NEKTAR THERAPEUTICS
Form 10-Q
November 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018

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.)

455 Mission Bay Boulevard South

San Francisco, California 94158

(Address of principal executive offices)

415-482-5300

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 173,085,231 on November 1, 2018.

NEKTAR THERAPEUTICS

INDEX

Forward-Looking Statements

This report includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (Exchange Act). All statements other than statements of historical fact are “forward-looking statements” for purposes of this quarterly report on Form 10-Q, including any projections of market size, earnings, revenue, milestone payments, royalties, sales or other financial items, any statements of the plans and objectives of management for future operations (including, but not limited to, preclinical development, clinical trials and manufacturing), any statements related to our financial condition and future working capital needs, any statements regarding potential future financing alternatives, any statements concerning proposed drug candidates, any statements regarding the timing for the start or end of clinical trials or submission of regulatory approval filings, any statements regarding future economic conditions or performance, any statements regarding the initiation, formation, or success of our collaboration arrangements, timing of commercial launches and product sales levels by our collaboration partners and future payments that may come due to us under these arrangements, any statements regarding our plans and objectives to initiate or continue clinical trials, any statements related to potential, anticipated, or ongoing litigation and any statements of assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as “may,” “will,” “expects,” “plans,” “anticipates,” “estimates,” “potential” or “continue,” or the negative thereof or other compar terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, such expectations or any of the forward-looking statements may prove to be incorrect and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including, but not limited to, the risk factors set forth in Part II, Item 1A “Risk Factors” below and for the reasons described elsewhere in this quarterly report on Form 10-Q. All forward-looking statements and reasons why results may differ included in this report are made as of the date hereof and we do not intend to update any forward-looking statements except as required by law or applicable regulations. Except where the context otherwise requires, in this quarterly report on Form 10-Q, the “Company,” “Nektar,” “we,” “us,” and “our” refer to Nektar Therapeutics, Delaware corporation, and, where appropriate, its subsidiaries.

Trademarks

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

PART I: FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements—Unaudited:
NEKTAR THERAPEUTICS

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(Unaudited)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$222,261	$4,762
Short-term investments	1,198,149	291,370
Accounts receivable, net	31,937	5,014
Inventory	13,296	10,726
Advance payments to contract manufacturers	26,999	7,155
Other current assets	12,540	7,793
Total current assets	1,505,182	326,820
Long-term investments	619,140	57,088
Property, plant and equipment, net	44,881	47,463
Goodwill	76,501	76,501
Other assets	3,394	994
Total assets	$2,249,098	$508,866
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$7,494	$4,782
Accrued compensation	27,922	8,263
Accrued clinical trial expenses	21,966	9,461
Other accrued expenses	24,217	10,064
Interest payable	4,198	4,198
Deferred revenue, current portion	15,676	18,949
Other current liabilities	6,610	446
Total current liabilities	108,083	56,163
Senior secured notes, net	246,514	245,207
Liability related to the sale of future royalties, net	85,402	94,655
Deferred revenue, less current portion	11,410	19,021
Other long-term liabilities	7,567	5,992
Total liabilities	458,976	421,038
Commitments and contingencies		

Stockholders' equity:		
Preferred stock, $0.0001 par value; 10,000 shares authorized; no shares designated, issued or outstanding at September 30, 2018 or December 31, 2017	—	—
Common stock, $0.0001 par value; 300,000 shares authorized; 173,057 shares and 159,524 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	17	15
Capital in excess of par value	3,121,322	2,207,865
Accumulated other comprehensive loss	(5,378)	(2,111)
Accumulated deficit	(1,325,839)	(2,117,941)
Total stockholders' equity	1,790,122	87,828
Total liabilities and stockholders' equity	$2,249,098	$508,866

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

NEKTAR THERAPEUTICS

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share information)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Revenue:				
Product sales	$4,256	$4,448	$16,414	$24,897
Royalty revenue	10,259	9,302	29,898	23,953
Non-cash royalty revenue related to sale of future royalties	8,372	8,066	24,337	21,367
License, collaboration and other revenue	4,875	131,112	1,082,848	142,028
Total revenue	27,762	152,928	1,153,497	212,245
Operating costs and expenses:				
Cost of goods sold	4,783	5,674	16,951	20,794
Research and development	102,895	65,714	290,653	187,032
General and administrative	18,718	12,055	57,666	40,027
Total operating costs and expenses	126,396	83,443	365,270	247,853
Income (loss) from operations	(98,634)	69,485	788,227	(35,608)
Non-operating income (expense):				
Interest expense	(5,442)	(5,540)	(16,167)	(16,452)
Non-cash interest expense on liability related to sale of future royalties	(4,814)	(4,471)	(14,808)	(13,535)
Interest income and other income (expense), net	11,847	1,599	25,523	3,163
Total non-operating income (expense), net	1,591	(8,412)	(5,452)	(26,824)
Income (loss) before provision for income taxes	(97,043)	61,073	782,775	(62,432)
Provision for income taxes	(900)	202	3,250	434
Net income (loss)	$(96,143)	$60,871	$779,525	$(62,866)
Net income (loss) per share				
Basic	$(0.56)	$0.39	$4.63	$(0.41)
Diluted	$(0.56)	$0.37	$4.34	$(0.41)
Weighted average shares outstanding used in computing net income (loss) per share:				
Basic	172,698	156,411	168,363	155,153
Diluted	172,698	162,641	179,619	155,153

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Comprehensive income (loss)	$(97,519)	$60,626	$776,258	$(62,410)

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

NEKTAR THERAPEUTICS

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine months ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	$779,525	$(62,866)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Non-cash royalty revenue related to sale of future royalties	(24,337)	(21,367)
Non-cash interest expense on liability related to sale of future royalties	14,808	13,535
Stock-based compensation	63,895	25,118
Depreciation and amortization	7,799	12,081
Other non-cash transactions	(8,136)	(1,370)
Changes in operating assets and liabilities:		
Accounts receivable, net	(16,179)	12,364
Inventory	(2,570)	(2,545)
Other assets	(22,087)	(2,036)
Accounts payable	2,611	5,729
Accrued compensation	19,659	808
Accrued clinical trial expenses	12,505	(958)
Other accrued expenses	14,098	4,971
Deferred revenue	(10,931)	15,477
Other liabilities	5,104	1,046
Net cash provided by (used in) operating activities	835,764	(13)
Cash flows from investing activities:		
Purchases of investments	(1,944,178)	(314,439)
Maturities of investments	467,658	261,112
Sales of investments	11,963	8,823
Purchases of property, plant and equipment	(5,552)	(7,283)
Sales of property, plant and equipment	2,633	—
Net cash used in investing activities	(1,467,476)	(51,787)
Cash flows from financing activities:		
Payment of capital lease obligations	—	(2,159)
Issuance of common stock	790,231	—
Proceeds from shares issued under equity compensation plans	59,067	32,275
Net cash provided by financing activities	849,298	30,116
Effect of exchange rates on cash and cash equivalents	(87)	11
Net increase (decrease) in cash and cash equivalents	217,499	(21,673)
Cash and cash equivalents at beginning of period	4,762	59,640
Cash and cash equivalents at end of period	$222,261	$37,967

Supplemental disclosure of cash flow information:		
Cash paid for interest	$14,701	$14,989

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

NEKTAR THERAPEUTICS

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

(Unaudited)

Note 1 — Organization and Summary of Significant Accounting Policies

Organization

We are a research-based biopharmaceutical company headquartered in San Francisco, California and incorporated in Delaware. We are developing a pipeline of drug candidates that utilize our advanced polymer conjugate technology platforms, which are designed to enable the development of new molecular entities that target known mechanisms of action. Our research and development pipeline of new investigational drugs includes treatments for cancer, autoimmune disease and chronic pain.

Our research and development activities have required significant ongoing investment to date and are expected to continue to require significant investment. As a result, with the exception of the income resulting from the upfront payment in April 2018 from our collaboration agreement with Bristol-Myers Squibb and Company (BMS), we expect to continue to incur substantial losses and negative cash flows from operations in the future. We have financed our operations primarily through cash generated from licensing, collaboration and manufacturing agreements and financing transactions. At September 30, 2018, we had approximately $2.0 billion in cash and investments in marketable securities and debt of $250.0 million in principal of senior secured notes due in October 2020.

Basis of Presentation and Principles of Consolidation

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

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

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

Our comprehensive income (loss) consists of our net income (loss) plus our foreign currency translation gains and losses and unrealized holding gains and losses on available-for-sale securities, neither of which were significant during the three and nine months ended September 30, 2018 and 2017. In addition, there were no significant reclassifications out of accumulated other comprehensive loss to the statements of operations during the three and nine months ended September 30, 2018 and 2017.

The accompanying Condensed Consolidated Financial Statements are unaudited. The Condensed Consolidated Balance Sheet data as of December 31, 2017 was derived from the audited consolidated financial statements which are included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 1, 2018. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the consolidated financial statements and the accompanying notes to those financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017.

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

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Accounting estimates

and assumptions are inherently uncertain. Actual results could differ materially from those estimates and assumptions. Our estimates include those related to estimated selling prices of performance obligations and estimates of variable consideration in collaboration agreements, estimated royalty revenue, other estimates required for revenue recognition as described further below, the net realizable value of inventory, the impairment of investments, goodwill and long-lived assets, contingencies, accrued clinical trial, contract manufacturing and other expenses, estimated non-cash royalty revenue and non-cash interest expense from our liability related to our sale of future royalties, stock-based compensation, and ongoing litigation, among other estimates. We base our estimates on historical experience and on other assumptions that management believes are reasonable under the circumstances. These estimates form the basis for making judgments about the carrying values of assets and liabilities when these values are not readily apparent from other sources. As appropriate, estimates are assessed each period and updated to reflect current information and any changes in estimates will generally be reflected in the period first identified.

Reclassifications

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

Segment Information

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

Significant Concentrations

Our customers are primarily pharmaceutical and biotechnology companies that are located in the U.S. and Europe and with whom we have multi-year arrangements. Our accounts receivable balance contains billed and unbilled trade receivables from product sales, milestones, other contingent payments and royalties, as well as reimbursable costs from collaborative research and development agreements. When appropriate, we provide for an allowance for doubtful accounts by reserving for specifically identified doubtful accounts. We generally do not require collateral from our customers. We perform a regular review of our customers' payment histories and associated credit risk. We have not experienced significant credit losses from our accounts receivable and our allowance for doubtful accounts was not significant at either September 30, 2018 or December 31, 2017.

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

Adoption of New Accounting Principle

On January 1, 2018, we adopted Accounting Standards Codification (ASC) 606, Revenue Recognition - Revenue from Contracts with Customers. ASC 606 supersedes the guidance in ASC 605, Revenue Recognition. Under ASC 606, an entity recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. To determine

revenue recognition for units of account that an entity determines are within the scope of ASC 606, the entity performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. In our adoption, we used the practical expedients to analyze only those contracts that were still active contracts as of January 1, 2018 and evaluated those contracts based on the cumulative contract modifications through that date. We do not believe that the use of the practical expedients has or will have a material impact on our transition adjustment or our prospective accounting. We adopted ASC 606 on a modified retrospective basis under which we recognized the cumulative effect of adoption as a transition adjustment to opening accumulated deficit. Therefore, the periods prior to the adoption date of ASC 606 have not been restated.

