NEKTAR THERAPEUTICS
Form 10-Q
May 10, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2007

or,

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

For the transition period from ______ to ______

Commission File Number: 0-24006

NEKTAR THERAPEUTICS

(Exact name of registrant as specified in its charter)

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

150 Industrial Road

San Carlos, California 94070

(Address of principal executive offices)

650-631-3100

(Registrant s telephone number, including area code)

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

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

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

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

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

The number of outstanding shares of the registrant s Common Stock, $0.0001 par value, was 91,681,687 on April 30, 2007.

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Forward-Looking Statements

This report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the 1933 Act) and Section 21E of the Securities Exchange Act of 1934, as amended (the 1934 Act). All statements other than statements of historical fact are forward-looking statements for purposes of this quarterly report, including any projections of earnings, revenues or other financial items, any statements of the plans and objectives of management for future operations, any statements concerning proposed new products or services, any statements regarding future economic conditions or performance and any statement of assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as may, will, expects, plans, anticipates, estimates, p or continue, or the negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, there can be no assurance that such expectations or any of the forward-looking statements will prove to be correct and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including but not limited to the risk factors set forth in Part II Item 1A below and for the reasons described elsewhere in this annual report. All forward-looking statements and reasons why results may differ included in this report are made as of the date hereof and we do not intend to update any forward-looking statements except as required by law or applicable regulations.

Trademarks

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

Hematide (Affymax, Inc.) and Cimzia (UCB Group).

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, 2007 Unaudited	December 31, 2006 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 83,140	$ 63,760
Short-term investments	315,187	394,880
Accounts receivable, net of allowance of $1,062 and $357 at March 31, 2007 and December 31, 2006, respectively.	64,747	47,148
Inventory	16,770	14,656
Other current assets	11,733	14,595
Total current assets	$ 491,577	$ 535,039
Long-term investments		8,337
Property and equipment, net	132,345	133,812
Goodwill	78,431	78,431
Other intangible assets, net	3,390	3,626
Other assets	7,997	8,932
Total assets	$ 713,740	$ 768,177
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,658	$ 7,205
Accrued compensation	11,596	12,994
Accrued expenses	15,338	17,942
Interest payable	1,130	3,814
Capital lease obligations, current portion	760	711
Deferred revenue, current portion	8,635	16,409
Convertible subordinated notes, current portion	66,627	102,653
Other current liabilities	3,732	3,586
Total current liabilities	$ 111,476	$ 165,314
Convertible subordinated notes	315,000	315,000
Capital lease obligations	19,548	19,759
Deferred revenue	40,272	23,697
Other long-term liabilities	16,821	17,347
Total liabilities	$ 503,117	$ 541,117
Commitments and contingencies		
Stockholders equity:		

Preferred stock		
Common stock, $0.0001 par value; 300,000 authorized; 91,651 shares and 91,280 shares issued and outstanding at March 31, 2007 and December 31, 2006, respectively	9	9
Capital in excess of par value	1,292,977	1,283,982
Accumulated other comprehensive income	303	62
Accumulated deficit	(1,082,666)	(1,056,993)
Total stockholders equity	210,623	227,060
Total liabilities and stockholders equity	$ 713,740	$ 768,177

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

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

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share information)

(unaudited)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Revenue:		
Product sales and royalties	$ 73,019	$ 12,896
Contract research	11,997	16,063
Total revenue	85,016	28,959
Operating costs and expenses:		
Cost of goods sold	56,522	8,995
Research and development	37,492	31,401
General and administrative	16,735	20,373
Amortization of other intangible assets	236	1,364
Total operating costs and expenses	110,985	62,133
Loss from operations	(25,969)	(33,174)
Interest income	5,473	4,882
Interest expense	(4,933)	(5,142)
Other income (expense), net	6	(37)
Loss before provision for income taxes	(25,423)	(33,471)
Provision for income taxes	(250)	
Net loss	$ (25,673)	$ (33,471)
Basic and diluted net loss per share	$ (0.28)	$ (0.38)
Shares used in computing basic and diluted net loss per share	91,454	88,926

