

NEKTAR THERAPEUTICS  
Form 10-Q  
May 10, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

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

For the quarterly period ended March 31, 2006

or,

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

For the transition period from to

Commission File Number: 0-24006

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**NEKTAR THERAPEUTICS**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

150 Industrial Road

San Carlos, California 94070

94-3134940  
(IRS Employer  
Identification No.)

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(Address of principal executive offices)

650-631-3100

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The number of outstanding shares of the registrant's Common Stock, \$0.0001 par value, was 89,515,750 on April 30, 2006.

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**Forward-Looking Statements**

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

**Trademarks**

All Nektar brand and product names contained in this document are trademarks or registered trademarks of Nektar Therapeutics in the United States and other countries. The following, which may appear in this document, are registered or other trademarks owned by the following companies: Exubera and Somavert (Pfizer Inc); PEGASYS (Hoffmann-La Roche Ltd.); Neulasta (Amgen Inc.); Definity (Bristol-Myers Squibb Medical Imaging, Inc.); PEG-INTRON (Schering-Plough Corporation); DuraSeal and SprayGel (Confluent Surgical Inc.); Macugen ((OSI)-Eyetechn); Marinol (Solvay Pharmaceuticals, Inc.); and Cimzia (UCB Group).

**Table of Contents****PART I: FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements unaudited:****NEKTAR THERAPEUTICS****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except per share information)

|   | March 31, 2006<br>unaudited | December 31, 2005 |
|---|-----------------------------|-------------------|
| <b>ASSETS</b>   |                             |                   |
| Current assets:   |                             |                   |
| Cash and cash equivalents   | \$ 262,028                  | \$ 261,273        |
| Short-term investments  | 217,488                     | 214,928           |
| Accounts receivable, net of allowance for doubtful accounts and sales returns of \$152 and \$70 at March 31, 2006 and December 31, 2005, respectively                       | 17,432                      | 8,205             |
| Inventory, net  | 33,180                      | 18,627            |
| Other current assets  | 19,238                      | 16,810            |
| Total current assets  | 549,366                     | 519,843           |
| Investments in marketable securities  | 48,601                      | 90,222            |
| Property and equipment, net   | 140,301                     | 142,127           |
| Goodwill  | 78,431                      | 78,431            |
| Other intangible assets, net  | 11,944                      | 13,452            |
| Other assets  | 12,895                      | 14,479            |
| Total assets  | \$ 841,538                  | \$ 858,554        |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                             |                   |
| Current liabilities:  |                             |                   |
| Accounts payable  | \$ 14,633                   | \$ 18,895         |
| Accrued expenses  | 29,072                      | 20,988            |
| Other liabilities   | 10,016                      | 9,952             |
| Interest payable  | 2,903                       | 3,791             |
| Capital lease obligations   | 521                         | 482               |
| Convertible subordinated notes and debentures   | 36,026                      |                   |
| Deferred revenue  | 17,130                      | 15,487            |
| Total current liabilities   | 110,301                     | 69,595            |
| Convertible subordinated notes and debentures   | 381,627                     | 417,653           |
| Capital lease obligations   | 20,129                      | 20,276            |
| Other long-term liabilities   | 20,285                      | 21,810            |
| Accrued rent  | 2,390                       | 2,409             |
| Commitments and contingencies   |                             |                   |
| Stockholders' equity:   |                             |                   |
| Preferred Stock, 10,000 shares authorized   |                             |                   |
| Series A, \$0.0001 par value: 3,100 shares designated; no shares issued or outstanding at March 31, 2006 and December 31, 2005  |                             |                   |
| Convertible Series B, \$0.0001 par value: 40 shares designated; 20 shares issued and outstanding December 31, 2005; Liquidation preference of \$19,945 at December 31, 2005 |                             |                   |

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|  |                   |                   |
|--|-------------------|-------------------|
| Common stock, \$0.0001 par value; 300,000 authorized; 89,428 shares and 87,707 shares issued and outstanding at March 31, 2006 and December 31, 2005, respectively | 9                 | 9                 |
| Capital in excess of par value   | 1,244,234         | 1,233,690         |
| Deferred compensation  |                   | (2,949)           |
| Accumulated other comprehensive loss   | (1,734)           | (1,707)           |
| Accumulated deficit  | (935,703)         | (902,232)         |
| <b>Total stockholders' equity</b>  | <b>306,806</b>    | <b>326,811</b>    |
| <b>Total liabilities and stockholders' equity</b>  | <b>\$ 841,538</b> | <b>\$ 858,554</b> |

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

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**NEKTAR THERAPEUTICS**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share information)