The transition adjustment totaled $12.7 million, and included $10.7 million related to the recognition of royalty revenue. Previously, under ASC 605, we recognized certain of our royalty arrangements on a cash basis, generally one quarter in arrears. Beginning in the first quarter of 2018, we began to accrue our best estimate of these royalties earned based on our collaboration partners' sales of the associated drug compounds. As a result, in the first quarter of 2018, we recognized $11.1 million of

estimated royalty revenue associated with our partners' sales of MOVANTIK® and ADYNOVATE® in the first quarter of 2018. Previously, in the fourth quarter of 2017, we recognized $9.6 million in royalty revenue associated with sales of MOVANTIK® and ADYNOVATE® in the third quarter of 2017. The transition between the two accounting methods results in the $10.7 million in royalties for sales of MOVANTIK® and ADYNOVATE® in the fourth quarter of 2017 being recognized as a direct reduction of our accumulated deficit instead of being recognized in the statement of operations. The transition adjustment also includes $2.0 million for the reduction of deferred revenue related to one of our collaboration arrangements.

The impact of the adoption of ASC 606 on our Condensed Consolidated Balance Sheet and Condensed Consolidated Statement of Operations as of and for the three and nine months ended September 30, 2018 was as follows (in thousands):

	As reported	Adjustments	Balances Without the Adoption of Topic 606
Condensed Consolidated Balance Sheet data as of September 30, 2018			
Accounts receivable, net	$31,937	$ (10,549)	$21,388
Deferred revenue, current portion	15,676	1,191	16,867
Deferred revenue, less current portion	11,410	187	11,597
Accumulated deficit	(1,325,839)	(11,927)	(1,337,766)
Condensed Consolidated Statement of Operations data for the three months ended September 30, 2018			
Product sales	$4,256	$ —	$4,256
Royalty revenue	10,259	(674)	9,585
License, collaboration and other revenue	4,875	299	5,174
Total revenue	27,762	(375)	27,387
Condensed Consolidated Statement of Operations data for the nine months ended September 30, 2018			
Product sales	$16,414	$ (192)	$16,222
Royalty revenue	29,898	195	30,093
License, collaboration and other revenue	1,082,848	767	1,083,615
Total revenue	1,153,497	770	1,154,267

Revenue Recognition

We derive our revenue from our arrangements with pharmaceutical and biotechnology collaboration partners. We enter into collaboration arrangements, under which we may grant licenses to our collaboration partners to further develop and commercialize one of our proprietary drug candidates or grant licenses to partners to use our technology to research and develop their own proprietary drug candidates. We may also perform research, development, manufacturing and supply activities under our collaboration agreements. Consideration under these contracts generally includes an upfront payment, development milestones and other contingent payments, royalties based on net sales of approved drugs, and commercial sales milestone payments. Additionally, these contracts may provide options for the customer to purchase our proprietary PEGylation materials, drug candidates or additional research and development services under separate contracts.

We assess which activities in our collaboration agreements are performance obligations that should be accounted for separately and determine the arrangement transaction price, which includes the assessment of the probability of achievement of future milestones and other potential consideration. For arrangements that include multiple performance obligations, such as granting a license and performing research and development activities, we allocate upfront and milestone payments under a relative standalone selling price method. Accordingly, we develop assumptions that require judgment to determine the standalone selling price for each performance obligation identified in the contract. These key assumptions may include revenue forecasts, clinical development timelines and costs, discount rates and probabilities of clinical and regulatory success.

Product Sales

Product sales are primarily derived from manufacturing and supply agreements with our customers. We have assessed our current manufacturing and supply arrangements and have generally determined that they provide the customer an option to purchase our proprietary PEGylation materials. Accordingly, we treat each purchase order as a discrete exercise of the customer's option (i.e. a separate contract) rather than as a component of the overall arrangement. The pricing for the manufacturing and supply is generally at a fixed price and may be subject to annual producer price index (PPI) adjustments. We invoice and recognize product sales when title

and risk of loss pass to the customer, which generally occurs upon shipment. Customer payments are generally due 30 days from receipt of invoice. We test our products for adherence to technical specifications before shipment; accordingly, we have not experienced any significant returns from our customers.

Royalty Revenue

Generally, we are entitled to royalties from our collaboration partners based on the net sales of their approved drugs that are marketed and sold, in one or more countries where we hold royalty rights. For arrangements that include sales-based royalties, including commercial milestone payments based on the level of sales, we have concluded that the license is the predominant item to which the royalties relate. Accordingly, we recognize royalty revenue, including for our non-cash royalties, when the underlying sales occur based on our best estimates of sales of the drugs. Our partners generally pay royalties or commercial milestones after the end of the calendar quarter in accordance with contractual terms.

License, collaboration and other revenue

License Grants: For collaboration arrangements that include a grant of a license to our intellectual property, we consider whether the license grant is distinct from the other performance obligations included in the arrangement. Generally, we would conclude that the license is distinct if the customer is able to benefit from the license with the resources available to it. For licenses that are distinct, we recognize revenues from nonrefundable, upfront payments and other consideration allocated to the license when the license term has begun and we have provided all necessary information regarding the underlying intellectual property to the customer, which generally occurs at or near the inception of the arrangement.

Milestone Payments: At the inception of the arrangement and at each reporting date thereafter, we assess whether we should include any milestone payments or other forms of variable consideration in the transaction price, based on whether a significant reversal of revenue previously recognized is not probable upon resolution of the uncertainty. Since milestone payments may become payable to us upon the initiation of a clinical study or filing for or receipt of regulatory approval, we review the relevant facts and circumstances to determine when we should update the transaction price, which may occur before the triggering event. When we do update the transaction price for milestone payments, we allocate it on a relative standalone selling price basis and record revenue on a cumulative catch-up basis, which results in recognizing revenue for previously satisfied performance obligations in such period. Our partners generally pay development milestones subsequent to achievement of the triggering event.

Research and development services: For amounts allocated to our research and development obligations in a collaboration arrangement, we recognize revenue over time using a proportional performance model, representing the transfer of goods or services as we perform activities over the term of the agreement.

Our revenue recognition policies under ASC 605 are described in our Annual Report on Form 10-K for the year ended December 31, 2017.

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 drug candidates and technology development and for certain third parties under collaboration agreements. For our proprietary drug candidates and our internal technology development programs, we invest our own funds without reimbursement from a third party. Where we perform research and development activities under a clinical joint development collaboration, such as our collaboration with BMS, we record the cost reimbursement from our partner

as a reduction to research and development expense when reimbursement amounts are due to us under the agreement.

We record accruals for the estimated costs of our clinical trial activities performed by third parties. The financial terms of these agreements are subject to negotiation, vary from contract to contract and may result in uneven payment flows to our vendors. Payments under the contracts depend on factors such as the achievement of certain events, successful enrollment of patients, and completion of certain clinical trial activities. We generally accrue costs associated with the start-up and reporting phases of the clinical trials ratably over the estimated duration of the start-up and reporting phases. We generally accrue costs associated with the treatment phase of clinical trials based on the total estimated cost of the treatment phase on a per patient basis and we expense the per patient cost ratably over the estimated patient treatment period based on patient enrollment in the trials. In specific circumstances, such as for certain time-based costs, we recognize clinical trial expenses using a methodology that we consider to be more reflective of the timing of costs incurred. Advance payments for goods or services that will be used or rendered for future research and development activities are capitalized as prepaid expenses and recognized as expense as the related goods are delivered or the related services are performed. We base our estimates on the best information available at the time. However, additional information may become available to us

which may allow us to make a more accurate estimate in future periods. In this event, we may be required to record adjustments to research and development expenses in future periods when the actual level of activity becomes more certain. Such increases or decreases in cost are generally considered to be changes in estimates and will be reflected in research and development expenses in the period identified.

Long-Lived Assets

We assess the impairment of long-lived assets, primarily property, plant and equipment and goodwill, whenever events or changes in business circumstances indicate that the carrying amounts of the assets may not be fully recoverable. When such events occur, we determine whether there has been an impairment in value by comparing the carrying value of the asset with its fair value, as measured by the anticipated undiscounted net cash flows associated with the asset. In the case of goodwill impairment, we perform an impairment test at least annually, on October 1 of each year, and market capitalization is generally used as the measure of fair value. If an impairment in value exists, the asset is written down to its estimated fair value.

Income Taxes

For the three and nine months ended September 30, 2017, we recorded an income tax provision at an effective tax rate of approximately 35% as a result of taxable income at our Nektar India operations. For the nine months ended September 30, 2018, as a result of expected taxable income in India and the U.S. for the full year of 2018 resulting primarily from income recognized from the upfront payment from BMS, we recorded a global income tax provision at an effective tax rate of approximately 0.4%. The income tax benefit for the three months ended September 30, 2018 reflects our pre-tax loss for the three months ended September 30, 2018. We expect to have tax liabilities in certain states where we do not have sufficient net operating losses to offset our estimated apportioned taxable income. Our effective tax rate is based on certain assumptions and other estimates regarding the apportionment of taxable income and the states in which we have nexus in 2018. Our apportionment of taxable income includes estimates of the apportionment of the BMS upfront payment based on estimates of activities to be carried out under the collaboration agreement with BMS, as well as estimates of the apportionment of other sources of income. We will refine our estimates in future periods as more information becomes available.

Our effective tax rate reflects the release of the valuation allowance of net operating loss carryforwards and other tax credits to offset U.S. federal and state taxable income. It also reflects a benefit of $2.0 million for stock-based compensation windfalls during the nine months ended September 30, 2018. Our remaining deferred tax assets continue to be fully reserved, as we believe it is not more likely than not that the benefit of such assets will be realized in the future.

Our effective tax rate in 2018, including the benefit from utilization of net operating loss carryforwards and stock-based compensation windfalls, may vary based on changes in our estimates of taxable income, apportionment of the BMS upfront payment as well as other sources of income, and net operating loss carryforwards in states where we have not previously filed tax returns.

The U.S. Tax Cuts and Jobs Act was enacted on December 22, 2017 and reduces the U.S. federal corporate tax rate from 35% in 2017 to 21% in 2018.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board issued guidance to amend a number of aspects of lease accounting, including requiring lessees to recognize almost all leases with a term greater than one year as a right-of-use asset and corresponding liability, measured at the present value of the lease payments. The guidance will

become effective for us beginning in the first quarter of 2019 and is required to be adopted using a modified retrospective approach. We expect the adoption of this guidance to have a material effect on our balance sheet through the recognition of right-of-use assets and lease liabilities for our existing facilities leases. However, the initial asset and liability amounts recorded upon adoption will be subject to several factors that we are continuing to evaluate, including the timing of the delivery of additional space under our facilities lease agreements, the determination of whether any contracts contain embedded leases, and the selection of an appropriate discount rate.