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Cash flows used in operating activities:		
Net loss	$ (25,673)	$ (33,471)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	7,571	8,608
Loss on disposal of assets	304	
Amortization of gain related to sale of building	(219)	(218)
Stock-based compensation	6,861	7,749
Changes in assets and liabilities:		
Decrease (increase) in trade accounts receivable	(17,599)	(9,660)
Decrease (increase) in inventories	(2,114)	(14,552)
Decrease (increase) in prepaids and other assets	3,227	(696)
Increase (decrease) in accounts payable	(3,547)	(4,429)
Increase (decrease) in accrued compensation	(1,635)	(2,528)
Increase (decrease) in accrued expenses	(2,604)	10,793
Increase (decrease) in interest payable	(2,684)	(888)
Increase (decrease) in deferred revenue	8,801	1,433
Increase (decrease) in other liabilities	314	(859)
Net cash used in operating activities	$ (28,997)	$ (38,718)
Cash flows from investing activities:		
Purchases of investments	(79,411)	(33,725)
Maturities of investments	167,696	72,334
Purchases of property and equipment	(5,556)	(4,588)
Net cash provided by investing activities	$ 82,729	$ 34,021
Cash flows from financing activities:		
Repayments of convertible subordinated notes	(36,026)	
Payments of loan and capital lease obligations	(400)	(297)
Issuance of common stock related to employee stock purchase plan	572	769
Issuance of common stock related to employee stock option exercises	1,562	4,975
Net cash (used in) provided by financing activities	$ (34,292)	$ 5,447
Effect of exchange rates on cash and cash equivalents	(60)	5
Net increase in cash and cash equivalents	$ 19,380	$ 755
Cash and cash equivalents at beginning of period	63,760	261,273
Cash and cash equivalents at end of period	$ 83,140	$ 262,028

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2007

(unaudited)

Note 1 Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation

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

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 for the year ended December 31, 2006.

Principles of Consolidation

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

Segment Information

We operate in one business segment which focuses on applying our technology platforms to improve the performance of established and novel medicines. We 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.

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.

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Revenue Recognition

Beginning January 1, 2007, we recognized Exubera revenue upon shipment of product. Prior to January 1, 2007, we deferred Exubera revenue until the expiration of Pfizer s 60-day contractual right of return related to non-conformity with product quality specifications; even though prior to shipment, we and our contract manufacturers test, inspect and validate that all products meet contractual quality specifications. In 2006, we deferred Exubera revenue over the contractual right of return period because we did not have sufficient historical returns data to reasonably estimate product returns. As of January 1, 2007, we believe we have the ability to estimate returns as we have over 12 months of product shipment history and have not had any returns from Pfizer. As a result, we recognized revenue of $26.0 million and costs of goods sold $20.8 million related to the February and March 2007 Exubera shipments which would have previously been deferred for 60 days. Our gross margin increased $5.2 million and net loss per share decreased $0.06 as a result of our ability to recognize revenue upon shipment.

Income Taxes

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* effective for years beginning after December 15, 2006. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109). The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained upon tax authority examination, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement.

We adopted FIN 48 on January 1, 2007. Upon adoption, we did not recognize an increase or a decrease in the liability for net unrecognized tax benefits, which would be accounted for through retained earnings. Further, we did not have any significant unrecognized tax benefits on the date of adoption. We historically accrued for uncertain tax positions in deferred tax assets as we have been in a net operating loss position since inception and any adjustments to our tax positions would result in an adjustment of our net operating loss or tax credit carry forwards rather than resulting in a cash outlay. If the Company is eventually able to recognize these uncertain positions, our effective tax rate would be reduced. We currently have a full valuation allowance against our net deferred tax asset which would impact the timing of the effective tax rate benefit should any of these uncertain tax positions be favorably settled in the future.

Our policy is to include interest and penalties related to unrecognized tax benefits, if any, within the provision for taxes in the consolidated condensed statements of operations under the provisions of FIN 48. As of the date of adoption of FIN 48, the Company has not accrued any amounts for the payment of interest and penalties relating to unrecognized tax benefits.

The Company or its subsidiaries files income tax returns in the U.S. as well as California, Alabama and various other foreign jurisdictions. The Company is currently not the subject of any income tax examinations. In general, the earliest open year subject to examination is 2002, although depending upon jurisdiction, tax years may remain open subject to limitations.

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 March 31, 2007	Estimated Fair Value at December 31, 2006
Cash and cash equivalents	$ 83,140	$ 63,760
Short-term investments (less than one year to maturity)	315,187	394,880
Long-term investments (one to two years to maturity)		8,337
Total Cash and Available-for-Sale Securities	$ 398,327	$ 466,977

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

	Estimated Fair Value at	
	March 31, 2007	December 31, 2006
U.S. corporate commercial paper	$ 207,169	$ 234,512
Obligations of U.S. corporations	109,650	151,288
Obligations of U.S. government agencies	31,921	27,372
Repurchase agreements	23,038	33,948
Cash and other debt securities	26,549	19,857