income from such transactions in the future. Other expense, net of the gain from the sale of our investment in Confluent Technologies is $0.1 million and is primarily related to net foreign exchange gains and losses.

During the year ended December 31, 2004, we terminated our lease obligation related to 45,574 square feet of space located at our headquarters in San Carlos, California. We recorded other expense of approximately $1.1 million, representing the write-off of our capital lease asset partially offset by a reduction in the present value of our future rent liability. In addition, other income for the year ended December 31, 2004, included $0.7 million of income related to our real estate partnership which was dissolved in September 2004.

Loss on debt extinguishment (in thousands except percentages)

	Years ended December 31			Increase/ (Decrease)	Increase/ (Decrease)	Percentage Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2006	2005	2004	2006 vs 2005	2005 vs 2004	2006 vs 2005	2005 vs 2004
Loss on Debt Extinguishment	**$ –**	$ 303	$ 9,258	$ (303)	$ (8,955)	N/A	(97)%

During the year ended December 31, 2005, we recognized a loss on debt extinguishment of approximately $0.3 million in connection with the retirement of $25.4 million and $45.9 million aggregate principal amount of our outstanding 5% and 3.5% convertible subordinated notes due February 2007 and October 2007, respectively for total cash payments of $71.0 million, in privately negotiated transactions. As a result these transactions, we wrote off approximately $0.1 million and $0.5 million of capitalized debt issuance costs related to the 5% and 3.5% convertible subordinated notes, respectively.

During the year ended December 31, 2004, we recognized a loss on debt extinguishment in connection with two privately negotiated transactions to convert our outstanding convertible subordinated notes into shares of our common stock. In January 2004, certain holders of our outstanding 3.5% convertible subordinated notes due October 2007 completed an exchange and cancellation of $9.0 million in aggregate principal amount of the notes for the issuance of 0.6 million shares of our common stock. In February 2004, certain holders of our outstanding 3% convertible subordinated notes due June 2010 converted approximately $36.0 million in aggregate principal amount of such notes for approximately 3.2 million shares of our common stock and a cash payment of approximately $3.1 million. As a result of these transactions, we recognized losses on debt extinguishment of approximately $7.8 million and $1.5 million, respectively.

Liquidity and Capital Resources

We had cash, cash equivalents and investments in marketable securities of $467.0 million and indebtedness of $447.9 million, including $417.7 million of convertible subordinated notes, $20.5 million in capital lease obligations and $9.7 million in other long-term liabilities as of December 31, 2006.

We have financed our operations primarily through revenue from product sales and research and development contracts, public and private placements of debt and equity securities and financing of equipment acquisitions and certain tenant leasehold improvements. We do not utilize off-balance sheet financing arrangements as a source of liquidity or financing.

Cashflow Activities

During the year ended December 31, 2006, we used approximately $92.7 million in operating cash flows. To date, revenue has not been sufficient to cover our expenses and we are not generating positive cash flow through our operations. Cash used in operating activities included an $11.0 million cash payment made in connection with the University of Alabama Huntsville litigation settlement. In 2006, we also purchased $22.5 million of property and equipment and repaid $10.5 million in debt obligations. These uses of cash were partially offset by $22.3 million in cash collected from employees for the purchase of common stock.

During the year ended December 31, 2005, we used $78.0 million in operating cashflows. We purchased $18.0 million of property and equipment and spent $30.7 million for the purchase of Aerogen, Inc. Additionally, we repaid $2.5 million in debt obligations. These uses of cash were offset by $234.7 million in proceeds from the issuance, net of repurchases, of convertible subordinated notes, as well as proceeds from the issuance of common stock to employees and a secondary offering of $10.9 million and $31.6 million, respectively.

We expect to use a substantial portion of our cash to fund our on-going operations over the next few years and to repay our $447.9 million of indebtedness outstanding as of December 31, 2006, including $102.7 million of convertible subordinated notes due in 2007. In February 2007, we repaid $36.0 million of our 5% convertible subordinated notes with cash.

Contractual Obligations

The following is a summary of our contractual obligations as of December 31, 2006 (in thousands)

	Payments due by period				
	Total	<=1 yr 2007	2–3 yrs 2008–2009	3–5yrs 2010–2011	2012+
Obligations [1]					
Convertible subordinated notes, including interest [2]	$ 478,711	$ 115,083	$ 20,475	$ 20,475	$ 322,678
Capital leases, including interest	41,834	3,992	8,200	8,376	21,266
Operating leases	17,595	3,770	6,632	5,741	1,452
Purchase commitments [3]	44,457	44,457	–	–	–
Litigation Settlement and other long-term liabilities, including interest	12,129	3,129	2,000	2,000	5,000
	$ 594,726	$ 170,431	$ 37,307	$ 36,592	$ 350,396

1 The above table does not include certain commitments and contingencies which are discussed in Note 9 of Notes to Consolidated Financial Statements.

2 We repaid $36.0 million of the 5% convertible subordinated notes on February 7, 2007.

3 Substantially all of this amount had been ordered on open purchase orders as of December 31, 2006 under existing contracts with the Company. This amount does not represent minimum contract termination liability.

Given our current cash requirements, we forecast that we will have sufficient cash to meet our net operating expense requirements and contractual obligations through 2007. We plan to continue to invest in our growth and our future cash requirements will depend upon the timing of these investments. Our capital needs will depend on many factors, including continued progress in our research and development programs, progress with preclinical and clinical trials of our proprietary and partnered product candidates, the time and costs involved in obtaining regulatory approvals, the costs of developing and scaling our clinical and commercial manufacturing operations, the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims, the need to acquire licenses to new technologies and the status of competitive products.

To date we have been primarily dependent upon equity and convertible debt financings for capital and have incurred substantial debt as a result of our issuances of subordinated notes that are convertible into our common stock. Our substantial debt, the market price of our securities, and the general economic climate, among other factors, could have material consequences for our financial position and could affect our sources of short-term and long-term funding. There can be no assurance that additional funds, if and when required, will be available to us on favorable terms, if at all.

Critical Accounting Policies

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, and evaluate our estimates on an ongoing basis. Actual results may differ from those estimates under different assumptions or conditions. We have determined that for the periods reported in this report, the following accounting policies and estimates are critical in understanding our financial condition and results of our operations.

Revenue Recognition

Product revenues from Exubera Inhalation Powder and Inhalers are primarily derived from the cost-plus manufacturing and supply agreement with Pfizer, are subject to quarterly manufacturing variance adjustments, and are recognized at the earlier of acceptance of products by Pfizer or 60 days from shipment. Under generally accepted accounting principles, revenue should be recognized when the related revenue is fixed and determinable. Under contracts such as the Pfizer contract, where the right of return exists, management must make a determination whether to estimate returns based on historical activity or to defer recognition of revenue until the contractual right of return period has lapsed.

Because commercial activities began in 2006, we did not have historical return data to use as a basis for product returns. To date, Pfizer has not returned any Exubera Inhalation Powder or Inhalers.

Product revenues and the related cost of goods sold for products that were shipped to Pfizer but have not been recognized within 60 days are recorded as deferred revenue, net of the deferred costs. As of December 31, 2006, we had net deferred margin relating to Exubera sales of $5.2 million, comprised of $23.1 million of deferred revenue and $17.9 million of deferred cost of sales. In the future, in lieu of deferring all revenue and related cost of sales, we expect to recognize revenue upon shipment of goods to Pfizer, net of a reserve for estimated product returns. We will make this change when we are able to reasonably estimate returns based on historical return experience and other factors.

Contract research revenue includes amortization of up-front fees. Up-front fees should be recognized ratably over the expected benefit period under the arrangement. Given the uncertainties of research and development collaborations, significant judgment is required to determine the duration of the arrangement. We have $17.7 million of deferred up-front fees related to two research and collaboration agreements that are being amortized over an average of 10 years. We considered shorter and longer amortization periods. The shortest reasonable period is the end of the development period (estimated to be 4 to 6 years). Given the statistical probability of drug development success in the bio-pharma industry, development programs have only a 5%-10% probability of reaching commercial success. The longest period is either the contractual life of the agreement, which is generally 10 years from the first commercial sale, or the end of the patent life, which is frequently 15–17 years. If we had determined a longer or shorter amortization period was appropriate, our annual up-front fee amortization could be as low as $1.0 million or as high as $4.4 million.

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

Stock-Based Compensation

During 2006, we issued RSU awards totaling 1,088,300 shares of our common stock to certain employees and directors. The RSU awards are settled by delivery of shares of our common stock on or shortly after the date the awards vest. A significant portion of these awards vest base upon achieving three pre-determined performance milestones which were initially expected to occur over a period of 40 months. We are expensing the grant date fair value of the awards ratably over the expected performance period. During the period ended September 30, 2006 management determined that one of the milestones, representing 40% of the total awards, was no longer probable (as defined in SFAS No. 5: *Accounting for Contingencies*) of vesting. As a result, we reversed all previously recorded compensation expense related to this performance milestone, or approximately $0.8 million. If we had determined that this milestone was probable, we would have expensed an additional $1.9 million during the year ended December 31, 2006. The remaining 60% of the performance based RSUs are expected to vest over a 27 month period from the award date. We recorded compensation expense of $5.0 million in the year ended December 31, 2006 related to the remaining 60% of these performance-based RSU awards.

Impairment of Goodwill and Other Long-Lived Assets

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets,* goodwill is tested for impairment at least annually or on an interim basis if an event occurs or circumstances change that would Indicate the carrying value may not be fully recoverable.

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

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

In December 2005, we were apprised of unfavorable results at our Bradford, UK facility and certain clinical data related to those activities. We re-performed our annual impairment test of the goodwill assigned to the Super Critical Fluids reporting unit. We determined the fair value of the Super Critical Fluids reporting unit, based on a discounted cash flow analysis, was less than the carrying amount of the reporting units assets, including assigned goodwill. Consequently, we recorded an impairment charge of $59.6 million in the year ended December 31, 2005. In connection with this impairment, we also impaired certain equipment used at the Bradford location resulting an additional charge of $5.7 million. These charges are reflected in the Impairment of long-lived assets line item in our Consolidated Statements of Operations. See Note 13 in Notes to Consolidated Financial Statements for more information regarding the winding down of the Bradford facility.

During the second half of 2006, we began a process of evaluating business activities outside our focus areas of pulmonary technology and PEGylation technology. In late December 2006, we entered into a non-binding letter of intent to sell our nebulizer device business. We determined that the non-binding letter of intent to sell the nebulizer device business, coupled with our general efforts to focus on core technologies, were indicators that our intangible asset related to these products acquired from the 2005 Aerogen acquisition does not have future value. After reassessing the remaining useful life of this intangible asset and evaluating the historical net losses from the nebulizer device business, we determined the intangible asset was fully impaired and recorded a $5.5 million charge for the year ended December 31, 2006. This charge is reflected in the Impairment of long-lived assets line item in our Consolidated Statements of Operations.

Recent Accounting Pronouncements

SFAS No. 157

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements,* which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective beginning in October 2008. We are evaluating whether adoption of this statement will result in a change to its fair value measurements.

SAB No. 108

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.* SAB 108 requires analysis of misstatements using both an income statement (rollover approach) and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. SAB 108 is effective for the Company's fiscal year 2007 annual financial statements. We do not expect the adoption of the statement to have a material impact on its consolidated results of operations, financial position or cash flows.

FIN 48

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes.* This interpretation, among other things, creates a two-step approach for evaluating uncertain tax positions. Recognition occurs when an enterprise concludes that a tax position, based on its technical merits, is more likely than not to be sustained upon examination. Measurement determines the amount of benefit that more likely than not will be realized. De-recognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for de-recognition of tax positions, and it has expanded disclosure requirements. FIN 48 is effective for fiscal years beginning after December 15, 2006, in which the impact of adoption should be accounted for as a cumulative-effect adjustment to the beginning balance of retained earnings. We believe adoption of this pronouncement will not impact our financial position, results of operation or cash flows due to our history of net losses and fully reserved deferred tax assets, however we are still evaluating FIN 48 and have not yet determined the impact the adoption will have on the our tax disclosures in the Notes to the Consolidated Financial Statements.

Quantitative and Qualitative Disclosures About Market Risk

INTEREST RATE RISK

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we invest in highly liquid and high quality debt securities. Our investments in debt securities are subject to interest rate risk. To minimize the exposure due to an adverse shift in interest rates, we invest in short term securities and maintain a weighted average maturity of one year or less.