Note 2 — Cash and Investments in Marketable Securities

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

	Estimated Fair Value at	
	September 30, 2018	December 31, 2017
Cash and cash equivalents	$222,261	$4,762
Short-term investments	1,198,149	291,370
Long-term investments	619,140	57,088
Total cash and investments in marketable securities	$2,039,550	$353,220

We invest in liquid, high quality debt securities. Our investments in debt securities are subject to interest rate risk. To minimize the exposure due to an adverse shift in interest rates, we invest in securities with maturities of two years or less and maintain a weighted average maturity of one year or less. As of September 30, 2018 and December 31, 2017, all of our long-term investments had maturities between one and two years.

Gross unrealized gains and losses were not significant at either September 30, 2018 or December 31, 2017. During the nine months ended September 30, 2018 and 2017, we sold available-for-sale securities totaling $12.0 million and $8.8 million. Gross realized gains and losses on those sales were not significant. During the three months ended September 30, 2018 and 2017, we did not sell any of our available-for-sale securities. The cost of securities sold is based on the specific identification method.

Under the terms of our 7.75% senior secured notes due October 2020, we are required to maintain a minimum cash and investments in marketable securities balance of $60.0 million.

Our portfolio of cash and investments in marketable securities includes (in thousands):

	Fair Value Hierarchy	Estimated Fair Value at	
	Level	September 30, 2018	December 31, 2017
Corporate notes and bonds	2	$1,198,008	$216,253
Corporate commercial paper	2	737,027	128,096
Obligations of U.S. government agencies	2	2,972	2,977
Available-for-sale investments		1,938,007	347,326
Money market funds	1	89,785	302
Certificate of deposit	N/A	9,198	1,132
Cash	N/A	2,560	4,460
Total cash and investments in marketable securities		$2,039,550	$353,220

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

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

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

We use a market approach to value our Level 2 investments. The disclosed fair value related to our investments is based on market prices from a variety of industry standard data providers and generally represents quoted prices for similar assets in active markets or has been derived from observable market data. During the three and nine months ended September 30, 2018 and 2017, there were no transfers between Level 1 and Level 2 of the fair value hierarchy.

Additionally, as of September 30, 2018, based on a discounted cash flow analysis using Level 3 inputs including financial discount rates, we believe the fair value of the $250.0 million in principal amount of our 7.75% senior secured notes due October 2020 is approximately $259.0 million. We may redeem some or all of these notes at a redemption price equal to 102% of the principal amount of the notes if the redemption date is prior to October 5, 2019, or 100% of the principal amount of the notes if the redemption date is on or after October 5, 2019, plus, in each case, accrued and unpaid interest to the applicable redemption date.

Note 3 — Inventory

Inventory consists of the following (in thousands):

	September 30, 2018	December 31, 2017
Raw materials	$ 1,802	$ 1,796
Work-in-process	9,339	4,843
Finished goods	2,155	4,087
Total inventory	$ 13,296	$ 10,726

Inventory is generally manufactured upon receipt of firm purchase orders from our collaboration partners. Inventory includes direct materials, direct labor, and manufacturing overhead and cost is determined on a first-in, first-out basis. Inventory is valued at the lower of cost or net realizable value and defective or excess inventory is written down to net realizable value based on historical experience or projected usage.

Note 4 — Liability Related to Sale of Future Royalties

On February 24, 2012, we entered into a Purchase and Sale Agreement (the Purchase and Sale Agreement) with RPI Finance Trust (RPI), an affiliate of Royalty Pharma, pursuant to which we sold, and RPI purchased, our right to receive royalty payments (the Royalty Entitlement) arising from the worldwide net sales, from and after January 1, 2012, of (a) CIMZIA®, under our license, manufacturing and supply agreement with UCB Pharma (UCB), and (b) MIRCERA®, under our license, manufacturing and supply agreement with F. Hoffmann-La Roche Ltd and Hoffmann-La Roche Inc. (together referred to as Roche). We received aggregate cash proceeds of $124.0 million for the Royalty Entitlement. As part of this sale, we incurred approximately $4.4 million in transaction costs, which will be amortized to interest expense over the estimated life of the Purchase and Sale Agreement. Although we sold all of our rights to receive royalties from the CIMZIA® and MIRCERA® products, as a result of our ongoing manufacturing and supply obligations related to the generation of these royalties, we will continue to account for these royalties as revenue. We recorded the $124.0 million in proceeds from this transaction as a liability (Royalty Obligation) that will be amortized using the interest method over the estimated life of the Purchase and Sale Agreement as royalties from the CIMZIA® and MIRCERA® products are remitted directly to RPI. During the nine months ended September 30, 2018 and 2017, we recognized $24.3 million and $21.4 million, respectively, in non-cash royalty revenue from net sales of CIMZIA® and MIRCERA®, and we recorded $14.8 million and $13.5 million, respectively, of related non-cash interest expense.

We periodically assess the estimated royalty payments to RPI from UCB and Roche and to the extent such payments are greater or less than our initial estimates or the timing of such payments is materially different from our original estimates, we will prospectively adjust the amortization of the Royalty Obligation. From inception through 2017, our estimate of the total interest expense on the Royalty Obligation resulted in an effective annual interest rate of approximately 17%. During the three months ended December 31, 2017, as a result of increases in the forecasted sales of CIMZIA®, our estimate of the effective annual interest rate over the life of the agreement increased to 17.6%, which results in a prospective interest rate of approximately 21%.

The Purchase and Sale Agreement grants RPI the right to receive certain reports and other information relating to the Royalty Entitlement and contains other representations and warranties, covenants and indemnification obligations that are customary for a transaction of this nature. To our knowledge, we are currently in compliance with these provisions of the Purchase and Sale Agreement; however, if we were to breach our obligations, we could be required to pay damages to RPI that are not limited to the purchase price we received in the sale transaction.

Note 5 — Commitments and Contingencies

Operating Leases

In May 2018, we entered into a Lease Agreement (the Lease) with Kilroy Realty Finance Partnership, L.P. to lease 135,936 square feet of space located at 360 Third St., San Francisco, California (the Third Street Facility) from 2018 to 2030. An initial 1,726 square feet was delivered in June 2018, and the remaining space is expected to be delivered in phases during the fourth quarter of 2018 and during 2019. The Lease will provide us additional facilities to support increased personnel for our San Francisco-based R&D activities and corporate offices.

The lease term will end on January 31, 2030, subject to our right to extend the term of the Lease for a consecutive five-year period. We have a one-time right of first offer with respect to certain additional rental space at the Third Street Facility. The Lease includes various covenants, indemnities, defaults, termination rights, security deposits and other provisions customary for lease transactions of this nature.

As of September 30, 2018, our minimum lease payments for the delivered space in the Third Street Facility are not material. However, provided that all phases are delivered as expected, our annual base rent on an industrial gross lease basis, which includes certain expenses and property taxes paid directly by the landlord, would be approximately $10.9 million, which will escalate each year over the term at an annual rate of increase of three percent (3%).

Legal Matters

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

rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. If any unfavorable ruling were to occur in any specific period, there exists the possibility of a material adverse impact on the results of our operations of that period and on our cash flows and liquidity.

On October 30, 2018, the Company and its CEO and CFO were named in a putative securities class action entitled, Mulquin v. Nektar Therapeutics et. al., N.D. Cal. The case asserts that for the period of November 11, 2017 through October 2, 2018, the Company's stock was inflated due to alleged misrepresentations about the efficacy and safety of NKTR-214. We believe, however, that the allegations lack merit. The case is in the early stages. Accordingly, we cannot reasonably estimate any range of potential future charges, and we have not recorded any accrual for a contingent liability associated with this legal proceeding. However, an unfavorable resolution could potentially have a material adverse effect on our business, financial condition, and results of operations or prospects, potentially delay or limit our ability to use some of our research and development programs, and potentially result in paying monetary damages.

Indemnifications in Connection with Commercial Agreements

As part of our collaboration agreements with our partners related to the license, development, manufacture and supply of drugs based on our proprietary technologies and drug candidates, we generally agree to defend, indemnify and hold harmless our partners from and against third party liabilities arising out of the agreement, including product liability (with respect to our activities) and infringement of intellectual property to the extent the intellectual property is developed by us and licensed to our partners. The term of these indemnification obligations is generally perpetual any time after execution of the agreement. There is generally no limitation on the potential amount of future payments we could be required to make under these indemnification obligations.

From time to time, we enter into other strategic agreements such as divestitures and financing transactions pursuant to which we are required to make representations and warranties and undertake to perform or comply with certain covenants, including our obligation to RPI described in Note 4. In the event it is determined that we breached certain of the representations and warranties or covenants made by us in any such agreements, we could incur substantial indemnification liabilities depending on the timing, nature, and amount of any such claims.

To date, we have not incurred costs to defend lawsuits or settle claims related to these indemnification obligations. Because the aggregate amount of any potential indemnification obligation is not a stated amount, the overall maximum amount of any such obligations cannot be reasonably estimated. No liabilities have been recorded for these obligations in our Condensed Consolidated Balance Sheets at either September 30, 2018 or December 31, 2017.

Note 6 — License and Collaboration Agreements

We have entered into various collaboration agreements including license agreements and collaborative research, development and commercialization agreements with various pharmaceutical and biotechnology companies. We analyze our agreements to determine whether we should account for the agreements within the scope of ASC 808, Collaborative Arrangements, and, if so, we analyze whether we should account for any elements under the relevant revenue recognition guidance. As described in Note 1, on January 1, 2018, we adopted ASC 606, Revenue Recognition - Revenue from Contracts with Customers, which supersedes the guidance in ASC 605, Revenue Recognition. We recognized revenue under ASC 606 for the nine months ended September 30, 2018 and under ASC 605 for the nine months ended September 30, 2017. In accordance with our collaboration agreements, we recognized

license, collaboration and other revenue as follows (in thousands):

		Three months ended September 30,		Nine months ended September 30,	
Partner	Drug or Drug Candidate	2018	2017	2018	2017
Bristol-Myers Squibb	NKTR-214	$—	$—	$1,059,768	$—
Baxalta Incorporated/Shire	ADYNOVATE®	300	312	10,328	357
Eli Lilly and Company	NKTR-358	3,221	127,553	8,627	127,553
Amgen, Inc.	Neulasta®	1,250	1,250	3,750	3,750
AstraZeneca AB	MOVANTIK® and MOVANTIK® fixed-dose combination program	—	—	—	4,600
Other		104	1,997	375	5,768
License, collaboration and other revenue		$4,875	$131,112	$1,082,848	$142,028

In the three and nine months ended September 30, 2018, we recognized $18.6 million and $64.2 million of revenue for performance obligations that we had satisfied in prior periods. This amount includes all of our royalty revenue and non-cash royalty revenue because these royalties substantially relate to the licenses that we had previously granted. This amount also includes the $10.0 million development milestone payment earned and received from Baxalta in the nine months ended September 30, 2018 described below.