(unaudited)

|   | <b>Three months ended</b> |                    |
|---|---------------------------|--------------------|
|   | <b>March 31,</b>          |                    |
|   | <b>2006</b>               | <b>2005</b>        |
| <b>Revenue:</b>   |                           |                    |
| Contract research revenue                                     | \$ 14,817                 | \$ 19,529          |
| Product sales and royalty revenue                             | 12,397                    | 6,392              |
| Exubera commercialization readiness revenue                   | 1,745                     | 2,573              |
| <b>Total revenue</b>  | <b>28,959</b>             | <b>28,494</b>      |
| <b>Operating costs and expenses:</b>                          |                           |                    |
| Cost of goods sold  | 7,500                     | 5,255              |
| Exubera commercialization readiness costs                     | 1,495                     | 2,294              |
| Research and development                                      | 31,401                    | 34,945             |
| General and administrative                                    | 20,373                    | 9,110              |
| Amortization of other intangible assets                       | 1,364                     | 982                |
| <b>Total operating costs and expenses</b>                     | <b>62,133</b>             | <b>52,586</b>      |
| <b>Loss from operations</b>                                   | <b>(33,174)</b>           | <b>(24,092)</b>    |
| Interest income   | 4,882                     | 2,272              |
| Interest expense  | (5,142)                   | (3,060)            |
| Other income (expense), net                                   | (37)                      | (1,285)            |
| <b>Loss before provision for income taxes</b>                 | <b>(33,471)</b>           | <b>(26,165)</b>    |
| Provision for income taxes                                    |                           |                    |
| <b>Net loss</b>   | <b>\$ (33,471)</b>        | <b>\$ (26,165)</b> |
| Basic and diluted net loss per share                          | \$ (0.38)                 | \$ (0.31)          |
| Shares used in computing basic and diluted net loss per share | 88,926                    | 84,708             |

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

**Table of Contents****NEKTAR THERAPEUTICS****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(unaudited)

|   | <b>Three months ended</b> |                 |
|---|---------------------------|-----------------|
|   | <b>March 31,</b>          |                 |
|   | <b>2006</b>               | <b>2005</b>     |
| <b>Cash flows used in operating activities:</b>                             |                           |                 |
| Net loss  | \$ (33,471)               | \$ (26,165)     |
| Adjustments to reconcile net loss to net cash used in operating activities: |                           |                 |
| Depreciation  | 6,506                     | 4,119           |
| Amortization of other intangible assets                                     | 1,508                     | 1,128           |
| Amortization of debt issuance costs   | 594                       | 208             |
| Amortization of gain related to sale of building                            |                           | (278)           |
| Loss on termination of capital lease  | (218)                     | 1,137           |
| Non-cash compensation for employee retirement plans                         | 546                       | 285             |
| Stock-based compensation  | 7,203                     | 493             |
| Increase in provision for doubtful accounts and sales returns reserve       | 82                        | 285             |
| Changes in assets and liabilities:  |                           |                 |
| Decrease (increase) in trade accounts receivable                            | (9,308)                   | 6,219           |
| Decrease (increase) in inventories  | (14,552)                  | 8               |
| Decrease (increase) in prepaids and other assets                            | (1,130)                   | 1,952           |
| Increase (decrease) in accounts payable                                     | (4,258)                   | (2,018)         |
| Increase (decrease) in accrued expenses                                     | 8,096                     | (676)           |
| Increase (decrease) in interest payable                                     | (888)                     | 217             |
| Increase (decrease) in deferred revenue                                     | 1,433                     | (1,261)         |
| Increase (decrease) in other liabilities                                    | (874)                     | (16)            |
| <b>Net cash used in operating activities</b>                                | <b>(38,731)</b>           | <b>(14,363)</b> |
| <b>Cash flows from investing activities:</b>                                |                           |                 |
| Purchases of investments  | (33,725)                  | (49,633)        |
| Sales of investments  |                           | 40,750          |
| Maturities of investments   | 72,334                    | 41,087          |
| Purchases of property and equipment   | (4,588)                   | (4,531)         |
| <b>Net cash provided by investing activities</b>                            | <b>34,021</b>             | <b>27,673</b>   |
| <b>Cash flows from financing activities:</b>                                |                           |                 |
| Payments of loan and capital lease obligations                              | (284)                     | (838)           |
| Issuance of common stock related to employee stock purchase plan            | 769                       | 647             |
| Issuance of common stock related to employee stock option exercises         | 4,975                     | 2,340           |
| <b>Net cash provided by financing activities</b>                            | <b>5,460</b>              | <b>2,149</b>    |
| Effect of exchange rates on cash and cash equivalents                       | 5                         | (7)             |
| <b>Net increase in cash and cash equivalents</b>                            | <b>755</b>                | <b>15,452</b>   |
| <b>Cash and cash equivalents at beginning of period</b>                     | <b>261,273</b>            | <b>32,064</b>   |