A hypothetical 50 basis point increase in interest rates would result in an approximate $0.7 million decrease, less than 0.5%, in the fair value of our available-for-sale securities at December 31, 2006. This potential change is based on sensitivity analyses performed on our investment securities at December 31, 2006. Actual results may differ materially. The same hypothetical 50 basis point increase in interest rates would have resulted in an approximate $1.1 million decrease, less than 1%, in the fair value of our available-for-sale securities at December 31, 2005.

FOREIGN CURRENCY RISK

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

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of
Nektar Therapeutics

We have audited the accompanying consolidated balance sheets of Nektar Therapeutics as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the index at 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Nektar Therapeutics at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As discussed in Notes 1 and 15 to the Notes to Consolidated Financial Statements, in fiscal 2006 Nektar Therapeutics changed its method of accounting for stock-based compensation in accordance with guidance provided in Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment.*

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Nektar Therapeutics' internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 28, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Palo Alto, California

February 28, 2007

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of
Nektar Therapeutics

We have audited management's assessment, included in the accompanying "Management's Report on Internal Control over Financial Reporting," that Nektar Therapeutics maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Nektar Therapeutics' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that Nektar Therapeutics maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Nektar Therapeutics maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Nektar Therapeutics as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006, of Nektar Therapeutics and our report dated February 28, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Palo Alto, California

February 28, 2007

Management's Report on Internal Control Over Financial Reporting

As Nektar's Chief Executive Officer and Chief Financial Officer, we are responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-l5(f) under the Securities Exchange Act of 1934). Our internal control system is designed to provide reasonable assurance to management, users of our financial statements and our board of directors regarding the reliability of financial reporting and preparation of published financial statements in accordance with accounting principles generally accepted in the United States ("GAAP").

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

Our management has assessed our internal control over financial reporting using the criteria issued in the report Internal Control—Integrated Framework by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our management has concluded that our internal control over financial reporting was effective as of December 31, 2006.

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

Nektar Therapeutics

Consolidated Balance Sheets

(In thousands, except per share information)

December 31,	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 63,760**	$ 261,273
Short-term investments	**394,880**	214,928
Accounts receivable, net of allowance of $357 and $70 at December 31, 2006 and 2005, respectively.	**47,148**	12,494
Inventory	**14,656**	18,627
Other current assets	**14,595**	12,521
Total current assets	**$ 535,039**	$ 519,843
Long-term investments	**8,337**	90,222
Property and equipment, net	**133,812**	142,127
Goodwill	**78,431**	78,431
Other intangible assets, net	**3,626**	13,452
Other assets	**8,932**	14,479
Total assets	**$ 768,177**	$ 858,554
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 8,160**	$ 16,131
Accrued compensation	**12,994**	10,385
Accrued expenses	**16,987**	12,439
Interest payable	**3,814**	3,791
Capital lease obligations, current portion	**711**	536
Deferred revenue, current portion	**16,409**	15,487
Convertible subordinated notes, current portion	**102,653**	–
Other current liabilities	**3,586**	10,826
Total current liabilities	**$ 165,314**	$ 69,595
Convertible subordinated notes	**315,000**	417,653
Capital lease obligations	**19,759**	20,470
Deferred revenue	**23,697**	8,374
Other long-term liabilities	**17,347**	15,651
Total liabilities	**$ 541,117**	$ 531,743
Commitments and contingencies		
Stockholders' equity:		
Preferred stock	**–**	–
Common stock, $0.0001 par value; 300,000 authorized; 91,280 shares and 87,707 shares issued and outstanding at December 31, 2006 and 2005, respectively	**9**	9
Capital in excess of par value	**1,283,982**	1,233,690
Deferred compensation	**–**	(2,949)
Accumulated other comprehensive income (loss)	**62**	(1,707)
Accumulated deficit	**(1,056,993)**	(902,232)
Total stockholders' equity	**227,060**	326,811
Total liabilities and stockholders' equity	**$ 768,177**	$ 858,554

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

Nektar Therapeutics

Consolidated Statements Of Operations

(in thousands, except per share information)

	Years ended December 31,		
	2006	2005	2004
Revenue:			
Product sales and royalties	**$ 153,556**	$ 29,366	$ 25,085
Contract research	**56,303**	81,602	89,185
Exubera commercialization readiness	**7,859**	15,311	–
Total revenue	**$ 217,718**	$ 126,279	$ 114,270
Operating costs and expenses:			
Cost of goods sold	**113,921**	23,728	19,798
Exubera commercialization readiness costs	**4,168**	12,268	–
Research and development	**149,381**	151,659	133,523
General and administrative	**78,319**	43,852	30,967
Litigation settlement	**17,710**	–	–
Amortization of intangible assets	**4,039**	4,206	3,924
Impairment of long lived assets	**9,410**	65,340	–
Purchased in-process research and development	–	7,859	–
Total operating costs and expenses	**$ 376,948**	$ 308,912	$ 188,212
Loss from operations	**(159,230)**	(182,633)	(73,942)
Interest income	**23,450**	13,022	6,602
Interest expense	**(20,256)**	(14,085)	(25,747)
Other income (expense), net	**2,103**	(1,249)	296
Loss on extinguishment of debt	–	(303)	(9,258)
Loss before (provision) benefit for income taxes	**$ (153,933)**	$ (185,248)	$ (102,049)
(Provision) benefit for income taxes	**(828)**	137	163
Net loss	**$ (154,761)**	$ (185,111)	$ (101,886)
Basic and diluted net loss per share	**$ (1.72)**	$ (2.15)	$ (1.30)
Shares used in computing basic and diluted net loss per share	**89,789**	85,915	78,461

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

Nektar Therapeutics Consolidated Statements Of Stockholders' Equity

(in thousands)

	Preferred Shares		Common Shares						
	Shares	Amount Paid In	Shares	Par Value	Capital In Excess of Par Value	Deferred Compensation	Accumulated Other Comprehensive Income/(Loss)	Accumulated Deficit	Total Stockholders' Equity
Balance at December 31, 2003	40	–	56,197	6	778,500	(38)	958	(615,235)	164,191
Common stock issued upon exercise of stock options	–	–	1,817	–	13,665	–	–	–	13,665
Common stock issued in secondary offering net of issuance costs of $3,088	–	–	9,500	1	196,411	–	–	–	196,412
Conversion of convertible subordinated debentures net of issuance costs of $2,315	–	–	15,974	1	191,281	–	–	–	191,282
Preferred stock purchased by Enzon, Inc.	(20)	–	880	–	–	–	–	–	–
Compensation in connection with stock options granted to consultants	–	–	–	–	678	–	–	–	678
Compensation in connection with severance	–	–	–	–	247	–	–	–	247
Amortization of deferred compensation	–	–	–	–	3,902	(2,726)	–	–	1,176
Shares issued for ESPP	–	–	126	–	1,285	–	–	–	1,285
Shares issued for retirement plans	–	–	66	–	1,158	–	–	–	1,158
Exercise of warrants	–	–	12	–	–	–	–	–	–
Tax benefit related to employee stock option exercises	–	–	–	–	448	–	–	–	448
Other comprehensive income (loss)	–	–	–	–	–	–	(1,314)	–	(1,314)
Net loss	–	–	–	–	–	–	–	(101,886)	(101,886)
Comprehensive loss									(103,200)
Balance at December 31, 2004	20	–	84,572	8	1,187,575	(2,764)	(356)	(717,121)	467,342
Common stock issued upon exercise of stock options	–	–	1,015	–	9,621	–	–	–	9,621
Common stock issued in secondary offering net of issuance costs of $427	–	–	1,891	1	31,563	–	–	–	31,564
Compensation in connection with stock options granted to consultants	–	–	–	–	208	–	–	–	208
Amortization of deferred compensation	–	–	34	–	2,039	(185)	–	–	1,854
Shares issued for ESPP	–	–	108	–	1,239	–	–	–	1,239
Shares issued for retirement plans	–	–	87	–	1,445	–	–	–	1,445
Other comprehensive income (loss)	–	–	–	–	–	–	(1,351)	–	(1,351)
Net loss	–	–	–	–	–	–	–	(185,111)	(185,111)
Comprehensive loss									(186,462)
Balance at December 31, 2005	20	–	87,707	$ 9	$ 1,233,690	$ (2,949)	$ (1,707)	$ (902,232)	$ 326,811

Nektar Therapeutics Consolidated Statements Of Stockholders' Equity (Continued)

(in thousands)

	Preferred Shares		Common Shares		Capital In Excess of Par Value	Deferred Compensation	Accumulated Other Comprehensive Income/(Loss)	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount Paid In	Shares	Par Value					
Common stock issued upon exercise of stock options	–	–	2,326	–	20,642	–	–	–	20,642
Stock-based compensation	–	–	–	–	29,143	–	–	–	29,143
Compensation in connection with stock options granted to consultants	–	–	–	–	31	–	–	–	31
Conversion of preferred Stock	(20)	–	1,023	–	–	–	–	–	–
Exercise of warrants	–	–	12	–	–	–	–	–	–
Transition adjustment upon adoption of SFAS No 123R	–	–	–		(2,949)	2,949	–	–	–
Shares issued for ESPP	–	–	109	–	1,617	–	–	–	1,617
Shares issued for retirement plans	–	–	103	–	1,808	–	–	–	1,808
Other comprehensive income (loss)	–	–	–	–	–	–	1,769	–	1,769
Net loss	–	–	–	–	–	–	–	(154,761)	(154,761)
Comprehensive loss									(152,992)
Balance at December 31, 2006	**–**	**–**	**91,280**	**$ 9**	**$ 1,283,982**	**$ –**	**$ 62**	**$ (1,056,993)**	**$ 227,060**

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

Nektar Therapeutics

Consolidated Statements Of Cash Flows

(in thousands)

	Years ended December 31,		
	2006	2005	2004
Cash flows used in operating activities:			
Net loss	**$ (154,761)**	$ (185,111)	$ (101,886)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	**33,509**	25,311	18,011
Stock-based compensation	**30,982**	3,507	3,259
Impairment of long-lived assets	**9,410**	65,340	–
Amortization of gain related to sale of building	**(874)**	(934)	–
Gain on disposal of investment	**(2,252)**	–	–
Loss on termination of capital lease	**–**	1,136	–
Loss (gain) on sale or disposal of assets	**123**	–	(462)
Loss on extinguishment of debt	**–**	303	9,258
In process research and development	**–**	7,859	–
Tax benefit related to employee stock option exercises	**–**	–	448
Changes in assets and liabilities:			
Decrease (increase) in trade accounts receivable	**(34,654)**	2,468	(7,404)
Decrease (increase) in inventories	**3,971**	(7,420)	(2,132)
Decrease (increase) in other assets	**1,095**	(3,542)	(3,686)
Increase (decrease) in accounts payable	**(7,971)**	9,009	(1,384)
Increase (decrease) in accrued compensation	**3,581**	1,756	(446)
Increase (decrease) in accrued expenses	**4,548**	4,823	(1,373)
Increase (decrease) in interest payable	**23**	1,781	(426)
Increase (decrease) in deferred revenue	**16,245**	(7,174)	11,341
Increase (decrease) in other liabilities	**4,310**	2,890	(1,260)
Net cash used in operating activities	**$ (92,715)**	$ (77,998)	$ (78,142)
Cash flows from investing activities:			
Purchases of investments	**(502,230)**	(234,991)	(534,717)
Sales of investments	**2,252**	88,950	177,547
Maturities of investments	**405,622**	227,113	220,260
Business acquisition, net of cash acquired	**–**	(30,714)	–
Purchases of property and equipment	**(22,524)**	(17,955)	(27,194)
Proceeds from sale of partnership interest	**–**	–	22,450
Net cash provided by (used in) investing activities	**$ (116,880)**	$ 32,403	$ (141,654)
Cash flows from financing activities:			
Proceeds from debt and capital lease financing	**–**	261	4,399
Payments of loan and capital lease obligations	**(10,488)**	(2,517)	(7,971)
Proceeds from convertible subordinated notes	**–**	305,645	–
Repurchase of convertible subordinated notes	**–**	(70,964)	(376)
Issuance of common stock, net of issuance costs	**22,259**	42,424	211,362
Net cash provided by financing activities	**$ 11,771**	$ 274,849	$ 207,414
Effect of exchange rates on cash and cash equivalents	**311**	(45)	–
Net increase (decrease) in cash and cash equivalents	**$ (197,513)**	$ 229,209	$ (12,382)
Cash and cash equivalents at beginning of year	**261,273**	32,064	44,446
Cash and cash equivalents at end of year	**$ 63,760**	$ 261,273	$ 32,064
Supplemental disclosure of cash flows information (in thousands):			
Cash paid for interest	**$ 14,371**	$ 12,468	$ 25,226
Cash paid for income taxes	**$ –**	$ 27	$ 238
Supplemental schedule of non-cash investing and financing activities (in thousands):			
Conversion of debt into common stock	**$ –**	$ –	$ 186,029
Deferred compensation related to the issuance of stock options	**$ –**	$ 2,039	$ 3,902

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

NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND BASIS OF PRESENTATION

We are a biopharmaceutical company headquartered in San Carlos, California and incorporated in Delaware. Our mission is to develop breakthrough products that make a difference in patients' lives. We create differentiated, innovative products by applying our platform technologies to established or novel medicines. Our two leading technology platforms are Pulmonary Technology and PEGylation Technology. Nine products using these technology platforms have received regulatory approval in the U.S. or the European Union (EU). Our two technology platforms are the basis of substantially all of the partnered and proprietary programs. In June 2006, we terminated the research and development activity related to the Nektar Super Critical Fluids Technology, which was conducted at our Bradford, UK facility.