The following table presents the changes in our deferred revenue balance from our collaboration agreements during the nine months ended September 30, 2018 (in thousands):

	Nine months ended September 30, 2018
Deferred revenue—December 31, 2017	$ 37,970
Transition adjustment related to adoption of ASC 606	(1,953)
Additions to deferred revenue	4,000
Recognition of previously unearned revenue	(12,931)
Deferred revenue—September 30, 2018	$ 27,086

Our balance of deferred revenue contains the transaction price from our collaboration agreements allocated to performance obligations which are partially unsatisfied. We expect to recognize approximately $15.7 million of our deferred revenue over the next twelve months and recognize the majority of the remaining $11.4 million over the following twelve months.

As of September 30, 2018, our accounts receivable balance includes $13.1 million of receivables from customer contracts.

As of September 30, 2018, our collaboration agreements with partners included potential future payments for development and regulatory milestones totaling approximately $1.7 billion, including amounts from our agreements with BMS and Lilly described below. In addition, under our collaboration agreements we are entitled to receive contingent sales milestone payments, other contingent payments and royalty payments, as described below.

There have been no material changes to our collaboration agreements in the three and nine months ended September 30, 2018, except as described below.

Bristol-Myers Squibb (BMS): NKTR-214

On February 13, 2018, we entered into a Strategic Collaboration Agreement with BMS (BMS Collaboration Agreement) and Share Purchase Agreement, both of which became effective on April 3, 2018. Pursuant to these agreements, we and BMS will jointly develop NKTR-214, including, without limitation, in combination with BMS's Opdivo® (nivolumab) and Opdivo® plus Yervoy® (ipilimumab), and other compounds of BMS, us or any third party. The parties have agreed to jointly commercialize NKTR-214 on a worldwide basis. We retained the right to record all worldwide sales for NKTR-214. We will share global commercialization profits and losses with BMS for NKTR-214, with Nektar sharing 65% and BMS sharing 35% of the net profits and losses. The parties will share the internal and external development costs for NKTR-214 in combination regimens based on each party's relative ownership interest

in the compounds included in the regimens. In accordance with the agreement, the parties will share development costs for NKTR-214 in combination with Opdivo®, 67.5% of costs to BMS and 32.5% to Nektar, and for NKTR-214 in a triplet combination with Opdivo® and Yervoy®, 78% of costs to BMS and 22% to Nektar.

The BMS Collaboration Agreement superseded and replaced the Clinical Trial Agreement we entered into with BMS in September 2016 to develop NKTR-214 in combination with Opdivo®. Under the Clinical Trial Agreement, we acted as the sponsor of each Combination Therapy Trial and BMS was responsible for 50% of all out-of-pocket costs reasonably incurred in connection with third party contract research organizations, laboratories, clinical sites and institutional review boards. We recorded cost reimbursement payments to us from BMS as a reduction to research and development expense. Each party was otherwise responsible for its own internal costs, including internal personnel costs, incurred in connection with each Combination Therapy Trial.

Upon the effective date in April 2018, BMS paid us a non-refundable upfront cash payment of $1.0 billion. We are eligible to receive additional cash payments up to a total of approximately $1.4 billion upon the achievement of certain development and regulatory milestones and up to a total of $350.0 million upon the achievement of certain sales milestones. In April 2018, BMS also purchased 8,284,600 shares of our common stock for total additional cash consideration of $850.0 million.

We determined that the BMS Collaboration Agreement falls within the scope of ASC 808. As mentioned above, BMS shares certain percentages of development costs incurred by us and we share certain percentages of development costs incurred by BMS. We consider these activities to represent collaborative activities under ASC 808 and we recognize such cost sharing proportionately with the performance of the underlying services. We recognize BMS' reimbursement of our costs as a reduction of research and

development expense and our reimbursement of BMS' costs as research and development expense. During the three and nine months ended September 30, 2018, we recorded $20.7 million and $45.4 million, respectively, as a reduction of research and development expenses for BMS' share of our costs and we recorded $1.8 million and $2.6 million, respectively of research and development expenses for our share of BMS' costs. As of September 30, 2018, we have recorded a receivable of $18.8 million from BMS in accounts receivable in our Condensed Consolidated Balance Sheet.

We analogized to ASC 606 for the accounting for our two performance obligations, consisting of the delivery of the licenses to develop and commercialize NKTR-214 and our participation on joint steering and other collaboration committees. We determined that our committee participation is not material.

We aggregated the total consideration of $1.85 billion received under the agreements and allocated it between the stock purchase and the revenue-generating elements, because we and BMS negotiated the agreements together and the effective date of the BMS Collaboration Agreement was dependent upon the effective date of the Share Purchase Agreement. We recorded the estimated fair value of the shares of $790.2 million in stockholders' equity based on the closing date price of our common stock of $99.36, adjusted for a discount for lack of marketability reflecting the unregistered nature of the shares. We allocated the remaining $1,059.8 million to the transaction price of the collaboration agreement. We consider the future potential development, regulatory and sales milestones of up to approximately $1.8 billion to be variable consideration. We excluded these milestones from the transaction price as of September 30, 2018 because we determined such payments to be fully constrained under ASC 606 as the achievement of such milestone payments are uncertain and highly susceptible to factors outside of our control. We will re-evaluate the transaction price at each reporting period and as uncertain events are resolved or other changes in circumstances occur.

Accordingly, we allocated the entire transaction price of $1,059.8 million to the granting of the licenses and therefore recognized $1,059.8 million in the nine months ended September 30, 2018 as license, collaboration and other revenue.

Eli Lilly and Company (Lilly): NKTR-358

Effective August 23, 2017, we entered into a worldwide license agreement with Eli Lilly and Company (Lilly) to co-develop NKTR-358, a novel immunological drug candidate that we invented. Under the terms of the agreement we (i) received an initial payment of $150.0 million in September 2017 and are eligible for up to $250.0 million in additional development milestones, (ii) will co-develop NKTR-358 with Lilly, for which we are responsible for completing Phase 1 clinical development and certain drug product development and supply activities, (iii) will share with Lilly Phase 2 development costs with 75% of those costs borne by Lilly and 25% of the costs borne by us, (iv) will have the option to contribute funding to Phase 3 development on an indication-by-indication basis ranging from zero to 25% of development costs, and (v) will have the opportunity to receive up to double-digit sales royalty rates that escalate based upon our Phase 3 development cost contribution and the level of annual global product sales. Lilly will be responsible for all costs of global commercialization and we will have an option to co-promote in the U.S. under certain conditions. A portion of the development milestones may be reduced by 50% under certain conditions, related to the final formulation of the approved product and the timing of prior approval (if any) of competitive products with a similar mechanism of action, which could reduce these milestone payments by 75% if both conditions occur.

The agreement will continue until Lilly no longer has any royalty payment obligations or, if earlier, the termination of the agreement in accordance with its terms. The agreement may be terminated by Lilly for convenience, and may also be terminated under certain other circumstances, including material breach.

We identified our license grant to Lilly, our ongoing Phase 1 clinical development obligation and our drug product development obligation as the significant performance obligations in the arrangement. The valuation of each performance obligation involves significant estimates and assumptions, including but not limited to, expected market opportunity and pricing, assumed royalty rates, clinical trial costs, timelines and likelihood of success; in each case these estimates and assumptions covering long time periods. We determined the selling price for the license based on a discounted cash flow analysis of projected revenues from NKTR-358 and development and commercial costs using a discount rate based on a market participant's weighted average cost of capital adjusted for forecasting risk. We determined the selling prices for our Phase 1 clinical development and drug product development deliverables based on the nature of the services to be performed and estimates of the associated efforts and third-party rates for similar services.

Although we are entitled to significant development milestones under this arrangement, we did not include any of such milestones in the transaction price due to the significant uncertainties involved with clinical development. We have therefore determined the transaction price to consist of the upfront payment of $150.0 million in September 2017. Based on our estimates of the standalone selling prices of the performance obligations, we allocated the $150.0 million upfront payment as $125.9 million to the license, $17.6 million to the Phase 1 clinical development and $6.5 million to the drug product development.

Under our adoption of ASC 606 as of January 1, 2018, we made no changes to our deferred revenue balance. We concluded that it was appropriate to have recognized the $125.9 million of revenue allocated to the license upon the effective date of the license

agreement in August 2017, since we determined that the license was a right to use our intellectual property, for which, as of the effective date, we had provided all necessary information to Lilly to benefit from the license and the license term had begun. We recognize revenue for the Phase 1 clinical development and drug product development using an input method, using costs incurred, as this method depicts our progress towards providing Lilly with the results of clinical trials and drug production processes. As of September 30, 2018, we have deferred revenue of approximately $11.3 million related to this agreement, which we expect to recognize through December 2019, the estimated end of our performance obligations under this agreement.

Baxalta Incorporated/Shire: Hemophilia

We are a party to an exclusive research, development, license and manufacturing and supply agreement with Baxalta Incorporated (Baxalta), a subsidiary of Shire plc, entered into in September 2005 to develop products designed to improve therapies for Hemophilia A patients using our PEGylation technology. Under the terms of the agreement, we are entitled to research and development funding for our active programs, which are now complete for Factor VIII, and are responsible for supplying Shire with its requirements for our proprietary materials. Shire is responsible for all clinical development, regulatory, and commercialization expenses. The agreement is terminable by the parties under customary conditions.

This Hemophilia A program includes ADYNOVATE®, which was approved by the United States Food and Drug Administration (FDA) in November 2015 for use in adults and adolescents, aged 12 years and older, who have Hemophilia A, and is now marketed in the U.S., the European Union, and many other countries. As a result of the marketing authorization in the EU in January 2018, we earned a $10.0 million development milestone, which was received in March 2018. In addition, we are entitled to sales milestones upon achievement of annual sales targets and royalties based on annual worldwide net sales of products resulting from this agreement.

In October 2017, we entered into a right to sublicense agreement with Baxalta, a subsidiary of Shire, under which we granted to Baxalta the right to grant a nonexclusive sublicense to certain patents that were previously exclusively licensed to Baxalta under our 2005 agreement. Under the right to sublicense agreement, Baxalta paid us $12.0 million in November 2017 and agreed to pay us single digit royalty payments based upon net sales of the products covered under the sublicense throughout the term of the agreement.

Under our adoption of ASC 606 as of January 1, 2018, we determined that our satisfied performance obligations consist of granting the license, granting the right to sublicense and performing research and development services. We determined that we have an unsatisfied performance obligation related to our ongoing supply of PEGylation materials at a price less than their standalone selling prices. We updated the arrangement transaction price for the $10.0 million EU approval milestone upon achievement in January 2018 since we had previously excluded it due to the significant uncertainty from regulatory approval. Based on the terms of this milestone, we allocated the entire milestone to the license grant and research and development services, and therefore recognized the entire $10.0 million in the nine months ended September 30, 2018 as we had previously satisfied those performance obligations. As of September 30, 2018, we have deferred revenue of $0.9 million related to this agreement.