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|  |            |           |
|--|------------|-----------|
| Cash and cash equivalents at end of period | \$ 262,028 | \$ 47,516 |
|--|------------|-----------|

**Non-cash Investing and Financing Activities**

|   |    |          |
|---|----|----------|
| Deferred compensation related to the issuance of restricted stock units | \$ | \$ 2,039 |
|---|----|----------|

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



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**NEKTAR THERAPEUTICS**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2006**

**(unaudited)**

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

**Organization and Basis of Presentation**

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

We are a biopharmaceutical company developing breakthrough products that make a difference in patients' lives. We create differentiated, innovative products by applying our drug delivery technologies to established or novel medicines. Our leading technologies are Nektar Pulmonary Technology and Nektar Advanced PEGylation Technology. Nine products using these technologies have received regulatory approval in the United States or the European Union. Our two technology platforms are the basis of nearly all of the partnered and proprietary products we currently have in preclinical and clinical development. We are also engaged in exploratory development with other early stage technologies.

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

Revenues, expenses, assets, and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year. The information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K/A for the year ended December 31, 2005.

**Principles of Consolidation**

Our consolidated financial statements include the financial position and results of operations and cash flows of our wholly-owned subsidiaries: Nektar Therapeutics AL, Corporation ( Nektar AL ); Nektar Therapeutics UK, Ltd. ( Nektar UK ), Nektar Therapeutics (India) Private Unlimited, Inhale Therapeutic Systems Deutschland GmbH ( Inhale Germany ), 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.

**Use of Estimates**

The preparation of financial statements in conformity with U.S. 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.

**Segment, Significant Customer, and Geographic Information**

We report segment information in accordance with SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*. The Company is managed as one operating segment. The entire business is comprehensively managed by our Executive Committee which reports to

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the Chief Executive Officer. The Executive Committee is our chief operating decision maker. We have multiple technologies, all of which are marketed to a common customer base (pharmaceutical and biotechnology companies which are typically located in the U.S. and EU). Within this segment we operate two remaining business units, Nektar Pulmonary Technology and Nektar Advanced PEGylation.

During the three month period ended December 31, 2005 our other business unit, Nektar Super Critical Fluids (Bradford), located in Bradford, England, was deemed to be significantly impaired, which resulted in a write off of \$59.6 million of goodwill and \$5.7 million of certain fixed assets

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representing more than 95% of the fair value. In the three month period ended March 31, 2006 we have initiated a plan to discontinue operations of Bradford. As of March 31, 2006, the remaining \$1.9 million of net assets at Bradford is not considered material to our consolidated financial statements and therefore not all of the requisite disclosures for discontinued operations under FAS 146 are included in the financial statements. In March 2006, the Bradford employees were provided a retention incentive to pursue the clinical protocols while the Company determines an exit strategy. The estimated cost of the retention incentives and severance costs are \$2.6 million, of which \$0.4 million was expensed in the three-month period ended March 31, 2006, and the remainder is to be amortized through July 31, 2006. We are continuing to evaluate our alternatives regarding the disposition of this business unit.

Our revenue is derived primarily from clients in the pharmaceutical and biotechnology industries. Revenue from Pfizer represented 44% and 63% of our total revenue for the three-month periods ended March 31, 2006 and 2005, respectively. Deferred revenue from Pfizer represented 61% and 42% of total deferred revenue as of March 31, 2006 and December 31, 2005, respectively. Product sales relate to Advanced PEGylation Technology and inhaled insulin (Exubera®) products.

Our accounts receivable balance contains trade receivables from product sales, collaborative research agreements, and Exubera® commercialization readiness revenue. On March 31, 2006, three different customers represented 40%, 16%, and 14% of our trade accounts receivable, respectively. At December 31, 2005, two different customers represented 49% and 10% of our accounts receivable, respectively.

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

|  | <b>Three-months ended</b> |                  |
|--|---------------------------|------------------|
|  | <b>March 31,</b>          |                  |
|  | <b>2006</b>               | <b>2005</b>      |
| <b>Contract research revenue</b>         |                           |                  |
| United States                            | \$ 13,029                 | \$ 18,646        |
| All other countries                      | 1,788                     | 883              |
| <b>Total contract research revenue</b>   | <b>\$ 14,817</b>          | <b>\$ 19,529</b> |
| <b>Product sales and royalty revenue</b> |                           |                  |
| United States                            | \$ 8,171                  | \$ 4,291         |
| European countries                       | 4,162                     | 1,303            |
| All other countries                      | 64                        | 798              |
|  | &n                        |                  |