PRINCIPLES OF CONSOLIDATION AND USE OF ESTIMATES

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

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

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. Actual results could differ from those estimates.

RECLASSIFICATIONS

Certain items previously reported in specific financial statement captions have been reclassified to conform to the current period presentation. Such reclassifications have not impacted previously reported revenues, operating loss or net loss.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, accrued compensation and other accrued liabilities, approximate fair value because of their short-term maturities.

SIGNIFICANT CONCENTRATIONS

Our customers are primarily pharmaceutical and biotechnology companies that are located in the U.S. and EU. Our accounts receivable balance contains billed and unbilled trade receivables from product sales and royalties, collaborative research agreements, and commercialization readiness revenue. We provide for an allowance for doubtful accounts by reserving for specifically identified doubtful accounts. We have not experienced significant credit losses from our accounts receivable or collaborative research agreements and none are expected. We perform a regular review of our customers' payment histories and associated credit risk. We generally do not require collateral from our customers. At December 31, 2006, three different customers represented 56%, 15% and 14%, respectively, of our accounts receivable. At December 31, 2005, two customers represented 48% and 10%, respectively, of our accounts receivable.

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

CASH, CASH EQUIVALENTS AND INVESTMENTS

We consider all investments in marketable securities with an original maturity of three months or less to be cash equivalents. Investments are designated as available-for-sale and are carried at fair value, with unrealized gains and losses reported in stockholders' equity as accumulated other comprehensive income (loss). The disclosed fair value related to our investments is based primarily on the reported fair values in our period-end brokerage statements. We independently validate these fair values using available market quotes and other information. Investments with maturities greater than one year from the balance sheet date are classified as long-term.

Interest and dividends on securities classified as available-for-sale, as well as amortization of premiums and accretion of discounts to maturity, are included in interest income. Realized gains and losses and declines in value of available-for-sale securities judged to be other-than-temporary, if any, are included in other income (expense). The cost of securities sold is based on the specific identification method.

INVENTORIES

Inventories are computed on a first-in, first-out basis and stated net of reserves at the lower of cost or market.

PROPERTY AND EQUIPMENT

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

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we periodically review our property and equipment for recoverability whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Generally, an impairment loss would be recognized if the carrying amount of an asset exceeds the sum of the discounted cash flows expected to result from the use and eventual disposal of the asset.

GOODWILL

Goodwill represents the excess of the price paid for another entity over the fair value of the assets acquired and liabilities assumed in a business combination. We account for our goodwill asset in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, and test for impairment as of October 1 each year, as well as at other times when impairment indicators exists or when events occur or circumstances change that would indicate the carrying amount may not be fully recoverable. For purposes of our annual impairment test, we have identified and assigned goodwill to two reporting units (as defined in SFAS No. 142) Pulmonary Technology and Advanced PEGylation Technology. Goodwill is tested for impairment at the reporting unit level using a two-step approach. The first step is to compare the fair value of a reporting unit's net assets, including assigned goodwill, to the book value of its net assets, including assigned goodwill. If the fair value of the reporting unit is greater than its net book value, the assigned goodwill is not considered impaired. If the fair value is less than the reporting unit's net book value, we perform a second step to measure the amount of the impairment, if any. The second step would be to compare the book value of the reporting unit's assigned goodwill to the implied fair value of the reporting unit's goodwill. At December 31, 2006, there were no indications of impairment.

OTHER INTANGIBLE ASSETS

Other intangible assets include proprietary technology, intellectual property, and supplier and customer relationships acquired from third parties or in business combinations. Other intangible assets with a finite useful life are amortized ratably over their estimated useful lives, which we currently estimate to be a period of five years. Once an intangible asset is fully amortized, we remove the gross costs and accumulated amortization from our Consolidated Balance Sheets.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we periodically review our intangible assets for recoverability whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Generally, an impairment loss would be recognized if the carrying amount of an intangible asset exceeds the sum of the discounted cash flows expected to result from the use and eventual disposal of the assets.

REVENUE RECOGNITION

We recognize revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements" ("SAB 104") and Emerging Issues Task Force, Issue No. 00-21 ("EITF 00-21"), "Revenue Arrangements with Multiple Deliverables."

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

Product Sales and Royalty Revenue

Product revenues from Exubera Inhalation Powder and Inhalers are primarily derived from the cost-plus manufacturing and supply agreement with Pfizer, are subject to quarterly manufacturing variance adjustments, and are recognized at the earlier of acceptance of products by Pfizer or 60 days from shipment. Product revenues and the related cost of goods sold for products that were shipped to Pfizer but have not been recognized within 60 days are recorded as deferred revenue, net of the deferred costs. To date, Pfizer has not returned any Exubera Inhalation Powder or Inhalers.

Product revenues from our PEGylation Technology platform are primarily derived from cost-plus manufacturing and supply agreements with customers in our industry, and are recognized in accordance with the terms of the related contract. We have not experienced any significant returns from our customers.

Generally, we are entitled to royalties from our customers based on their net sales. We recognize royalty revenue when the cash is received or when the royalty amount to be received is estimable and collection is reasonably assured. Royalties from the sale of Exubera Inhalation Powder and Exubera Inhalers were insignificant during the year ended December 31, 2006.

Contract Research Revenue

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

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

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

Exubera Commercialization Readiness Revenue

Exubera commercialization readiness revenue represents reimbursements from Pfizer, of certain agreed upon operating costs relating to our Exubera Inhalation Powder manufacturing facilities and our device contract manufacturing locations in preparation for commercial production, plus a markup on such costs. Exubera commercialization readiness costs are start up manufacturing costs we have incurred in our Exubera Inhalation Powder manufacturing facility and our Exubera Inhaler device contract manufacturing locations in preparation for commercial production. We do not anticipate incurring any additional costs related to commercialization readiness in connection with the ongoing commercial launch of Exubera, but will continue to recognize revenue and amortize the remaining commercialization readiness costs previously incurred in accordance with our reimbursement arrangement with Pfizer through October, 2007.

SHIPPING AND HANDLING COSTS

We record costs related to shipping and handling of product to customers in cost of goods sold.

STOCK-BASED COMPENSATION

Stock-based compensation arrangements covered by SFAS No. 123R currently include stock option grants and restricted stock unit ("RSU") awards under our option plans and purchases of common stock by our employees at a discount to the market price under our Employee Stock Purchase Plan ("ESPP"). Stock compensation expense is recorded ratably over the vesting period of stock option or performance period of the RSU. Stock-based compensation expense for purchases under the ESPP are recognized based on the estimated fair value of the common stock during each offering period and the percentage of the purchase discount.

Prior to January 1, 2006, we accounted for stock-based employee compensation plans using the intrinsic value method of accounting in accordance with APB Opinion No. 25 ("APB No. 25"), *Accounting for Stock Issued to Employees*, and related interpretations. Under the provisions of APB No. 25, no compensation expense was recognized with respect to employee purchases of our common stock under the ESPP or when stock options were granted with exercise prices equal to or greater than market value on the date of grant. However, for stock-based awards issued below the market price of our common stock on the grant date, we were required to record deferred compensation for this intrinsic value and expense this value ratably over the underlying vesting period.

Effective January 1, 2006, we adopted the fair value method of accounting for stock-based compensation arrangements in accordance with SFAS No. 123R: *Accounting for Share-Based Payment* ("SFAS No. 123R") using the modified prospective method of transition. Under the modified prospective method of transition, we are not required to restate our prior period financial statements to reflect expensing of stock-based compensation under SFAS No. 123R. Therefore, the results for the year ended December 31, 2006 are not directly comparable to the years ended December 31, 2005 and 2004.

We use the Black-Scholes option valuation model adjusted for the estimated historical forfeiture rate for the respective grant to determine the estimated fair value of our stock-based compensation arrangements on the date of grant ("grant date fair value") and expense this value ratably over the estimated life of the option or performance period of the RSU award. We have separated the employee population into two groups for valuation purposes, including forfeiture rates: (1) executive management and board members (executives) and (2) all other employees (staff). Expense amounts are allocated among cost of revenue, research and development expenses for drug discovery, and general and administrative expenses based on the function of the applicable employee. The Black-Scholes option pricing model requires the input of highly subjective assumptions. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models may not provide a reliable single measure of the fair value of our employee stock options or common stock purchased under the ESPP. In addition, management will continue to assess the assumptions and methodologies used to calculate estimated fair value of stock-based compensation. Circumstances may change and additional data may become available over time, which could result in changes to these assumptions and methodologies, and which could materially impact our fair value determination.

In November of 2005, the FASB issued FASB Staff Position FAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share Base Payment Awards," which allowed a one-time election to adopt one of two acceptable methodologies for calculating the initial additional paid-in capital pool ("APIC pool"). We elected the "short-cut" method to establish our APIC pool required under FAS 123(R) for the year ended December 31, 2006. In subsequent periods, the APIC pool will be increased by tax benefits from stock-based compensation and decreased by tax deficiencies caused when the recorded stock-based compensation for book purposes exceeds the allowable tax deduction.

RESEARCH AND DEVELOPMENT EXPENSE

Research and development costs are expensed as incurred and include salaries, benefits and other operating costs such as outside services, supplies and allocated overhead costs. We perform research and development for our proprietary products and technology development and for others pursuant to collaboration agreements. For our proprietary products and our internal technology development programs, we invest our own funds without reimbursement from a third party. Costs associated with treatment phase of clinical trials are accrued based on the total estimated cost of the clinical trials and are expensed ratably based on patient enrollment in the trials. Costs associated with the start-up and reporting phases of the clinical trials are expensed as incurred.

Collaboration agreements typically include the development and licensing of our technology. Under these agreements, we may be reimbursed for development costs, entitled to milestone payments when and if certain development or regulatory milestones are achieved, compensated for the manufacture and supply of clinical and commercial product and entitled to royalties on sales of commercial product. All of our collaboration agreements are generally cancelable by the partner without significant financial penalty. Certain collaboration agreements may involve feasibility research which is designed to evaluate the applicability of our technologies to a particular molecule. Due to the nature of this research, we are reimbursed for the cost of work performed and our commitment is generally completed in less than one year.

From time to time we acquire in-process research and development programs as part of strategic business acquisitions. Generally, in-process research and development purchased in a business combination is expensed on the acquisition date primarily because the acquired technology has not yet reached technological feasibility and has no future alternative use. In the year ended December 31, 2005, we recorded a charge of $7.9 million for in-process research and development costs in connection with our acquisition of Aerogen.

NET LOSS PER SHARE

Basic net loss per share is calculated based on the weighted-average number of common shares outstanding during the periods presented. For all years presented in the Consolidated Statements of Operations, the net loss available to common shareholders 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. These potentially dilutive securities have been excluded from the diluted net loss per share calculation and are as follows (in thousands):

	December 31,		
	2006	2005	2004
Convertible subordinated notes	**16,896**	16,896	3,831
Stock options and restricted stock units	**7,049**	6,481	5,862
Warrants	**16**	36	36
Convertible preferred stock	**—**	1,023	875
Total	**23,961**	24,436	10,604

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. Because of our lack of earnings history, our net deferred tax assets have been fully reserved.