Amgen, Inc.: Neulasta®

In October 2010, we amended and restated an existing supply and license agreement by entering into a supply, dedicated suite and manufacturing guarantee agreement (the amended and restated agreement) and a license agreement with Amgen Inc. and Amgen Manufacturing, Limited (together referred to as Amgen). Under the terms of the amended and restated agreement, we received a $50.0 million payment in the fourth quarter of 2010 in return for our guaranteeing the supply of certain quantities of our proprietary PEGylation materials to Amgen.

Under our adoption ASC 606 as of January 1, 2018, we determined that our obligation to manufacture and supply of our PEGylation materials and to maintain the dedicated manufacturing suite solely for the production of such materials for Amgen represented an obligation to stand ready to manufacture such materials. We concluded that we should recognize revenue based on the passage of time as this method depicts the satisfaction of Amgen's right to require production of PEGylation materials at any time. As of September 30, 2018, we have deferred revenue of approximately $10.4 million related to this agreement, which we expect to recognize through October 2020, the estimated end of our obligations under this agreement.

AstraZeneca AB: MOVANTIK® (naloxegol oxalate), previously referred to as naloxegol and NKTR-118, and MOVANTIK® fixed-dose combination program, previously referred to as NKTR-119

In September 2009, we entered into an agreement with AstraZeneca AB (AstraZeneca) under which we granted AstraZeneca a worldwide, exclusive license under our patents and other intellectual property to develop, market, and sell MOVANTIK® and MOVANTIK® fixed-dose combination program. AstraZeneca is responsible for all research, development and commercialization and is responsible for all drug development and commercialization decisions for MOVANTIK® and the MOVANTIK® fixed-dose

combination program. In September 2014 and December 2014, MOVANTIK® /MOVENTIG® was approved in the US and EU, respectively. As of September 30, 2018, we have received a total of $385.0 million of upfront and contingent milestone payments from this agreement, all of which was received in or before 2015. We are entitled to receive up to $75.0 million of commercial launch contingent payments related to the MOVANTIK® fixed-dose combination program, based on development events to be pursued and completed solely by AstraZeneca. In addition, we are entitled to significant and escalating double-digit royalty payments and sales milestone payments based on annual worldwide net sales of MOVANTIK® and MOVANTIK® fixed-dose combination products.

In March 2016, AstraZeneca announced that it had entered into an agreement with ProStrakan Group plc, a subsidiary of Kyowa Hakko Kirin Co. Ltd. (Kirin), granting Kirin exclusive marketing rights to MOVENTIG® in the EU, Iceland, Liechtenstein, Norway and Switzerland. Under our license agreement with AstraZeneca, we and AstraZeneca will share the upfront payment, market access milestone payments, royalties and sales milestone payments made by Kirin to AstraZeneca with AstraZeneca receiving 60% and Nektar receiving 40%. In the nine months ended September 30, 2017, we recognized a total of $4.6 million related to our share of license-related payments made from Kirin to AstraZeneca. As of September 30, 2018, we do not have deferred revenue related to our agreement with AstraZeneca.

Other

In addition, as of September 30, 2018, we have a number of other collaboration agreements, including with our collaboration partners UCB and Halozyme, under which we are entitled to up to a total of $45.5 million of development milestone payments upon achievement of certain development objectives, as well as sales milestones upon achievement of annual sales targets and royalties based on net sales of commercialized products, if any. However, given the current phase of development of the potential products under these collaboration agreements, we cannot estimate the probability or timing of achieving these milestones and, therefore, have excluded all development milestones from the respective transaction prices for these agreements. As of September 30, 2018, we have deferred revenue of approximately $4.5 million related to these other collaboration agreements.

Note 7 — Stock-Based Compensation

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Cost of goods sold	$1,176	$547	$3,470	$1,639
Research and development	15,365	5,212	40,449	14,429
General and administrative	6,746	3,076	19,976	9,050
Total stock-based compensation	$23,287	$8,835	$63,895	$25,118

During the three months ended September 30, 2018 and 2017, we granted 190,000 and 833,290 stock options, respectively, and these options had a weighted average grant-date fair value of $30.52 per share and $10.38 per share, respectively. During the nine months ended September 30, 2018 and 2017, we granted 928,675 and 2,118,310 stock options, respectively, and these options had a weighted average grant-date fair value of $39.28 per share and $9.36 per share, respectively. During the three and nine months ended September 30, 2018, we granted 152,151 and 558,391 RSUs, respectively. During the three and nine months ended September 30, 2017, we granted 110,500 RSUs.

As a result of stock issuances under our equity compensation plans, during the three months ended September 30, 2018 and 2017, we issued 642,024 and 1,092,371 shares of our common stock, respectively, and during the nine months ended September 30, 2018 and 2017, we issued 5,247,748 and 3,741,140 shares of our common stock, respectively.

Note 8 — Net Income (Loss) Per Share

Basic net income (loss) per share is calculated based on the weighted-average number of common shares outstanding during the periods presented. Diluted net income (loss) per share is calculated based on the weighted-average number of shares of common stock outstanding, including potentially dilutive securities. For all periods presented in the accompanying Condensed Consolidated Statements of Operations, the net income (loss) available to common stockholders is equal to the reported net income (loss).

The calculation of diluted earnings per share includes the weighted-average of potentially dilutive securities, which consists of shares of common stock underlying outstanding stock options and RSUs. The effect of these dilutive securities under the treasury stock method was approximately 11.3 million and 6.2 million shares for the nine months ended September 30, 2018 and three months

ended September 30, 2017, respectively. During the nine months ended September 30, 2018 and three months ended September 30, 2017, shares of common stock underlying outstanding stock options totaling approximately 3.2 million and 1.9 million weighted-average shares outstanding, respectively, were excluded from the computation of diluted net income per share for that period because their effect was antidilutive.

For the three months ended September 30, 2018 and the nine months ended September 30, 2017 and, basic and diluted net loss per share are the same due to our net losses and the requirement to exclude potentially dilutive securities which would have an antidilutive effect on net loss per share. During the three months ended September 30, 2018 and the nine months ended September 30, 2017, potentially dilutive securities consisted of common shares underlying outstanding stock options and RSUs. During the three months ended September 30, 2018 and the nine months ended September 30, 2017, there were weighted average outstanding stock options and RSUs of 17.6 million and 20.4 million shares, respectively.

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

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

Overview

Strategic Direction of Our Business

Nektar Therapeutics is a research-based biopharmaceutical company that discovers and develops innovative new medicines in areas of high unmet medical need. Our research and development pipeline of new investigational drugs includes treatments for cancer, autoimmune disease and chronic pain. We leverage our proprietary and proven chemistry platform to discover and design new drug candidates. These drug candidates utilize our advanced polymer conjugate technology platforms, which are designed to enable the development of new molecular entities that target known mechanisms of action.

We continue to make significant investments in building and advancing our pipeline of proprietary drug candidates as we believe that this is the best strategy to build stockholder value. Described below are certain key events and activities where we are making investments in advancing our research and development pipeline.

Immunooncology

- On February 13, 2018, we entered into the BMS Collaboration Agreement, pursuant to which we and BMS are working to jointly develop NKTR-214, our lead immunooncology drug candidate, in combination with BMS's Opdivo® (nivolumab) and/or Opdivo® plus Yervoy® (ipilimumab), in more than 20 indications across nine tumor types, as well as potential combinations with other anti-cancer agents from BMS, us and third parties. On April 3, 2018, the closing date of the transaction, BMS made a non-refundable upfront cash payment of $1.0 billion to us under the BMS Collaboration Agreement. On April 3, 2018, BMS also paid the purchase price of $102.60 per share for the sale and issuance of 8,284,600 shares of our common stock, or a total of approximately $850.0 million, under a Share Purchase Agreement. On June 2, 2018, at the 2018 American Society of Clinical Oncology (ASCO) Annual Meeting, we presented interim data from the PIVOT-02 Phase 1/2 study, which is designed to evaluate the combination of NKTR-214 with BMS's Opdivo® (nivolumab) across several tumor types. On September 14, 2018, a study of NKTR-214 combined with Opdivo was initiated in patients with previously untreated inoperable or metastatic melanoma and this trial is currently enrolling subjects.
    - In 2017, as part of our broad Phase 1/2 clinical collaboration with BMS in five tumor types and eight potential indications, we commenced a broad clinical development program for NKTR-214 in combination with other immunooncology agents, including a dose-escalation study in combination with Opdivo® (nivolumab), and numerous preclinical collaboration programs. In 2017, we also began dosing a clinical study evaluating the efficacy and safety of NKTR-214 in combination with approved immunooncology agents, TECENTRIQ® (atezolizumab) and KEYTRUDA® (pembrolizumab).
- In the last half of 2017, we completed enrollment in the dose-escalation phase of the NKTR-214 study evaluating NKTR-214 in combination with Opdivo® (nivolumab) in patients with melanoma, renal cell carcinoma and non-small cell lung cancer which we call the PIVOT-02 study. On November 11, 2017, we announced interim data from the dose-escalation phase of the PIVOT-02 Phase 1/2 study. We have identified the Phase 2 dose for NKTR-214 and are currently enrolling subjects in the expansion phase of the study.
- We filed the IND for NKTR-262 in December 2017, initiated enrollment of patients in the initial Phase 1/2 study in April 2018, and we are currently enrolling subjects in the dose-escalation portion of the study. We are also completing preclinical research for NKTR-255 with the goal of advancing this program into the clinic in 2019.

- On May 30, 2018 we announced a collaboration with Syndax Pharmaceuticals, Inc. (Syndax) to evaluate the safety and efficacy of NKTR-214 in combination with Syndax's oral, small molecule Class 1 specific HDAC inhibitor, entinostat, in patients with metastatic melanoma.
- On April 24, 2018, we announced a clinical collaboration with Takeda Pharmaceutical Company Limited (Takeda) to evaluate NKTR-214 with Takeda's investigational medicine, TAK-659, a dual inhibitor of both spleen tyrosine kinase (SYK) and FLT-3.

Immunology

- In February 2017, we filed an investigational new drug (IND) application for NKTR-358, our autoimmune disease drug candidate. We began the Phase 1 clinical study to evaluate single-ascending doses of NKTR-358 in healthy volunteers in March 2017. On July 24, 2017, we entered into a license agreement with Lilly to co-develop NKTR-358. This study is designed to establish a range of dose levels and evaluate pharmacokinetics and safety. A Phase 1 multiple-ascending dose trial which was initiated in May of 2018 is currently enrolling subjects to evaluate NKTR-358 in patients with systemic lupus erythematosus.

Pain

- On July 30, 2018, we announced that the NDA for NKTR-181 for the treatment of chronic low back pain in adult patients new to opioid therapy was accepted by the FDA for review. The FDA has assigned a Prescription Drug User Fee Act (PDUFA) target action date of May 29, 2019. On March 20, 2017, we announced that NKTR-181 met its primary and secondary endpoints in the SUMMIT-07 Phase 3 efficacy study. On July 18, 2017, we announced positive top-line data for our pivotal human abuse potential study (the HAP study) for NKTR-181. The HAP study was designed to assess the relative oral abuse potential of NKTR-181 at its highest tested therapeutic dose as well as at the highest dose to which patients have been exposed in our long-term safety study and at a supratherapeutic dose compared to common therapeutic doses of oxycodone, a Schedule II opioid. If approved, we are evaluating several strategic alternatives to commercialize NKTR-181 including, without limitation, establishing a separate subsidiary company or joint venture with one or more partners with commercial capabilities and/or strategic capital partners. Since we have not yet established a commercial launch capability for NTKR-181, if approved, there remains substantial risk and uncertainties related to successful and timely completion of this process.

The level of our future research and development investment will depend on a number of trends and uncertainties including clinical outcomes, future studies required to advance programs to regulatory approval, and the economics related to potential future collaborations that may include upfront payments, development funding, milestones, and royalties.

We have historically derived all of our revenue and substantial amounts of operating capital from our collaboration agreements including the BMS collaboration for NKTR-214 that was completed on April 3, 2018, pursuant to which we recognized $1.06 billion in revenue and recorded $790.2 million in additional paid in capital for shares of our common stock issued in the transaction. While in the near-term we continue to expect to generate substantially all of our revenue from collaboration arrangements, including the potential $1.78 billion in development and regulatory milestones under the BMS collaboration, in the medium- to long-term our plan is to generate significant revenue from proprietary products. Since we do not have experience commercializing products or an established commercialization organization, there will be substantial risks and uncertainties in future years as we build commercial, organizational, and operational capabilities.

We also have significant milestone and royalty economic interests in approved drugs and drug candidates in late stage development with our collaboration partners. With AstraZeneca, we have a collaboration for MOVANTIK®, an oral peripherally-acting mu-opioid antagonist for the treatment of opioid-induced constipation in adult patients with non-cancer pain. MOVANTIK® is approved by health authorities in the United States, the European Union, and many other countries. We have a collaboration with Baxalta (a wholly-owned subsidiary of Shire plc) for ADYNOVATE®, that was approved by the FDA in late 2015 for use in adults and adolescents, aged 12 years and older, who have Hemophilia A. ADYNOVI™ was approved by health authorities in Europe in January 2018, and ADYNOVATE® is approved by health authorities in many other countries.

Our business is subject to significant risks, including the risks inherent in our development efforts, the results of our clinical trials, our dependence on the marketing efforts by our collaboration partners, uncertainties associated with

obtaining and enforcing patents, the lengthy and expensive regulatory approval process and competition from other products. For a discussion of these and some of the other key risks and uncertainties affecting our business, see Part II, Item 1A "Risk Factors."

While the approved drugs and clinical development programs described above are key elements of our future success, we believe it is critically important that we continue to make substantial investments in our earlier-stage drug candidate pipeline. We have several drug candidates in earlier stage clinical development or being explored in research that we are preparing to advance into the clinic in future years. We are also advancing several other drug candidates in preclinical development in the areas of cancer immunotherapy, immunology, and other therapeutic indications. While we believe that our substantial investment in research and development has the potential to create significant value if one or more of our drug candidates demonstrates positive clinical results, receives regulatory approval in one or more major markets and achieves commercial success, drug research and development is an inherently uncertain process and there is a high risk of failure at every stage prior to approval and the timing and outcome of clinical trial results are extremely difficult to predict. Clinical development successes and failures can have a disproportionately positive or negative impact on our scientific and medical prospects, financial condition and prospects, results of operations and market value.

Historically, we have entered into a number of license and supply contracts under which we manufactured and supplied our proprietary polymer reagents on a fixed price or cost-plus basis. Our current strategy is to manufacture and supply polymer reagents to support our proprietary drug candidates or our third-party collaborators where we have a strategic development and commercialization relationship or where we derive substantial economic benefit.

Key Developments and Trends in Liquidity and Capital Resources

We estimate that we have working capital to fund our current business plans through at least the next twelve months. As of September 30, 2018, we had approximately $2.0 billion in cash and investments in marketable securities and had debt of $250.0 million in principal of senior secured notes due in October 2020.

Results of Operations

Three and Nine Months Ended September 30, 2018 and 2017

Revenue (in thousands, except percentages)

	Three months ended September 30,		Increase/ (Decrease) 2018 vs. 2017	Percentage Increase/ (Decrease) 2018 vs. 2017
	2018	2017		
Product sales	$4,256	$4,448	$(192)	(4)%
Royalty revenue	10,259	9,302	957	10 %
Non-cash royalty revenue related to sale of future royalties	8,372	8,066	306	4 %
License, collaboration and other revenue	4,875	131,112	(126,237)	(96)%
Total revenue	$27,762	$152,928	$(125,166)	(82)%

	Nine months ended September 30,		Increase/ (Decrease) 2018 vs. 2017	Percentage Increase/ (Decrease) 2018 vs. 2017
	2018	2017		
Product sales	$16,414	$24,897	$(8,483)	(34)%
Royalty revenue	29,898	23,953	5,945	25 %
Non-cash royalty revenue related to sale of future royalties	24,337	21,367	2,970	14 %
License, collaboration and other revenue	1,082,848	142,028	940,820	>100 %
Total revenue	$1,153,497	$212,245	$941,252	>100 %

As described in Note 1 to our Condensed Consolidated Financial Statements, on January 1, 2018, we adopted Accounting Standards Codification (ASC) 606, Revenue Recognition - Revenue from Contracts with Customers. ASC 606 supersedes the guidance in ASC 605, Revenue Recognition. We adopted ASC 606 on a modified retrospective basis under which we recognized the $12.7 million cumulative effect of adoption as a reduction to opening accumulated deficit. Revenue for the nine months ended September 30, 2017 was recorded under ASC 605, while revenue for the nine months ended September 30, 2018 was recorded under ASC 606. If we had continued to use ASC 605 during 2018, revenue would have been $27.4 million and $1,154.3 million in the three and nine months ended September 30, 2018, respectively.

Our revenue is derived from our collaboration agreements, under which we may receive product sales revenue, royalties, license fees, milestone and other contingent payments and/or contract research payments. Revenue is recognized when we transfer promised goods or services to our collaboration partners. The amount of upfront fees received under our license and collaboration agreements allocated to continuing obligations, such as manufacturing and supply commitments, is generally recognized as we deliver products or provide development services. As a result, there may be significant variations in the timing of receipt of cash payments and our recognition of revenue. We make our best estimate of the timing and amount of products and services expected to be required to fulfill our performance obligations. Given the uncertainties in research and development collaborations, significant judgment is required by us to make these estimates.

Product Sales

Product sales include predominantly fixed price manufacturing and supply agreements with our collaboration partners and are the result of firm purchase orders from those partners. The timing of shipments is based solely on the demand and requirements of our collaboration partners and is not ratable throughout the year.

Product sales decreased for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 primarily due to decreased product demand from Ophthotech Corporation as a result of the termination in October 2017 of our collaboration agreement. We expect product sales for the full year of 2018 to decrease compared to 2017 primarily due to the termination of the Ophthotech agreement.

Royalty Revenue

We receive royalty revenue from certain of our collaboration partners based on their net sales of commercial products. Royalty revenue for AstraZeneca's MOVANTIK® and MOVENTIG® and Baxalta's (a wholly-owned subsidiary of Shire plc) ADYNOVATE®, each of which was launched in 2015, increased for the three and nine months ended September 30, 2018 compared to the three and nine months ended September 30, 2017. We expect royalty revenue for the full year of 2018 to increase as compared to 2017 due to royalties we expect to receive as a result of continued sales growth of ADYNOVATE® and the approval of ADYNOVI™ in the EU in January 2018.

As part of its approval of MOVANTIK®, the FDA required AstraZeneca to perform a post-marketing, observational epidemiological study comparing MOVANTIK® to other treatments of opioid-induced constipation in patients with chronic, non-cancer pain. As a result, the royalty rate payable to us from net sales of MOVANTIK® in the U.S. by AstraZeneca can be reduced by up to two percentage points to fund 33% of the external costs incurred by AstraZeneca to fund such post approval study, subject to a $35.0 million aggregate cap. As of September 30, 2018, our cumulative share of the post-approval study expenses has been $1.1 million. Any costs incurred by AstraZeneca can only be recovered by the reduction of the royalty paid to us. In no case can amounts be recovered by the reduction of a contingent payment due from AstraZeneca to us or through a payment from us to AstraZeneca.

Non-cash Royalty Revenue Related to Sale of Future Royalties

In February 2012, we sold all of our rights to receive future royalty payments on CIMZIA® and MIRCERA®. As described in Note 4 to our Condensed Consolidated Financial Statements, this royalty sale transaction has been recorded as a liability that amortizes over the estimated royalty payment period. As a result of this liability accounting, even though the royalties from UCB and Roche are remitted directly to the purchaser of these royalty interests, we will continue to record revenue for these royalties. We expect non-cash royalties from net sales of CIMZIA® and MIRCERA® for the full year of 2018 to increase compared to 2017.

License, Collaboration and Other Revenue

License, collaboration and other revenue includes the recognition of upfront payments, milestone and other contingent payments received in connection with our license and collaboration agreements and certain research and development activities. The level of license, collaboration and other revenue depends in part upon the achievement of milestones and other contingent events, the continuation of existing collaborations, the amount of our research and development services, and entering into new collaboration agreements, if any.

License, collaboration and other revenue increased for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 primarily due to the recognition of $1,059.8 million from the BMS Collaboration Agreement as described in Note 6 to our Condensed Consolidated Financial Statements. In addition,

during the nine months ended September 30, 2018, we recognized a $10.0 million milestone payment received in March 2018 as a result of the marketing authorization of ADYNOVI™ in the EU in January 2018. During the three and nine months ended September 30, 2017, we recognized $127.6 million of the $150.0 million upfront payment we received in September 2017 from our collaboration agreement with Eli Lilly for NKTR-358 as described in Note 6 to our Condensed Consolidated Financial Statements.

We expect that our license, collaboration and other revenue will increase significantly in the full year of 2018 compared to 2017 as a result of the BMS Collaboration Agreement.

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

	Three months ended September 30,		Increase/ (Decrease) 2018 vs. 2017	Percentage Increase/ (Decrease) 2018 vs. 2017
	2018	2017		
Cost of goods sold	$4,783	$5,674	$ (891)	(16)%
Product gross profit	(527)	(1,226)	699	(57)%
Product gross margin	(12)%	(28)%		

	Nine months ended September 30,		Increase/ (Decrease) 2018 vs. 2017	Percentage Increase/ (Decrease) 2018 vs. 2017
	2018	2017		
Cost of goods sold	$16,951	$20,794	$ (3,843)	(18)%
Product gross profit	(537)	4,103	(4,640)	>(100)%
Product gross margin	(3)%	16 %		

As noted above, our strategy is to manufacture and supply polymer reagents to support our proprietary drug candidates or our third-party collaborators where we have a strategic development and commercialization relationship or where we derive substantial economic benefit. We have elected to only enter into and maintain those manufacturing relationships associated with long-term collaboration agreements which include multiple sources of revenue, which we view holistically and in aggregate. We have a predominantly fixed cost base associated with our manufacturing activities, which generally results in similar total cost of goods sold amounts each year. As a result, our product gross profit and margin are significantly impacted by the mix and volume of products sold in each period.