RECENT ACCOUNTING PRONOUNCEMENTS

SFAS No. 157

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective beginning in October 2008. The Company is evaluating whether adoption of this statement will result in a change to its fair value measurements.

SAB 108

In September 2006, the SEC issued SAB 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 requires analysis of misstatements using both an income statement (rollover approach) and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. SAB 108 is effective for the Company's fiscal year 2007 annual financial statements. We do not expect the application of the guidance to have a material impact on its consolidated results of operations, financial position or cash flows.

SFAS No. 123R

In the first quarter of fiscal 2006, the Company adopted SFAS No. 123R, *Share-Based Payment*, and recognized stock-based compensation expense in our financial statements. Adoption of this statement had a material effect on our consolidated results of operations. However, adoption did not have a material effect on our financial position or cash flows. See Note 15 for a discussion of the impact on operating results for the year ended December 31, 2006.

FIN 48

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes." This interpretation, among other things, creates a two-step approach for evaluating uncertain tax positions. Recognition occurs when an enterprise concludes that a tax position, based on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement determines the amount of benefit that more-likely-than-not will be realized upon ultimate settlement. De-recognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for de-recognition of tax positions, and it has expanded disclosure requirements. FIN 48 is effective for fiscal years beginning after December 15, 2006, in which the impact of adoption should be accounted for as a cumulative-effect adjustment to the beginning balance of retained earnings. We believe adoption of this pronouncement will not impact our financial position, results of operation or cash flows due to our history of net losses and fully reserved deferred tax assets, however we are still evaluating FIN 48 and has not yet determined the impact the adoption will have on the our tax disclosures in the Notes to the Consolidated Financial Statements.

NOTE 2—CASH AND CASH EQUIVALENTS, SHORT-TERM INVESTMENTS, AND INVESTMENTS IN MARKETABLE SECURITIES

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

	Estimated Fair Value at December 31,	
	2006	2005
Cash and cash equivalents	**$ 63,760**	$ 261,273
Short-term investments (less than one year to maturity)	**394,880**	214,928
Long-term investments (one to two years to maturity)	**8,337**	90,222
Total Cash and Available-for-Sale Securities	**$ 466,977**	$ 566,423

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

	Estimated Fair Value at December 31,	
	2006	2005
U.S. corporate commercial paper	**$ 234,512**	$ 179,597
Obligations of U.S. corporations	**151,288**	179,128
Obligations of U.S. government agencies	**27,372**	123,048
Repurchase agreements	**33,948**	64,199
Obligations of non U.S. corporations	**—**	2,975
Cash and other debt securities	**19,857**	17,476
Total Cash and Available-for-Sale Securities	**$ 466,977**	$ 566,423

At December 31, 2006 and 2005, the average portfolio duration was approximately four months, and the contractual maturity of any single investment did not exceed 24 months.

Gross unrealized gains on the portfolio were nil as of both December 31, 2006 and 2005. Gross unrealized losses on the portfolio were $ 0.5 million and $ 2.0 million as of December 31, 2006 and 2005, respectively. We have a history of holding our investments to maturity. Additionally, we have the ability and intent to hold our debt securities to maturity when they will be redeemed at full par value. Accordingly, management considers these unrealized losses to be temporary and has not recorded a provision for impairment.

At December 31, 2006 and 2005, we had letter of credit arrangements with certain financial institutions and vendors, including our landlord, totaling $2.6 million. These letters of credit are secured by investments in similar amounts.

NOTE 3—INVENTORY

Inventory consists of the following (in thousands):

	December 31,	
	2006	2005
Raw material	**$ 8, 609**	$ 8,050
Work-in-process	**4,736**	2,740
Finished goods	**1,311**	7,837
Total	**$ 14,656**	$ 18,627

Raw materials primarily include materials used in the production of our PEGylation products. Exubera Inhalers are manufactured and supplied by two of our contract manufacturers, then drop shipped to our customer. No inventory of Exubera Inhalers is held at Nektar. Reserves are determined using specific identification plus an estimated reserve against finished goods for potential defective or excess inventory based on historical experience or projected usage. Inventories are reflected net of reserves of $4.7 million and $3.1 million as of December 31, 2006 and 2005 respectively.

NOTE 4—PROPERTY AND EQUIPMENT

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

	December 31,	
	2006	2005
Building and leasehold improvements	**$ 118,574**	$ 114,902
Laboratory equipment	**43,066**	41,116
Manufacturing equipment	**23,406**	23,929
Assets at contract manufacturer locations .	**25,886**	23,750
Furniture, fixtures and other equipment	**20,970**	19,115
Construction-in-progress	**8,508**	6,059
Property and equipment at cost	**$ 240,410**	$ 228,871
Less: accumulated depreciation	**(106,598)**	(86,744)
Property and equipment, net	**$ 133,812**	$ 142,127

Building and leasehold improvements include our commercial manufacturing, clinical manufacturing, research and development and administrative facilities and the related improvements to these facilities. Laboratory and manufacturing equipment primarily includes assets that support both our manufacturing and research and development efforts. Assets at contract manufacturer locations are automated assembly line equipment used in the manufacture of the inhaler device for Exubera.

Construction-in-progress includes assets being built to enhance our commercial manufacturing operations and with automated assembly line equipment located at our contract manufacturers' sites. As a result of a contract renegotiation with one of our collaboration partners in the fourth quarter of 2006, we determined that one of our construction-in-progress assets would no longer be completed and we recorded an impairment loss for the costs incurred to date of $2.7 million. Additionally, as a result of our decision to wind down Bradford, UK operations, we determined that certain laboratory and office equipment had no remaining useful life. Consequently, we recorded impairment charges of $1.2 million and $5.7 million for the years ended December 31, 2006 and 2005, respectively.

These charges are reflected in the Impairment of Long-lived Assets line item in our Consolidated Statements of Operations. See Note 13 for more information regarding the wind down of the Bradford operations.

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 was $26.8 million, $19.2 million and $12.6 million, respectively.

NOTE 5—GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

As of December 31, 2006 and 2005, carrying value of our goodwill was $78.4 million, which for purposes of our periodic impairment evaluations, $69.0 million is assigned to our PEGylation Technology reporting unit and $9.4 million is assigned to our Pulmonary Technology reporting unit.

In the fourth quarter of 2006, we performed our annual impairment test for goodwill and determined there was no indication of impairment.

In December 2005, we were apprised of unfavorable results at our Bradford, UK facility and certain clinical data related to those activities. We re-performed our annual impairment test of the goodwill assigned to the super critical fluids reporting unit. We determined the fair value of the Super Critical Fluids reporting unit, based on a discounted cash flow analysis, was less than the carrying amount of the reporting units assets, including assigned goodwill. Consequently, we recorded an impairment charge of $59.6 million in the year ended December 31, 2005. This charge is reflected in the Impairment of Long-lived Assets line item in our Consolidated Statements of Operations. See Note 13 for more information regarding the winding down of the Bradford facility.

Other Intangible Assets

Other intangible assets are comprised of the following (in thousands except useful lives):

	December 31, 2006				December 31, 2005		
	Useful Life in Years	**Gross Carrying Amount**	**Accumulated Amortization**	Net	Gross Carrying Amount	Accumulated Amortization	Net
Core technology	**5**	**$ –**	**$ –**	$ –	$ 15,270	$ (7,529)	$ 7,741
Developed product technology	**5**	**–**	**–**	–	2,900	(2,610)	290
Intellectual property	**5–7**	**–**	**–**	–	7,301	(6,779)	522
Supplier and customer relations	**5**	**4,730**	**(1,104)**	3,626	9,870	(4,971)	4,899
Total		**$ 4,730**	**$ (1,104)**	$ 3,626	$ 35,341	$ (21,889)	$ 13,452

Amortization expense related to other intangible assets totaled $4.3 million, $4.9 million and $4.5 million for the years ended December 31, 2006, 2005, and 2004, respectively.

During the second half of 2006, we began a process of evaluating business activities outside our focus areas of Pulmonary Technology and PEGylation Technology. In late December 2006, we entered into a non-binding letter of intent to sell our nebulizer device business. We determined that the non-binding letter of intent to sell the nebulizer device business, coupled with our general efforts to focus on core technologies, were indicators that our intangible asset related to these products acquired from the 2005 Aerogen acquisition does not have future value. After reassessing the remaining useful life of this intangible asset and evaluating the historical net losses from the nebulizer device business, we determined the intangible asset was fully impaired and recorded a $5.5 million charge for the year ended December 31, 2006. This charge is reflected in the Impairment of Long-lived Assets line item in our Consolidated Statements of Operations.

Future amortization expense of our existing supplier and customer relations intangible asset is approximately $0.9 million per year until October 2010, when it will be fully amortized.

NOTE 6—CONVERTIBLE SUBORDINATED NOTES

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

	Semi-Annual Interest Payment Dates	December 31, 2006	December 31, 2005
5% Notes due February 2007	August 8, February 8	$ 36,026	$ 36,026
3.5% Notes due October 2007	April 17, October 17	66,627	66,627
3.25% Notes due September 2012	March 28, September 28	315,000	315,000
Total outstanding convertible subordinated notes		$ 417,653	$ 417,653
Less: current portion		(102,653)	–
Convertible subordinated notes		$ 315,000	$ 417,653

Our convertible subordinated notes are unsecured and subordinated in right of payment to our future senior debt. The carrying value approximates fair value for both periods presented. Costs related to the issuance of these convertible notes are recorded in Other Assets in our Consolidated Balance Sheets and are amortized to interest expense on a straight-line basis over the contractual life of the notes. The unamortized deferred financing costs were $7.3 million and $9.7 million for the years ended December 31, 2006 and 2005, respectively.

Conversion

The notes are convertible at the option of the holder at any time on or prior to maturity into shares of our common stock. The 3.25% Notes have a conversion rate of 46.4727 shares per $1,000 principal amount, which is equal to a conversion price of approximately $21.52. Additionally, at any time prior to maturity, if a fundamental change as defined in the 3.25% subordinated debt indenture occurs, we may be required to pay a make-whole premium on notes converted in connection therewith by increasing the conversion rate applicable to the notes. The amount of the make-whole premium will be determined in accordance with a table showing the make-whole premium that would apply at various common stock prices and fundamental change effective dates.

The 3.5% Notes have a conversion rate of 19.8177, which is equal to a conversion price of $ 50.46 per share.

The 5% Notes were repaid in full on February 7, 2007 and are, therefore, no longer subject to conversion or redemption.

Redemption

Beginning on September 28, 2008, we may redeem the 3.25% Notes in whole or in part for cash at a redemption price equal to 100% of the principal amount of the 3.25% Notes plus any accrued but unpaid interest if the closing price of the common stock has exceeded 150% of the conversion price of the 3.25% notes for at least 20 days in any consecutive 30 day trading period.

The 3.5% Notes are also redeemable in whole or in part at any time, at certain redemption prices dependent upon the date of redemption if the closing price of our Common Stock has exceeded 120% of the conversion price then in effect for at least 20 trading days within a period of 30 consecutive trading days.

Loss on Early Extinguishment of Convertible Subordinated Notes

In September 2005, we retired $25.4 million and $45.9 million aggregate principal amount of our outstanding 5% Notes and 3.5% Notes, respectively, in cash, in privately negotiated transactions. As a result of the transactions, we recognized losses related to the early extinguishment of approximately $0.3 million.

In January 2004, certain holders of our outstanding 3.5% Notes completed an exchange and cancellation of $9.0 million in aggregate principal amount of the notes for the issuance of 0.6 million shares of our common stock in a privately negotiated transaction. In February 2004, certain holders of our outstanding 3% Notes, in privately negotiated transactions, converted approximately $36.0 million in aggregate principal amount of such notes for approximately $3.2 million shares of our common stock and a cash payment of approximately $3.1 million. As a result of these transactions, we recognized losses on debt extinguishment of approximately $7.8 million and $1.5 million, respectively.

NOTE 7—CAPITAL LEASES

We lease one of the buildings in our San Carlos facility under a capital lease arrangement that resulted from a sale-leaseback transaction completed in 2004. In accordance with SFAS No. 13, *Accounting for Leases*, we evaluated the lease at inception and accounted for it as a capital lease by recording a capital lease asset and capital lease obligation equal to the fair market value of approximately $25.5 million. It has a current gross carrying value of $21.2 million. Accumulated amortization of the building under the lease was approximately $4.1 million and $2.3 million as of December 31, 2006 and 2005, respectively. The outstanding capital lease obligation was $20.3 million and $20.8 million as of December 31, 2006 and 2005, respectively, which represents the present value of future minimum payments on the lease. Under the terms of the lease, the rent will escalate 2% in October of each year until the lease expires in September 2016.