Cost of goods sold decreased during the three and nine months ended September 30, 2018 compared to the three and nine months ended September 30, 2017 primarily due to decreased product sales. The decrease in product gross profit and product gross margin during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 is primarily due to decreased product sales as well as a more unfavorable product mix in 2018 compared to 2017. We have a manufacturing arrangement with a partner that includes a fixed price which is less than the fully burdened manufacturing cost for the reagent, and we expect this situation to continue with this partner in future years. There were more shipments to this partner relative to shipments to other customers during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. In addition to product

sales from reagent materials supplied to the partner where our sales are less than our fully burdened manufacturing cost, we also receive royalty revenue from this collaboration. In the three and nine months ended September 30, 2018 and 2017, the royalty revenue from this collaboration exceeded the related negative gross profit.

We expect product gross margin to continue to fluctuate in future periods depending on the level and mix of manufacturing orders from our customers due to the predominantly fixed cost base associated with our manufacturing activities. We currently expect product gross margin to decrease for the full year of 2018 as compared to 2017 and gross margin may be negative in the full year of 2018 as a result of the anticipated decrease in product sales described above.

Research and Development Expense (in thousands, except percentages)

	Three months ended September 30,		Increase/ (Decrease) 2018 vs. 2017	Percentage Increase/ (Decrease) 2018 vs. 2017	
	2018	2017			
Research and development expense	$102,895	$65,714	$37,181	57	%

	Nine months ended September 30,		Increase/ (Decrease) 2018 vs. 2017	Percentage Increase/ (Decrease) 2018 vs. 2017	
	2018	2017			
Research and development expense	$290,653	$187,032	$103,621	55	%

Research and development expense consists primarily of clinical study costs, contract manufacturing costs, direct costs of outside research, materials, supplies, licenses and fees as well as personnel costs (including salaries, benefits, and stock-based compensation). Research and development expense also includes certain overhead allocations consisting of support and facilities-related costs. Where we perform research and development activities under a clinical joint development collaboration, such as our collaboration with BMS, we record the cost reimbursement from our partner as a reduction to research and development expense when reimbursement amounts are due to us under the agreement.

Research and development expense increased during the three and nine months ended September 30, 2018 compared to the three and nine months ended September 30, 2017 primarily due to our clinical development of NKTR-214, NKTR-262, NKTR-358, and preclinical activities for NKTR-255, as well as pre-commercial manufacturing and costs related to our NDA filing for NKTR-181. In addition, the increase in research and development expense during the three and nine months ended September 30, 2018 compared with the three and nine months ended September 30, 2017 includes increases in non-cash stock-based compensation and other personnel costs. These increases were partially offset by cost reimbursements by BMS under our collaboration agreement. During the three months ended September 30, 2018 and 2017, we recorded reductions to research and development expense for BMS' reimbursements of our costs of $20.7 million and $2.3 million, respectively. During the nine months ended September 30, 2018 and 2017, we recorded reductions to research and development expense for BMS' reimbursements of our costs of $45.4 million and $5.8 million, respectively. We expect research and development expense to increase significantly for the full year of 2018 compared to 2017 primarily as a result of the development of NKTR-214 under the BMS Collaboration Agreement. In addition, we expect non-cash stock-based compensation expense to increase in 2018 primarily due to

the increases in our stock price in 2017 and 2018 compared to the prior years.

Other than as described in the Overview section above, there have been no material changes to the status of clinical programs in the nine months ended September 30, 2018 from the activities discussed in our Annual Report on Form 10-K for the year ended December 31, 2017 on file with the SEC.

General and Administrative Expense (in thousands, except percentages)

	Three months ended September 30,		Increase/ (Decrease) 2018 vs. 2017	Percentage Increase/ (Decrease) 2018 vs. 2017	
	2018	2017			
General and administrative expense	$18,718	$12,055	$ 6,663	55	%

	Nine months ended September 30,		Increase/ (Decrease) 2018 vs. 2017	Percentage Increase/ (Decrease) 2018 vs. 2017	
	2018	2017			
General and administrative expense	$57,666	$40,027	$ 17,639	44	%

General and administrative expense includes the cost of administrative staffing, business development, marketing, finance, and legal activities. General and administrative expense increased during the three and nine months ended September 30, 2018 compared

with the three and nine months September 30, 2017 primarily due to increased non-cash stock based compensation expense as well as other costs related to personnel, facilities and outside services. We expect general and administrative expenses in the full year of 2018 to increase compared to 2017, including an increase in non-cash stock-based compensation expense primarily due to the increases in our stock price in 2017 and 2018 compared to the prior years.

Interest Expense (in thousands, except percentages)

	Three months ended September 30,		Increase/ (Decrease) 2018 vs. 2017	Percentage Increase/ (Decrease) 2018 vs. 2017
	2018	2017		
Interest expense	$5,442	$5,540	$ (98)	(2)%
Non-cash interest expense on liability related to sale of future royalties	4,814	4,471	343	8 %

	Nine months ended September 30,		Increase/ (Decrease) 2018 vs. 2017	Percentage Increase/ (Decrease) 2018 vs. 2017
	2018	2017		
Interest expense	$16,167	$16,452	$ (285)	(2)%
Non-cash interest expense on liability related to sale of future royalties	14,808	13,535	1,273	9 %

Interest expense for the three and nine months ended September 30, 2018 decreased marginally compared with the three and nine months ended September 30, 2017 due to decreased interest expense from our capital leases, which were fully repaid as of December 31, 2017. Interest expense during the three and nine months ended September 30, 2018 and 2017 primarily consists of interest from our senior secured notes. In October 2015, we issued $250.0 million in aggregate principal amount of 7.75% senior secured notes due October 2020. Interest on the 7.75% senior secured notes is calculated based on actual days outstanding over a 360 day year. We expect interest expense during the full year of 2018 to decrease marginally compared to 2017.

Non-cash interest expense on the liability related to sale of future royalties for the three and nine months ended September 30, 2018 increased compared with the three and nine months ended September 30, 2017 as a result of the increase to our estimated interest rate. On February 24, 2012, we sold all of our rights to receive future royalty payments on CIMZIA® and MIRCERA® in exchange for $124.0 million. As described in Note 4 to our Condensed Consolidated Financial Statements, this royalty sale transaction has been recorded as a liability that amortizes over the estimated royalty payment period as CIMZIA® and MIRCERA® royalties are remitted directly to the purchaser. We impute interest on the transaction and record interest expense at the effective interest rate, which we estimated to be approximately 17% from inception to 2017. During the three month period ended December 31, 2017, as a result of increases in the forecasted sales of CIMZIA®, our estimate of the effective annual interest rate over the life of the agreement increased to approximately 17.6%, which results in a prospective interest rate of 21%. There are a number of factors that could materially affect the estimated interest rate, in particular, the amount and timing of royalty payments from future net sales of CIMZIA® and MIRCERA®, and we will assess this estimate on a periodic basis. As a result, future interest rates could differ significantly and any such change in interest rate will be adjusted prospectively. Unless we adjust our estimated interest rate, we expect non-cash interest expense on the liability related to sale of future royalties for the full year of 2018 to increase marginally compared to 2017 as a result of the increase of the estimated prospective interest rate noted above.

Interest Income and Other Income (Expense), net (in thousands, except percentages)

	Three months ended September 30,		Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2018	2017	2018 vs. 2017	2018 vs. 2017
Interest income and other income (expense), net	$11,847	$1,599	$ 10,248	>100%

	Nine months ended September 30,		Increase/ (Decrease)	Percentage Increase/ (Decrease)
	2018	2017	2018 vs. 2017	2018 vs. 2017
Interest income and other income (expense), net	$25,523	$3,163	$ 22,360	>100%

Interest income and other income (expense) for the three and nine months ended September 30, 2018 increased significantly compared to the three and nine months ended September 30, 2017 primarily due to increased interest income resulting from our investments in debt securities purchased with the $1.85 billion received in April 2018 from BMS under the BMS Collaboration Agreement and the Share Purchase Agreement. We expect that our interest income and other income (expense), net will increase significantly in the full year of 2018 compared to 2017 as a result of the increased interest income resulting from our increased investments balances.

Income Tax Expense

For the three and nine months ended September 30, 2017, we recorded an income tax provision at an effective tax rate of approximately 35% as a result of taxable income at our Nektar India operations. For the nine months ended September 30, 2018, as a result of expected taxable income in India and the U.S. for the full year of 2018 resulting primarily from income recognized from the upfront payment from BMS, we recorded a global income tax provision at an effective tax rate of approximately 0.4%. The income tax benefit for the three months ended September 30, 2018 reflects our pre-tax loss for the three months ended September 30, 2018. We expect to have tax liabilities in certain states where we do not have sufficient net operating losses to offset our estimated apportioned taxable income. Our effective tax rate is based on certain assumptions and other estimates regarding the apportionment of taxable income and the states in which we have nexus in 2018. Our apportionment of taxable income includes estimates of the apportionment of the BMS upfront payment based on estimates of activities to be carried out under the collaboration agreement with BMS, as well as estimates of the apportionment of other sources of income. We will refine our estimates in future periods as more information becomes available.

Our effective tax rate reflects the release of the valuation allowance of net operating loss carryforwards and other tax credits to offset U.S. federal and state taxable income. It also reflects a benefit of $2.0 million for stock-based compensation windfalls during the nine months ended September 30, 2018. Our remaining deferred tax assets continue to be fully reserved, as we believe it is not more likely than not that the benefit of such assets will be realized in the future.

Our effective tax rate in 2018, including the benefit from utilization of net operating loss carryforwards and stock-based compensation windfalls, may vary based on changes in our estimates of taxable income, apportionment of the BMS upfront payment as well as other sources of income, and net operating loss carryforwards in states where we have previously not filed tax returns.

The U.S. Tax Cuts and Jobs Act was enacted on December 22, 2017 and reduces the U.S. federal corporate tax rate from 35% in 2017 to 21% in 2018.

Liquidity and Capital Resources

We have financed our operations primarily through revenue from product sales, royalties and strategic collaboration agreements, as well as public offering and private placements of debt and equity securities. At September 30, 2018, we had approximately $2.0 billion in cash and investments in marketable securities and had debt of $250.0 million in principal of senior secured notes due on October 2020.

We estimate that we have working capital to fund our current business plans through at least the next twelve months. We expect the clinical development of our proprietary drug candidates, including NKTR-214, NKTR-358, NKTR-262, NKTR-255, NKTR-181, and ONZEALD®, will continue to require significant investment in order to continue to advance in clinical development and to obtain

regulatory approval, as well as for NKTR-181 commercialization activities. In the past, we have received a number of significant payments from collaboration agreements and other significant transactions. In April 2018, we received a total of $1.85 billion from BMS under the BMS Collaboration Agreement and the Share Purchase Agreement. In addition, in July 2017, we entered into a collaboration agreement for NKTR-358 with Lilly, under which we received a $150.0 million upfront payment. In the future, we expect to receive substantial payments from our collaboration agreements with BMS and Lilly and other existing and future collaboration transactions if drug candidates in our pipeline achieve positive clinical or regulatory outcomes. We have no credit facility or any other sources of committed capital.