Additionally, we lease certain office equipment under another capital lease.

Future minimum payments for the two capital leases at December 31, 2006 are as follows (in thousands):

Years ending December 31,	
2007	$ 3,992
2008	4,071
2009	4,129
2010	4,146
2011	4,230
2012 and thereafter	21,266
Total minimum payments required	$ 41,834
Less: amount representing interest	21,364
Present value of future payments	$ 20,470
Less: current portion	711
Non-current portion	$ 19,759

The 2004 sale-leaseback transaction qualified for sales treatment under SFAS No. 98, ***Accounting for Leases*** and we recorded a deferred gain of $12.7 million which is reflected in Other Liabilities. This amount is being amortized over the term of the lease as a reduction of depreciation expense. During the years ended December 31, 2006, 2005 and 2004, we amortized a gain of $0.9 million, $0.9 million and $0.5 million, respectively.

NOTE 8—LITIGATION SETTLEMENT

On June 30, 2006, we, our subsidiary Nektar AL, and a former officer, Milton Harris, entered into a Settlement Agreement and General Release with the University of Alabama Huntsville (UAH) related to an intellectual property dispute. Under the terms of the Settlement Agreement, the Company, Nektar AL, Mr. Harris and UAH agreed to full and complete satisfaction of all claims asserted in the litigation in exchange for $25 million in cash payments. We and Mr. Harris made an initial payment of $15.0 million on June 30, 2006, of which we paid $11.0 million and Mr. Harris paid $4.0 million. Beginning July 1, 2007, we will pay UAH 10 annual installment payments of $1.0 million each, representing an accrued liability of $7.0 million at December 31, 2006, or the present value of the future payments using an 8% annual discount rate. We recorded a litigation settlement charge of $17.7 million during the year ended December 31, 2006 which reflects the net present value of the settlement payments.

NOTE 9—COMMITMENTS AND CONTINGENCIES

Operating Leases

We lease certain facilities under arrangements expiring through June 2012. Rent expense for operating leases was approximately $4.1 million, $3.1 million, and $3.0 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Future minimum lease payments under non-cancelable operating leases as of December 31, 2006, are as follows (in thousands):

Years ending December 31,	
2007	$ 3,770
2008	3,704
2009	2,928
2010	2,836
2011	2,905
2012 and thereafter	1,452
Total minimum payments required	$ 17,595

We have several leases for our facilities in multiple locations. In the event that we do not exercise our option to extend the term of the lease of our San Carlos manufacturing facility, we are required to restore the property to certain conditions in place at the time of lease. We believe these costs would not be material to our operations. As a result of terminating our research and development efforts in the UK, we recorded a $1.0 million expense in the year ended December 31, 2006, related to the lease restoration of our Bradford facilities.

Legal Matters

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

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

Workers' Compensation

Pursuant to the terms of our workers' compensation insurance policy, we were subject to self-fund all claims up to $250,000 per occurrence subject to a maximum of $950,000 for the term of the insurance policy, through October 31, 2006. As of November 1, 2006, we began a fully funded workers compensation insurance policy. Historically, we have not been obligated to make significant payments for these obligations, and no significant liabilities have been recorded for these obligations on our balance sheet as of December 31, 2006 or 2005.

Royalties

We have certain royalty commitments associated with the shipment and licensing of certain products. Royalty expense, which is reflected in Cost of Goods Sold in our Consolidated Statements of Operations, was approximately $5.5 million, $3.5 million, and $2.0 million for the years ended December 31, 2006, 2005, and 2004, respectively. The overall maximum amount of the obligations is based upon sales of the applicable product and cannot be reasonably estimated.

Security Agreement with Pfizer Inc.

In connection with the Collaboration, Development and License Agreement ("CDLA") dated January 18, 1995, that we entered into with Pfizer Inc. for the development of the Exubera product, we entered into a Security Agreement pursuant to which our obligations under the CDLA and certain Manufacturing and Supply Agreements related to the manufacture and supply of powdered insulin and pulmonary inhaler devices for the delivery of powdered insulin, are secured. Our default under any of these agreements triggers Pfizer rights with respect to property relating solely to, or used or which will be used solely in connection with, the development, manufacture, use and sale of Exubera including proceeds from the sale or other disposition of the property. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on our balance sheet as of December 31, 2006, 2005 or 2004.

Collaboration Agreements for Pulmonary Products

As part of our collaboration agreements with our partners for the development, manufacture and supply of products based on our Pulmonary Technology, we generally agree to defend, indemnify and hold harmless our partners from and against third party liabilities arising out of the agreement, including product liability and infringement of intellectual property. The term of these indemnification obligations is generally perpetual any time after execution of the agreement. There is no limitation on the potential amount of future payments we could be required to make under these indemnification obligations.

To date we have not incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the obligated amount under these agreements is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. No liabilities have been recorded for these obligations on our balance sheet as of December 31, 2006 or 2005.

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

As part of our license, manufacturing and supply agreements with our partners for the development or manufacture and supply of PEG reagents based on our PEGylation Technology, we generally agree to defend, indemnify and hold harmless our partners from and against third party liabilities arising out of the agreement, including product liability and infringement of intellectual property. The term of these indemnification obligations is generally perpetual any time after execution of the agreement. There is no limitation on the potential amount of future payments we could be required to make under these indemnification obligations. We have never incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations in our Consolidated Balance Sheets as of December 31, 2006, 2005 or 2004.

Indemnification of Our Contract Manufacturers

We have a Manufacturing and Supply Agreement with our contract manufacturers to provide for the manufacturing of Exubera Inhalers. We have agreed to defend, indemnify, and hold harmless the contract manufacturers from and against third party liability arising out of the agreement, including product liability and infringement of intellectual property. There is no limitation on the potential amount of future payments we could be required to make under these indemnification obligations. We have never incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated.

Indemnification of Underwriters and Initial Purchasers of Our Securities

In connection with our sale of equity and convertible debt securities from, we have agreed to defend, indemnify and hold harmless our underwriters or initial purchasers, as applicable, as well as certain related parties from and against certain liabilities, including liabilities under the Securities Act of 1933, as amended. The term of these indemnification obligations is generally perpetual. There is no limitation on the potential amount of future payments we could be required to make under these indemnification obligations. We have never incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations are triggered, however, we may incur substantial liabilities. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations in our Consolidated Balance Sheets as of December 31, 2006, 2005 or 2004.

Director and Officer Indemnifications

As permitted under Delaware law, and as set forth in our Certificate of Incorporation and our Bylaws, we indemnify our directors, executive officers, other officers, employees, and other agents for certain events or occurrences that arose while in such capacity. The maximum potential amount of future payments we could be required to make under this indemnification is unlimited; however, we have insurance policies that may limit our exposure and may enable us to recover a portion of any future amounts paid. Assuming the applicability of coverage, the willingness of the insurer to assume coverage, and subject to certain retention, loss limits and other policy provisions, we believe any obligations under this indemnification are not material, other than an initial $500,000 per incident retention deductible per our insurance policy. However, no assurances can be given that the covering insurers will not attempt to dispute the validity, applicability, or amount of coverage without expensive litigation against these insurers, in which case we may incur substantial liabilities as a result of these indemnification obligations. Because the obligated amount of this agreement is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations in our Consolidated Balance Sheets as of December 31, 2006, 2005 or 2004.

NOTE 10—STOCKHOLDERS' EQUITY

Preferred Stock

We have authorized 10,000,000 shares of Preferred Stock, each share having a par value of $0.0001. Three million one hundred thousand (3,100,000) shares of Preferred Stock are designated Series A Junior Participating Preferred Stock (the "Series A Preferred Stock"). We had designated 40,000 shares of Preferred Stock as Series B Convertible Preferred Stock, however, on January 7, 2006, the remaining outstanding shares automatically converted to common stock. We have no preferred shares issued and outstanding as of December 31, 2006.

Series A Preferred Stock

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

The Rights are not exercisable until the Distribution Date (as defined in the Certificate of Designation for the Series A Preferred Stock). The Rights will expire on June 1, 2011, unless the Rights are earlier redeemed or exchanged by us. Each share of Series A Preferred Stock will be entitled to a minimum preferential quarterly dividend payment of $1.00 but will be entitled to an aggregate dividend of 100 times the dividend declared per share of Common Stock. In the event of liquidation, the holders of the Series A Preferred Stock would be entitled to a minimum preferential liquidation payment of $100 per share, but would be entitled to receive an aggregate payment equal to 100 times the payment made per Common Share. Each share of Series A Preferred Stock will have 100 votes, voting together with the Common Stock. Finally, in the event of any merger, consolidation or other transaction in which our Common Stock is exchanged, each share of Series A Preferred Stock will be entitled to receive 100 times the amount of consideration received per share of Common Stock. Because of the nature of the Series A Preferred Stock dividend and liquidation rights, the value of one one-hundredth of a share of Series A Preferred Stock should approximate the value of one share of Common Stock. The Series A Preferred Stock would rank junior to any other future series of preferred stock. Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder, including, without limitation, the right to vote or to receive dividends.

Series B Convertible Preferred Stock

In connection with a strategic alliance with Enzon Pharmaceuticals, Inc., we entered into a Preferred Stock Purchase Agreement pursuant to which Enzon purchased 40,000 shares of non-voting Series B Preferred Stock at a purchase price of one thousand dollars ($1,000) per share for an aggregate purchase price of $40.0 million. The Series B Preferred Stock was convertible into a number of Common Shares equal to the quotient of $1,000 per share divided by the conversion price which was initially $22.79 per share. In 2004, Enzon converted 20,000 Series B Preferred Stock into 880,000 Common Shares and on January 7, 2006, the remaining 20,000 automatically converted into 1,023,000 Common Shares.

Issuance of Common Stock

On August 15, 2005, we entered into a Common Stock Purchase Agreement with Mainfield Enterprises Inc. pursuant to which we sold approximately 1.9 million shares of our common stock at an average price of $16.93 per common share for proceeds of approximately $31.6 million, net of issuance costs.

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

During the first half of 2004, certain outstanding convertible subordinated notes with an aggregate principal amount of approximately $186.0 million were converted into 16.0 million shares of common stock. These conversions resulted in a $191.3 million increase to additional paid in capital.

Employee Stock Purchase Plan

In February 1994, our Board of Directors adopted the ESPP, pursuant to section 423(b) of the Internal Revenue Code of 1986. Under the ESPP, 800,000 shares of common stock have been authorized for issuance. The terms of the ESPP provide eligible employees with the opportunity to acquire an ownership interest in Nektar through participation in a program of periodic payroll deductions for the purchase of our common stock. Employees must make an election to enroll or re-enroll in the plan on a semi-annual basis. Stock is purchased at 85% of the lower of the closing price on the first day of the enrollment period or the last day of the enrollment period.

Stock Option Plans

The following table summarizes information with respect to shares of our common stock that may be issued under our existing equity compensation plans as of December 31, 2006 (share number in thousands):

Plan Category	Number of securities to be issued upon exercise of outstanding options (a)[1]	Weighted-average exercise price of outstanding options (b)	Number of securities remaining available for issuance under equity compensation plans [excluding securities reflected In column (a)] (c)
Equity compensation plans approved by security holders [2]	3,821	$ 19.53	7,919
Equity compensation plans not approved by security holders	7,765	$ 18.69	1,337
Total	11,586	$ 18.97	9,256

1 Does not include options to purchase 3,200 shares assumed in connection with the acquisition of Bradford Particle Design Ltd (with a weighted-average exercise price of $7.00 per share) and options to purchase 73,000 shares we assumed in connection with the acquisition of Shearwater Corporation (with a weighted-average exercise price of $0.03 per share).

2 Includes 316,639 shares of common stock available for future issuance under our ESPP as of December 31, 2006.

2000 Equity Incentive Plan

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

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

The Board may amend the 2000 Equity Incentive Plan at any time, although certain amendments would require stockholder approval. The 2000 Equity Incentive Plan will terminate on February 9, 2010, unless earlier terminated by the Board. On June 1, 2006, our stockholders approved an amendment to the 2000 Equity Incentive Plan to (i) provide that we will not effect a "repricing" of a stock award under the 2000 Equity Incentive Plan without prior stockholder approval (subject to certain exceptions) and (ii) increase the number of shares of Common Stock authorized for issuance under the Purchase Plan to a total of 18,250,000 shares.

2000 Non-Officer Equity Incentive Plan

Our 1998 Non-Officer Equity Incentive Plan was adopted by the Board of Directors on August 18, 1998, and was amended and restated in its entirety and renamed the "2000 Non-officer Equity Incentive Plan" on June 6, 2000 (the "2000 Plan"). The purpose of the 2000 Plan is to attract and retain qualified personnel, to provide additional incentives to employees and consultants and to promote the success of our business. Pursuant to the 2000 plan, we may grant or issue non-qualified stock options, rights to acquire restricted stock and stock bonuses to employees and consultants who are neither Officers nor Directors of Nektar. The maximum term of a stock option under the 2000 Plan is 10 years. The exercise price of stock options and the purchase price of restricted stock granted under the 2000 Plan are determined by the Board of Directors.

Non-Employee Directors' Stock Option Plan

On February 10, 1994, our Board of Directors adopted the Non-Employee Directors' Stock Option Plan under which options to purchase up to 400,000 shares of our Common Stock at the then fair market value may be granted to our non-employee directors. There are no remaining options available for grant under this plan as of December 31, 2006.

Restricted Stock Units

During the years ended December 31, 2006, 2005 and 2004, we issued RSUs to certain officers, non-employees, directors, employees and consultants. RSUs are similar to restricted stock in that they are issued for no consideration; however, the holder generally is not entitled to the underlying shares of common stock until the RSU vests. Also, because the RSUs are issued for $0.01, the grant-date fair value of the award is equal to its intrinsic value on the date of grant. The RSUs were issued under both the 2000 Equity Incentive Plan and the 2000 Non-Officer Equity Incentive Plan and are settled by delivery of shares of our common stock on or shortly after the date the awards vest. A significant portion of the 2006 RSUs vest upon the achievement of certain performance-based milestones, however, the RSUs issued in 2005 and 2004 are service based awards and vest based on the passage of time. At December 31, 2006, certain of these awards are expected to vest upon achievement of three performance-based milestones which are expected to occur over a 5 to 33 month period. Beginning with shares granted in the year ended December 31, 2005, each RSU depletes the pool of options available for grant by a ratio of 1:1.5.

Time Accelerated Restricted Stock Award Plan ("TARSAP")

During the year ended December 31, 2004, we issued options for 111,000 shares of stock under our 2000 Non-Officer Equity Incentive Plan to certain employees subject to vesting upon FDA approval of Exubera. The options had an exercise price equal to fair market value on the date of grant. These options vested upon the approval of Exubera by the FDA in January 2006.

Warrants

In November 1996, we issued warrants to purchase a total of 40,000 shares of common stock in connection with a tenant improvement loan for one of our facilities. The warrants had an exercise price of $6.56 per share and expired after 10 years. The warrants allowed for net share settlement at the option of the warrant holder and were accounted for as equity in accordance with EITF Issue No. 96-18 ("EITF 96-18") *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. The warrants were valued using a Black-Scholes option valuation model with the following weighted-average assumptions: risk free interest rate of 6.4%; dividend yield of 0.0%; volatility factor of 62%; and a weighted average expected life of ten years. In November 2004, one of the warrants representing 20,000 shares of common stock was exercised in the form of a net share settlement for 11,775 shares of common stock. In August 2006, the remaining warrant representing 20,000 shares of common stock was exercised in the form of a net share settlement for 12,087 shares of common stock. Expense related to these warrants was insignificant for the years ended December 31, 2006, 2005 and 2004.

In September 2000, we issued warrants to purchase 10,000 shares of common stock to the landlord of one of our facilities in connection with the signing of a capital lease on that facility. In November 2000, we issued warrants to certain consultants to purchase an additional 6,000 shares of common stock. These warrants were accounted for as equity in accordance with EITF 96–18 and were valued using a Black-Scholes option valuation model with the following weighted-average assumptions: a risk free interest rate of 6.4%; a dividend yield of 0.0%; a volatility factor of 68.8%; and a weighted average expected life of 10 years. Both warrants had an exercise price of $45.88 per share with a six year life, and both expired unexercised in September and November 2006, respectively. No warrants to purchase common shares were outstanding at December 31, 2006. Expense related to these warrants was insignificant for the years ended December 31, 2006, 2005 and 2004.

401(k) Retirement Plan

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

We issued approximately 103,000 shares, 87,000 shares, and 66,000 shares of our common stock valued at approximately $1.8 million, $1.4 million, and $1.2 million in connection with the match in 2006, 2005 and 2004, respectively. During part of 2004, shares reserved for issuance related to matching contributions that had been previously been approved by our Board of Directors became fully depleted. During this time, we purchased approximately 14,000 shares on the open market on behalf of employees for a total cost of $0.2 million and recorded this amount as compensation expense during the period. During the year ended December 31, 2004, our Board of Directors approved an additional 300,000 shares to be reserved for issuance related to matching contributions.

Change in Control Severance Plan

On December 6, 2006, the Board of Directors approved a Change of Control Severance Benefit Plan (the "CIC Plan") and on February 14, 2007 the Board of Directors amended and restated the CIC Plan. The CIC Plan is designed to make certain benefits available to eligible employees of the Company in the event of a change of control of the Company and, following such change of control, an employee's employment with the Company or successor company is terminated in certain specified circumstances. The Company adopted the CIC Plan to support the continuity of the business in the context of a change of control transaction. The CIC Plan was not adopted in contemplation of any specific change of control transaction. A brief description of the material terms and conditions of the CIC Plan is provided below.

Under the CIC Plan, in the event of a change of control of the Company and a subsequent termination of employment initiated by the Company or a successor company other than for Cause or initiated by the employee for a Good Reason Resignation (as hereinafter defined) in each case within 12 months following a change of control transaction, (i) the Chief Executive Officer would each be entitled to receive cash severance pay equal to 24 months base salary plus annual target incentive pay, the extension of employee benefits over this severance period and

the full acceleration of unvested outstanding equity awards, and (ii) the Chief Scientific Officer, Senior Vice Presidents and Vice Presidents (including Principal Fellows) would each be entitled to receive cash severance pay equal to 12 months base salary plus annual target incentive pay, the extension of employee benefits over this severance period and the full acceleration of unvested outstanding equity awards. In the event of a change of control of the Company and a subsequent termination of employment initiated by the Company or a successor company other than for Cause (as hereinafter defined) within 12 months following a change of control transaction, all other employees would each be entitled to receive cash severance pay equal to 6 months base salary plus annual target incentive pay, the extension of employee benefits over this severance period and the full acceleration of each such employee's unvested outstanding equity awards.

On December 6, 2006, the Board of Directors approved an amendment to all outstanding stock awards held by non-employee directors to provide for full acceleration of vesting in the event of a change of control transaction.

Reserved Shares

At December 31, 2006, we have reserved shares of common stock for issuance as follows (in thousands):

Convertible subordinated notes	16,896
Stock options and restricted stock units	16,337
ESPP	317
401(k) retirement plans	81
Total	33,631

NOTE 11—COMPREHENSIVE LOSS

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

	Years ended December 31,		
	2006	2005	2004
Net loss, as reported	**$ (154,761)**	$ (185,111)	$ (101,886)
Change in net unrealized gains (losses) on available-for-sale securities	**1,458**	(101)	(2,129)
Net unrealized gains reclassified into earnings	**–**	–	23
Translation adjustment	**311**	(1,250)	792
Total comprehensive loss	**$ (152,992)**	$ (186,462)	$ (103,200)

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

	December 31,	
	2006	2005
Unrealized loss on available-for-sale securities	**$ (499)**	$ (1,957)
Translation adjustment	**561**	250
Total accumulated other comprehensive income (loss)	**$ 62**	$ (1,707)

NOTE 12—SIGNIFICANT COLLABORATIVE RESEARCH AND DEVELOPMENT AGREEMENTS

We perform research and development for our biotechnology and pharmaceutical partners pursuant to collaboration agreements.

Revenues generated from our collaboration efforts are recorded as Contract Research revenue and our costs of performing these services are included in Research and Development expense. In accordance with these agreements, we recorded Contract research revenue as follows (in thousands):

Partner	Molecule	**2006**	2005	2004
Pfizer Inc.	Exubera® (insulin human [rDNA origin]) Inhalation Powder, Somavert® (pegvisomant)	**$ 29,315**	$ 64,091	$ 69,397
Novartis Pharma AG	Tobramycin inhalation powder (TIP)	**8,516**	4,831	7,307
Zelos Therapeutics, Inc.	Pulmonary Ostabolin-C	**5,479**	3,487	–
Bayer Healthcare AG	Ciprofloxacin Inhalation Powder (CIP)	**4,885**	4,074	–
Baxter Healthcare SA	Poly(ethylene) glycol reagent	**3,690**	310	–
Solvay Pharmaceuticals, Inc.	Pulmonary dronabinol (Dronabinol metered dose inhaler)	**1,002**	2,756	5,493
Other		**3,416**	2,053	6,988
Contract research revenue		**$ 56,303**	$ 81,602	$ 89,185

Under these collaborative research and development agreements, we are reimbursed for the cost of work performed on a revenue per annual full-time employee equivalent (FTE) basis, plus out of pocket third party costs. The initial annual FTE rate is established when the contract is executed and generally increases each year based on the consumer price index. Revenue recognized approximates the costs associated with these billable services.

We also are typically entitled to receive milestone payments when and if certain development or regulatory milestones are achieved. All of our research and development agreements are generally cancelable by our partners without significant financial penalty to the partner.

Pfizer Inc.

We are party to a collaboration agreement with Pfizer to develop Exubera based on our Pulmonary Technology. Under the terms of the agreement, we receive contract research and development revenue as well as milestone revenues relating to the Exubera Inhalation Powder and Exubera Inhalers.

We are party to a license, manufacturing, and supply agreement with Pfizer whereby we provide one of our PEG reagents used in the manufacture of Somavert (pegvisomant), a human growth hormone receptor antagonist that has been approved for use in the U.S. and EU for the treatment of certain patients with *acromegaly*.

Novartis Pharma AG

We are party to a collaboration agreement with Novartis Pharma AG (formerly Chiron Corporation) to develop a dry powder inhaled formulation of tobramycin for the treatment of *Pseudomonas aeruginosa* in cystic fibrosis patients and to explore the development of other inhaled antibiotics using our Pulmonary Technology. We may receive research and development funding, milestone payments as the program progresses through further clinical testing, and may receive royalty payments on product sales and manufacturing revenues if the product is commercialized.

Zelos Therapeutics, Inc.

We are party to a collaboration to develop an inhaleable powder form of Zelos Therapeutics' parathyroid hormone (PTH) analogue, called Ostabolin-C™. Under the terms of the agreement, Nektar is responsible for development of the formulated dry powder drug and inhalation system, as well as clinical and commercial manufacturing of the drug formulation and device combination. Zelos is responsible for supply of the active pharmaceutical ingredient or API, clinical development and commercialization. We receive research and development funding, milestone payments as the program progresses through further clinical testing, and may receive royalty payments on product sales and manufacturing revenues if the product is commercialized.

Bayer HealthCare AG

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

Baxter Healthcare SA and Baxter Healthcare Corp.

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

Solvay Pharmaceuticals, Inc.

We are party to a collaboration agreement with Unimed Pharmaceuticals, Inc., a wholly owned subsidiary of Solvay Pharmaceuticals, Inc., to develop a formulation of dronabinol (synthetic delta-9-tetrahydrocannabinol) to be delivered using a metered dose inhaler. The product is under development for multiple indications. Dronabinol is the active ingredient in Unimed's MARINOL® capsules, which are approved in the U.S. for multiple indications. Solvay initiated Phase II trials for pulmonary dronabinol in 2005 for the treatment of migraines with and without aura. We may receive research and development funding, milestone payments as the program progresses through further clinical testing, and may receive royalty payments on product sales and manufacturing revenues if the product is commercialized.

NOTE 13—BRADFORD, UK OPERATIONS

In December 2005, we determined that the assets of our UK subsidiary, located in Bradford, England ("Bradford"), were significantly impaired, and recorded an impairment charge of $59.6 million related to our goodwill asset and $5.7 million of accelerated depreciation related to certain fixed assets. These amounts are reflected in the Impairment of long-lived assets line item in the Consolidated Statement of Operations. Bradford's primary activities related to the Super Critical Fluid Technology reporting unit as defined under SFAS No. 142: *Goodwill and Other Intangible Assets.* These impairment charges represented a substantial portion of the fair value of Bradford's net assets as of December 31, 2005.

In March 2006, the Bradford employees were notified of a potential shut-down of operations. Retention and severance incentives were communicated at that time. In June 2006, we involuntarily terminated the majority of the personnel located in Bradford and commenced with plans to wind-down the location and its related operations. The retention and severance incentives totaling approximately $2.9 million were paid and expensed to research and development during the first and second quarters of 2006. Also in June 2006, we reassessed the useful life of the remaining laboratory and office equipment and determined these assets could not be redeployed and had no future use. Due to our revised estimate of useful life of these assets, we accelerated approximately $1.2 million of remaining depreciation in June 2006, which is reflected in the Impairment of long-lived assets line item in the Consolidated Statement of Operations. In the third quarter of 2006, we met the cease-of-use criteria outlined in SFAS No. 146: *Accounting for Cost Associated with Disposal* or Exit Activities and terminated the majority our facility leases in Bradford. As a result, we recorded approximately $1.0 million to general and administrative expense, related primarily to restoration costs necessary to return the buildings to their original condition.

NOTE 14—INCOME TAXES

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

	2006	2005	2004
Domestic	**$ (147,059)**	$ (172,232)	$ (95,999)
Foreign	**(6,874)**	(13,016)	(6,050)
Total	**$ (153,933)**	$ (185,248)	$ (102,049)

As of December 31, 2006, we had a net operating loss carryforward for federal income tax purposes of approximately $640.0 million, which will expire beginning in the year 2007. We had a total state net operating loss carryforward of approximately $323.0 million, which expires beginning in 2010. We had a foreign net operating loss carryforward of approximately $52.0 million. A substantial portion of the foreign net operating losses are UK losses which can be carried forward indefinitely.

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

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

	2006	2005	2004
Current:			
Federal	**$ —**	$ —	$ —
State	**(6)**	137	(665)
Foreign	**—**	—	—
Total Current	**(6)**	137	(665)
Deferred:			
Federal	—	—	—
State	**(822)**	—	828
Foreign	—	—	—
Total Deferred	**(822)**	—	828
(Provision) benefit for income taxes	**$ (828)**	$ 137	$ 163

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

	2006	2005	2004
U.S. federal (provision) benefit			
At statutory rate	**$ 52,337**	$ 62,984	$ 34,697
State taxes	**(6)**	137	163
Net operating losses not benefited	**(50,385)**	(58,645)	(33,000)
Non-deductible employee compensation	**(2,138)**	—	—
Investment impairment and non-deductible amortization	**(636)**	(1,667)	(1,532)
Non-deductible in process research charge	—	(2,672)	—
Other	—	—	(165)
Total	**$ (828)**	$ 137	$ 163

Deferred income taxes reflect the net tax effects of loss and credit carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes

and the amounts used for income tax purposes. Significant components of our deferred tax assets for federal and state income taxes are as follows (in thousands):

	December 31,	
	2006	2005
Deferred tax assets:		
Net operating loss carryforwards	**$ 246, 812**	$ 196,716
Research and other credits	**24,046**	20,301
Capitalized research expenses	**5,991**	7,529
Deferred revenue	**7,762**	7,177
Reserve and accruals	**25,543**	22,332
Stock-based compensation	**11,901**	793
Other	**4,563**	5,186
Deferred tax assets before valuation allowance	**326,618**	260,034
Valuation allowance for deferred tax assets	**(322,508)**	(250,630)
Total deferred tax assets	**$ 4,110**	$ 9,404
Deferred tax liabilities:		
Depreciation	**(2,715)**	(4,127)
Acquisition related intangibles	**(1,395)**	(4,455)
Total deferred tax liabilities	**$ (4,110)**	$ (8,582)
Net deferred tax assets	**$ –**	$ 822

Realization of our deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Because of our lack of earnings history, the net deferred tax assets have been fully offset by a valuation allowance. The valuation allowance increased by $71.9 million, and $31.2 million during the years ended December 31, 2006, and 2005, respectively. The valuation allowance includes approximately $35.1 million of benefit related to employee stock option exercises which will be credited to additional paid in capital when realized. Also, at December 31, 2006, approximately $14.0 million of the valuation allowance relates to acquisition related items, if and to the extent realized in future periods, will first reduce the carrying value of goodwill, then other long-lived intangible assets of our acquired subsidiary and then income tax expense. We also have federal research credits of approximately $14.5 million, which expire beginning in the year 2007 and state tax research credits of approximately $13.5 million which have no expiration date.

NOTE 15—STOCK-BASED COMPENSATION

We issue stock-based awards from two compensation plans, which are more fully described in Note 10—Stockholders' Equity. For the period ended December 31, 2006 we recorded approximately $29.1 million of stock-based compensation expense, which includes approximately $11.8 million of expense related to modifications of certain stock grants in connection with employment separation agreements. Generally, the modifications extended the optionee's exercise period beyond the 90 day period after termination and accelerated a portion of the optionee's unvested grants. In addition, during the year ended December 31, 2005 and 2004, we recorded approximately $1.9 million and $1.2 million, respectively of stock compensation expense pursuant to APB No. 25 related to RSUs that were granted at prices below the fair market value at the date of grant.

Under the modified prospective transition method outlined in SFAS No. 123R, we are not required to restate prior period financial statements to reflect expensing of stock-based compensation as if we had adopted SFAS No. 123R in prior periods. Therefore, the results for the year ended December 31, 2006 are not directly comparable to the years ended December 31, 2005 and 2004. Additionally, these stock-based compensation charges have no impact on our financial position or reported cash flows.

Stock-based compensation cost is recorded in the following line items of our Consolidated Financial Statements among the following categories:

	Year ended December 31, 2006
Inventory	**$ 51**
Cost of goods sold	**1,563**
Research and development	**9,692**
General and administrative expenses	**17,837**
Total	**$ 29,143**

Black-Scholes Assumptions

Upon adoption of SFAS No. 123R, we applied the guidance in Staff Accounting Bulletin No. 107 that permits the initial application of a "simplified" method based on the average of the vesting term and the term of the option. Previously, we calculated the estimated life based on the expectation that options would be exercised within five years on average. We based our estimate of expected volatility for options granted in fiscal year 2006 on the daily historical trading data of our common stock over the period equivalent to the expected term of the respective stock-based grant. Generally the stock-based grants have expected terms ranging from 38 months to 64 months. For the period ended December 31, 2006, the annual forfeiture rate for executives and staff was estimated to be 4.7% and 7.4%, respectively, based on our qualitative and quantitative analysis of our historical forfeitures.

The following tables list the Black-Scholes assumptions used to calculate the fair value of employee stock options and ESPP purchases. The grant date fair value of RSU awards is always equal to the intrinsic value of the award on the date of grant since the awards were issued for no consideration. The weighted average life of the 2006 RSUs is estimated to be 2.4 years.

	Year ended December 31, 2006	
	Employee Stock Options	ESPP
Average risk-free interest rate	**4.8%**	**5.2%**
Dividend yield	**0.0%**	**0.0%**
Volatility factor	**63.1%**	**33.3%**
Weighted average expected life	**5.20 years**	**0.5 years**

Summary of Stock Option Activity

The table below presents a summary of stock option activity under the 2000 Equity Incentive Plan, the Non-Employee Directors' Stock Option Plan and the 2000 Non-Officer Equity Incentive Plan (in thousands, except for per share information):

	Options Outstanding		Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value[1]
	Number of Shares	Exercise price Per Share			
Balance at December 31, 2003	14,851	$ 0.01-61.63	$ 16.49	6.65	$ 44,103
Options granted	1,394	10.10-22.49	17.33		
Options exercised	(1,817)	0.01-19.25	7.52		$ 20,972
Options expired and canceled	(841)	0.01-56.38	20.86		
Balance at December 31, 2004	13,587	0.01-61.63	17.57	6.03	$ 79,055
Options granted	1,791	13.46-19.76	17.44		
Options exercised	(1,014)	0.01-18.47	9.47		$ 8,198
Options expired and canceled	(1,115)	3.88-56.38	21.34		
Balance at December 31, 2005	13,249	$ 0.01-61.63	$ 17.85	5.38	$ 37,678
Options granted	1,115	14.36-21.51	17.88		
Options exercised	(2,160)	0.05-20.41	9.51		$ 18,651
Options expired and canceled	(1,501)	4.62-52.16	21.86		
Balance at December 31, 2006	10,703	$ 0.01-61.63	18.97	4.78	$ 15,348
Exercisable at December 31, 2006	8,185		19.88	4.09	$ 12,229
Exercisable at December 31, 2005	9,468		19.08	4.69	$ 25,967
Exercisable at December 31, 2004	9,066		18.30	5.25	$ 49,856

1 Aggregate Intrinsic Value represents the difference between the exercise price of the option and the closing market price of our common stock on the exercise date or December 31, as applicable.

The weighted-average grant-date fair value of options granted during the years 2006, 2005 and 2004 was $10.54, $10.26 and $10.45, respectively.

The following table provides information regarding our outstanding stock options as of December 31, 2006 (in thousands except for share information and contractual life):

	Options Outstanding			Options Exerciseable	
Range of Exercise Prices	Number	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life (in years)	Number	Weighted-Average Exercise Price Per Share
$ 0.01-8.66	1,156	$ 6.25	5.59	871	$ 6.06
8.67-13.54	1,140	11.76	4.25	1,001	11.87
13.62-14.50	1,187	14.12	3.83	980	14.09
4.53-16.17	1,102	15.31	4.07	792	15.27
16.19-18.34	1,201	17.49	6.72	571	17.82
18.38-19.55	1,134	18.83	6.56	535	18.87
19.59-23.50	1,142	22.02	4.99	795	22.81
23.94-27.88	1,701	27.74	3.59	1,701	27.74
27.96-61.63	940	36.28	3.75	939	36.27
$ 0.01- 61.63	10,703	$ 18.97	4.78	8,185	$ 19.88

Aggregate Unrecognized Stock-based Compensation Expense

As of December 31, 2006, there was approximately $38.4 million of aggregate unrecognized compensation expense related to unvested stock-based compensation arrangements under the Option Plans. This total unrecognized expense is expected to be recognized over a weighted-average period of approximately 2.6 years as follows:

Fiscal Year	(in millions)
2007	$ 17,135
2008	$ 11,011
2009	$ 6,446
2010	$ 2,984
2011 and thereafter	$ 836
Total	$ 38,412

Summary of RSU Award Activity

During 2006, we issued RSU awards totaling 1,088,300 shares of our common stock to certain employees and directors. The RSU awards are settled by delivery of shares of our common stock on or shortly after the date the awards vest. A significant portion of these awards vest base upon achieving three pre-determined performance milestones which were initially expected to occur over a period of 40 months. We are expensing the grant date fair value of the awards ratably over the expected performance period. During the period ended September 30, 2006 management determined that one of the milestones, representing 40% of the total awards, was no longer probable (as defined in SFAS No. 5: *Accounting for Contingencies*) of vesting. As a result, we reversed all previously recorded compensation expense related to this performance milestone, or approximately $0.8 million. If we had determined that this milestone was probable, we would have expensed an additional $1.9 million during the year ended December 31, 2006. The remaining 60% of the performance based RSUs are expected to vest over a 27 month period from the award date. We recorded compensation expense of $5.0 million in the year ended December 31, 2006 related to the remaining 60% of these performance-based RSU awards.

In February 2004 and March 2005, we issued 206,666 and 112,000 RSU awards, respectively to certain officers and employees on a time-based vesting schedule. Expense for these awards is recognized ratably over the underlying time-based vesting period and will settle by delivery of shares of our common stock on or shortly after the date the awards vest. The RSU awards become fully vested over a period of 36 to 48 months. The intrinsic value of these awards was recorded as deferred compensation in the Statement of Stockholders' Equity and totaled approximately $2.0 million and $3.9 million for the years ended December 31, 2005 and 2004, respectively. Upon adoption of SFAS No. 123R, we reversed this unamortized value from stockholders' equity, but continue to expense the remaining intrinsic value, which approximated the awards' fair value on the original grant date, ratably over the underlying vesting period. In connection with these RSU awards, we recorded compensation expense of $1.3 million, $1.9 million and $1.2 million for the years ended December 31, 2006, 2005 and 2004, respectively.

A summary of RSU activity is as follows (in thousands):

	Units Issued	Weighted-Average Remaining Contractual Life In Years	Weighted-Average Grant-Date Fair Value	Aggregate Intrinsic Value
Balance at January 1, 2004	–			–
Granted	206		$ 18.57	
Balance at December 31, 2004	206	1.52		$ 4,214
Granted	112		$ 18.30	
Released	(34)			$ 518
Balance at December 31, 2005	284	1.14		$ 4,676
Granted	1,088		$ 19.55	
Released	(178)			$ 3,184
Forfeited & Canceled	(110)			
Balance at December 31, 2006	**1,084**	**1.52**		**$ 16,479**

1 Fair value represents the difference between the exercise price of the award and the closing market price of our common stock on the release date or the year ended December 31, as applicable.

Proforma Effects of Applying SFAS No. 123 to Prior Periods

Prior to adoption SFAS No. 123R on January 1, 2006, we accounted for stock-based compensation under APB No. 25 and elected the disclosure only method of presenting fair value stock-based compensation expense. The disclosure only method required the presentation of net income (loss) as if SFAS No. 123 had been adopted for all periods presented in the Statements of Operations.

For purposes of the proforma net loss disclosure related to our employee stock options and ESPP purchases, we computed the estimated grant date fair values of the stock-based compensation using the Black-Scholes option valuation model based on the following assumptions:

	December 31,	
	2005	2004
Risk-free interest rate	4.0%	3.3%
Dividend yield	0.0%	0.0%
Volatility factor	0.710	0.707
Weighted average expected life	4.5 years	5.0 years

In the table below, we have presented proforma disclosures of our net loss and net loss per share for the prior year periods assuming the estimated fair value of the options granted prior to January 1, 2006 is amortized to expense over the option-vesting period.

	Year ended December 31, 2005	Revised Year ended December 31 2004*
Net loss, as reported	$ (185,111)	$ (101,886)
Add: Stock-based employee compensation expense included in reported net loss	1,854	1,423
Less: Total stock-based employee compensation expense determined under fair value based method for all options and RSUs granted	(21,986)	(25,183)
Proforma net loss	$ (205,243)	$ (125,646)
Net loss per share:		
Basic and diluted—as reported	$ (2.15)	$ (1.30)
Basic and diluted—proforma	$ (2.39)	$ (1.60)

** The revised reported proforma net loss for the year ended December 31, 2004 was decreased by approximately $6.0 million for options exchanged under the stock option exchange programs and adjustments for computational corrections.*

NOTE 16—SEGMENT REPORTING

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

Our revenue is derived primarily from clients in the pharmaceutical and biotechnology industries. Revenue from Pfizer Inc. represented 64%, 64% and 61% of our revenue for the years ended December 31, 2006, 2005 and 2004, respectively.

Revenues from customers in the following geographic areas are as follows (in thousands):

	Years ended December 31,		
	2006	2005	2004
United States	**$ 182,959**	$ 109,488	$ 100,855
European countries	**33,471**	14,967	11,606
All other countries	**1,288**	1,824	1,809
Total Revenue	**$ 217,718**	$ 126,279	$ 114,270

At December 31, 2006, the net book value of our property, plant and equipment was $133.8 million. Approximately 88% of such assets are located in the United States. At December 31, 2005, the net book value of property, plant, and equipment was $142.1 million, and approximately 85% of such assets were located in the United States.

NOTE 17—SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table sets forth certain unaudited quarterly financial data. In our opinion, the unaudited information set forth below has been prepared on the same basis as the audited information and includes all adjustments necessary to present fairly the information set forth herein. We have experienced fluctuations in our quarterly results. We expect these fluctuations to continue in the future.

Due to these and other factors, we believe that quarter-to-quarter comparisons of our operating results will not be meaningful, and you should not rely on our results for one quarter as an indication of our future performance. Certain items previously reported in specific financial statement captions have been reclassified to conform to the current period presentation. Such reclassifications have not impacted previously reported revenues, operating loss or net loss. All data is in thousands except per share information.

	Fiscal Year 2006				Fiscal Year 2005			
	Q1	**Q2**	**Q3**	**Q4**	Q1	Q2	Q3	Q4
Product sales and royalty revenue	**$ 12,397**	**$ 44,157**	**$ 41,451**	**$ 55,551**	$ 6,392	$ 5,470	$ 8,450	$ 9,054
Contract research revenue	**$ 14,817**	**$ 14,322**	**$ 15,111**	**$ 12,053**	$ 19,529	$ 19,552	$ 23,657	$ 18,864
Exubera commercialization readiness revenue	**$ 1,745**	**$ 1,744**	**$ 2,070**	**$ 2,300**	$ 2,573	$ 3,528	$ 4,247	$ 4,963
Gross margin on product sales	**$ 4,897**	**$ 8,426**	**$ 10,861**	**$ 15,451**	$ 1,137	$ 37	$ 2,325	$ 2,139
Research and development expenses	**$ 31,401**	**$ 40,474**	**$ 34,985**	**$ 42,521**	$ 34,945	$ 35,785	$ 38,591	$ 42,338
General and administrative expenses	**$ 20,373**	**$ 26,063**	**$ 14,442**	**$ 17,441**	$ 9,110	$ 10,135	$ 10,948	$ 13,659
Litigation Settlement	**$ –**	**$ 17,710**	**$ –**	**$ –**	$ –	$ –	$ –	$ –
Impairment of long lived assets	**$ –**	**$ 1,156**	**$ –**	**$ 8,254**	$ –	$ –	$ –	$ 65,340
Operating loss	**$ (33,174)**	**$ (63,212)**	**$ (22,682)**	**$ (40,162)**	$ (24,092)	$ (26,450)	$ (23,367)	$ (108,724)
Interest expense	**$ 5,142**	**$ 4,938**	**$ 5,255**	**$ 4,921**	$ 3,060	$ 2,856	$ 2,992	$ 5,177
Net loss	**$ (33,471)**	**$ (62,831)**	**$ (19,604)**	**$ (38,855)**	$ (26,165)	$ (26,912)	$ (23,795)	$ (108,239)
Basic and fully diluted net loss per share [1]	**$ (0.38)**	**$ (0.70)**	**$ (0.22)**	**$ (0.43)**	$ (0.31)	$ (0.32)	$ (0.28)	$ (1.23)

1 Quarterly loss per share amounts may not total the year-to-date loss per share due to rounding.

NOTE 18—SUBSEQUENT EVENTS (UNAUDITED)

On January 8, 2007, we announced the appointment of Howard W. Robin as our new President and Chief Executive Officer ("CEO"), effective January 15, 2007. Mr. Robin replaced Acting President and CEO Robert Chess who will remain Chairman of the Board of Directors.

On February 7, 2007, we repaid with cash our $36.0 million of outstanding 5% convertible subordinated notes plus accrued interest.

CORPORATE HEADQUARTERS

Nektar Therapeutics
150 Industrial Road
San Carlos, CA 94070-6256
Telephone (650) 631-3100
Facsimile (650) 631-3150

ANNUAL REPORT ON FORM 10-K

Copies of Nektar's Annual Report on Form 10-K, exclusive of exhibits, are available without charge upon written request to:

Investor Relations
Nektar Therapeutics
150 Industrial Road
San Carlos, CA 94070-6256

Or via email to:
investors@nektar.com; Online copies can also be obtained at www.nektar.com under "Investor Relations."

ANNUAL MEETING

The Annual Meeting of Stockholders
will be held on
June 7, 2007
1:00-2:30 p.m. (PST)
Crystal Springs Ballroom
San Mateo Marriott Hotel
1770 S. Amphlett Blvd.
San Mateo, CA 94402
650.653.6034

CORPORATE COUNSEL

Cooley Godward LLP
Palo Alto, CA

INDEPENDENT AUDITORS

Ernst & Young LLP
Palo Alto, CA

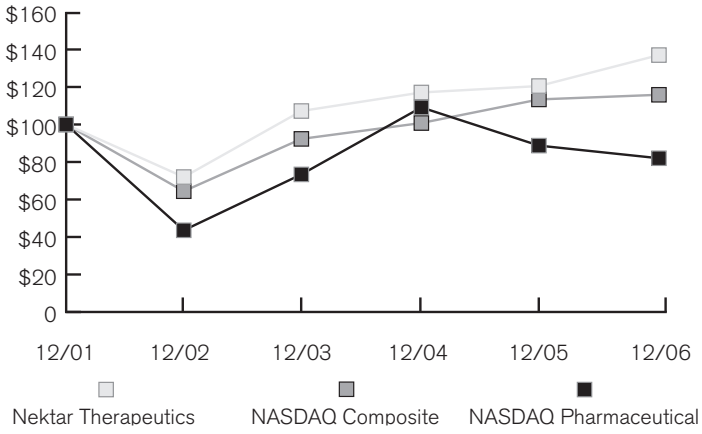
TRANSFER AGENT AND STOCKHOLDER SERVICES

Mellon Investor Services, LLC
525 Market Street, Suite 3500
San Francisco, CA 94105
1-800-522-6645

The following graph shows the total stockholder return of an investment of $100 in cash on December 31, 2001 for: (i) our common stock; (ii) the RDG Total Return Index for the Nasdaq Stock Market (U.S. companies); and (iii) the RDG Total Return Index for the Nasdaq Pharmaceutical Stocks for the period commencing on December 31, 2001 and ending on December 31, 2006 (2) All values assume reinvestment of the full amount of all dividends and are calculated as of December 31 of each year."

Comparison of 5-Year Cumulative Total Return

Among Nektar Therapeutics, The NASDAQ Composite Index
And The NASDAQ Pharmaceutical Index



* *$100 invested on 12/31/01 in stock or index-including reinvestment of dividends. Fiscal year ending December 31.*

SECURITIES

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

	Year ended December 31, 2005	
	High	Low
1st Quarter	$ 19.80	$ 13.41
2nd Quarter	$ 19.02	$ 13.72
3rd Quarter	$ 19.59	$ 16.24
4th Quarter	$ 17.49	$ 14.66

	Year ended December 31, 2006	
	High	Low
1st Quarter	**$ 21.76**	$ 16.44
2nd Quarter	**$ 22.75**	$ 16.99
3rd Quarter	**$ 18.53**	$ 13.10
4th Quarter	**$ 17.20**	$ 13.96

Nektar Management Team

Howard W. Robin
President and
Chief Executive Officer,
Director

Louis Drapeau
Senior Vice President,
Finance and
Chief Financial Officer

Nevan Elam
Senior Vice President,
Head of the Pulmonary
Business Unit

Elizabeth Frisby
Vice President,
Human Resources

Hoyoung Huh, M.D., Ph.D.
Senior Vice President,
Business Development
and Marketing

David Johnston, Ph.D.
Senior Vice President,
Research and Development

Gil Labrucherie
Senior Vice President,
General Counsel and Secretary

Truc Le
Senior Vice President,
Operations and Corporate Quality

John S. Patton, Ph.D.
Chief Scientific Officer,
Director and Founder

Christopher J. Searcy, Pharm.D.
Senior Vice President,
Corporate Development

David Tolley
Senior Vice President,
Operations and Site Manager,
Nektar Alabama

Tim Warner
Senior Vice President,
Investor Relations
and Corporate Affairs

Nektar Board of Directors

Robert B. Chess
Chairman of the Board
Nektar Therapeutics

Michael A. Brown
Chairman, Line 6
Director, Former Chairman
and Chief Executive Officer
Quantum Corp

Joseph J. Krivulka
Founder and President
Triax Pharmaceuticals

Christopher A. Kuebler
Former Chairman and
Chief Executive Officer
Covance

Irwin Lerner
Former Chairman and
Chief Executive Officer
F. Hoffmann-LaRoche

John S. Patton, Ph.D.
Co-Founder and
Chief Scientific Officer
Nektar Therapeutics

Howard W. Robin
President and
Chief Executive Officer
Nektar Therapeutics

Susan Wang
Former Executive
Vice President,
Corporate Development
and Chief Financial Officer
Solectron

Roy A. Whitfield
Former Chairman and
Chief Executive Officer
Incyte

The preceding discussion contains forward-looking statements that involve risks and uncertainties. Nektar's 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 Part 1 of the Form 10-K filed with the Securities Exchange Commission for the fiscal year ended December 31, 2006 under the heading "Risk Factors."

Design: Creative Strategy Group | csg-design.com

NEKTAR®

Nektar Therapeutics
201 Industrial Road
San Carlos, California 94070
USA
+1 650 631-3100 Global Headquarters
+1 650 631-3150 Main FAX
www.nektar.com
NASDAQ: NKTR