Due to the potential for adverse developments in the credit markets, we may experience reduced liquidity with respect to some of our investments in marketable securities. These investments are generally held to maturity, which, in accordance with our investment policy, is less than two years. However, if the need arises to liquidate such securities before maturity, we may experience losses on liquidation. At September 30, 2018, the average time to maturity of the investments held in our portfolio was approximately eight months. To date we have not experienced any liquidity issues with respect to these securities. We believe that, even allowing for potential liquidity issues with respect to these securities, our remaining cash and investments in marketable securities will be sufficient to meet our anticipated cash needs for at least the next twelve months.

Our current business plan is subject to significant uncertainties and risks as a result of, among other factors, clinical and regulatory outcomes for NKTR-214, the sales levels of our products, if and when they are approved, the sales levels for those products for which we are entitled to royalties, clinical program outcomes, whether, when and on what terms we are able to enter into new collaboration transactions, expenses being higher than anticipated, unplanned expenses, cash receipts being lower than anticipated, and the need to satisfy contingent liabilities, including litigation matters and indemnification obligations.

The availability and terms of various financing alternatives, if required in the future, substantially depend on many factors including the success or failure of drug development programs in our pipeline. The availability and terms of financing alternatives and any future significant payments from existing or new collaborations depend on the positive outcome of ongoing or planned clinical studies, whether we or our partners are successful in obtaining regulatory authority approvals in major markets, and if approved, the commercial success of these drugs, as well as general capital market conditions. We may pursue various financing alternatives to fund the expansion of our business as appropriate.

Cash flows from operating activities

Cash flows provided by operating activities for the nine months ended September 30, 2018 totaled $835.8 million, which includes $1,059.8 million of the payments received under the BMS Collaboration Agreement in April 2018 and a $10.0 million milestone payment from our collaboration agreement with Baxalta, partially offset by $219.3 million of net operating cash uses as well as $14.7 million for interest payments on our senior secured notes.

Cash flows used in operating activities for the nine months ended September 30, 2017 were less than $0.1 million, which includes $146.8 million of net operating cash uses as well as $14.6 million for interest payments on our senior secured notes, partially offset by the receipt of $161.4 million of milestones and advance payments from our collaboration agreements.

We expect that cash flows used in operating activities, excluding upfront, milestone and other contingent payments received, will increase in the full year of 2018 compared to 2017 primarily as a result of increased research and development expenses.

Cash flows from investing activities

We paid $5.6 million and $7.3 million to purchase property, plant and equipment in the nine months ended September 30, 2018 and 2017, respectively. In the nine months ended September 30, 2018, we received proceeds of $2.6 million for the sale of property, plant and equipment. We expect our capital expenditures in the full year of 2018 to be consistent with 2017.

During the nine months ended September 30, 2018, we purchased $1,476.5 million of investments in debt securities, net of maturities of investments, primarily as a result of the $1.85 billion received in April 2018 from BMS under the BMS Collaboration Agreement and the Share Purchase Agreement.

Cash flows from financing activities

We received $790.2 million for the issuance of our common stock to BMS under our Share Purchase Agreement in April 2018. We received proceeds from issuance of common stock related to our employee option and stock purchase plans of $59.1 million and $32.3 million in the nine months ended September 30, 2018 and 2017, respectively.

Contractual Obligations

Other than the lease agreement with Kilroy Realty Finance Partnership, L.P., as described in Note 5 to our Condensed Consolidated Financial Statements, there were no material changes during the nine months ended September 30, 2018 to the summary of contractual obligations included in our Annual Report on Form 10-K for the year ended December 31, 2017 on file with the SEC.

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

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

We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. We evaluate our estimates on an ongoing basis. Actual results may differ from those estimates under different assumptions or conditions. Other than as the result of the adoption of the new revenue recognition guidance (ASC 606) as described in Note 1 to our Condensed Consolidated Financial Statements, there have been no material changes to our critical accounting policies and estimates discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our market risks at September 30, 2018 have not changed materially from those discussed in Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2017 on file with the SEC.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

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

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the

effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon, and as of the date of, this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

We continuously seek to improve the efficiency and effectiveness of our internal controls. This results in refinements to processes throughout the Company. However, there was no change in our internal control over financial reporting that occurred in the three months ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Limitations on the Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Additionally,

controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

Reference is hereby made to our disclosures in “Legal Matters” under Note 5 to our Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q and the information under the heading “Legal Matters” is incorporated by reference herein.

Item 1A. Risk Factors

Investors in Nektar Therapeutics should carefully consider the risks described below before making an investment decision. The risks described below may not be the only ones relating to our company. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017. Additional risks that we currently believe are immaterial may also impair our business operations. Our business, results of operations, financial condition, cash flows and future prospects and the trading price of our common stock and our ability to repay our senior secured notes could be harmed as a result of any of these risks, and investors may lose all or part of their investment. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2017, including our consolidated financial statements and related notes, and our other filings made from time to time with the SEC.

Risks Related to Our Business

We are highly dependent on the success of NKTR-214, our lead I-O candidate. We are executing a broad development program for NKTR-214 and clinical and regulatory outcomes for NKTR-214, if not successful, will significantly harm our business.

Our future success is highly dependent on our ability to successfully develop, obtain regulatory approval for, and commercialize NKTR-214. In general, most early stage investigatory drugs, including oncology drug candidates such as NKTR-214, do not become approved drugs. Accordingly, there is a very meaningful risk that NKTR-214 will not succeed in one or more clinical trials sufficient to support one or more regulatory approvals. To date, reported clinical outcomes from NKTR-214 have had a significant impact on our market valuation, financial position, and business prospects and we expect this to continue in future periods. If one or more clinical studies of NKTR-214 are delayed or not successful, it would materially harm our market valuation, prospects, financial condition and results of operations. For example, under the BMS Collaboration Agreement, we are entitled to up to $1.43 billion in development milestones that are based upon clinical and regulatory successes from the NKTR-214 development program. One or more failures in NKTR-214 studies could jeopardize such milestone payments, and any product sales or royalty revenue or commercial milestones that we would otherwise be entitled to receive could be reduced, delayed or eliminated.

Delays in clinical studies are common and have many causes, and any significant delay in clinical studies being conducted by us or our partners could result in delay in regulatory approvals and jeopardize the ability to proceed to

commercialization.

We or our partners may experience delays in clinical trials of drug candidates. We have ongoing trials evaluating NKTR-214 including a trial evaluating NKTR-214 as a potential combination treatment with BMS's Opdivo® (nivolumab) as well as other ongoing and planned combination trials. We also have an ongoing Phase 1 dose-escalation study for NKTR-358 under our collaboration with Lilly, including an on-going dose-finding trial of NKTR-358 to evaluate single-ascending doses of NKTR-358 in healthy subjects, and we have an ongoing multiple-ascending dose trial to evaluate NKTR-358 in patients with systemic lupus erythematosus that was initiated in May of 2018 and is currently enrolling subjects. We also have a Phase 1 study evaluating NKTR-214 in combination with NKTR-262. We also have ongoing trials with our partners for the following: Halozyme has trials in Pancreatic, Non-Small Cell Lung Cancer and other multiple tumor types in Phase 1, 2, and 3 development. These and other clinical studies may not begin on time, enroll a sufficient number of patients or be completed on schedule, if at all. Clinical trials for any of our product candidates could be delayed for a variety of reasons, including:

- delays in obtaining regulatory authorization to commence a clinical study;
- delays in reaching agreement with applicable regulatory authorities on a clinical study design;
- imposition of a clinical hold by the FDA or other health authorities, which may occur at any time including after any inspection of clinical trial operations or trial sites;
- suspension or termination of a clinical study by us, our partners, the FDA or foreign regulatory authorities due to adverse side effects of a drug on subjects in the trial;

- delays in recruiting suitable patients to participate in a trial;
- delays in having patients complete participation in a trial or return for post-treatment follow-up;
- clinical sites dropping out of a trial to the detriment of enrollment rates;
- delays in manufacturing and delivery of sufficient supply of clinical trial materials; and
- changes in regulatory authorities policies or guidance applicable to our drug candidates.

If the initiation or completion of any of the planned clinical studies for our drug candidates is delayed for any of the above or other reasons, the regulatory approval process would be delayed and the ability to commercialize and commence sales of these drug candidates could be materially harmed, which could have a material adverse effect on our business, financial condition and results of operations. Clinical study delays could also shorten any periods during which our products have patent protection and may allow our competitors to bring products to market before we do, which could impair our ability to successfully commercialize our product candidates and may harm our business and results of operations.

Drug development is a long and inherently uncertain process with a high risk of failure at every stage of development.

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

Drug development is a highly uncertain scientific and medical endeavor, and failure can unexpectedly occur at any stage of preclinical and clinical development. Typically, there is a high rate of attrition for drug candidates in preclinical and clinical trials due to scientific feasibility, safety, efficacy, changing standards of medical care (including commercialization of a competing therapy in the same or similar indication for which our drug candidate is being studied) and other variables (such as commercial supply challenges). The risk of failure increases for our drug candidates that are based on new technologies, such as the application of our advanced polymer conjugate technology to, NKTR-214, NKTR-358, NKTR-262, NKTR-255, NKTR-181, ONZEALD®, and other drug candidates currently in discovery research or preclinical development. The failure of one or more of our drug candidates could have a material adverse effect on our business, financial condition and results of operations.

The risk of clinical failure for any drug candidate remains high prior to regulatory approval.

A number of companies have suffered significant unforeseen failures in clinical studies due to factors such as inconclusive efficacy or safety, even after achieving preclinical proof-of-concept or positive results from earlier clinical studies that were satisfactory both to them and to reviewing regulatory authorities. Clinical study outcomes remain very unpredictable and it is possible that one or more of our clinical studies could fail at any time due to efficacy, safety or other important clinical findings or regulatory requirements. The results from preclinical testing or early clinical trials of a product candidate may not predict the results that will be obtained in later phase clinical trials of the product candidate. We, the FDA, an independent Institutional Review Board (IRB), an independent ethics committee, or other applicable regulatory authorities may suspend clinical trials of a product candidate at any time for various reasons, including a belief that subjects participating in such trials are being exposed to unacceptable health risks or adverse side effects. Similarly, an IRB or ethics committee may suspend a clinical trial at a particular trial site. If one or more of our drug candidates fail in clinical studies, it could have a material adverse effect on our business, financial condition and results of operations.

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

If we or our contract manufacturers are not able to manufacture and supply sufficient drug quantities meeting applicable quality standards required to support large clinical studies or commercial manufacturing in a timely manner, it could delay our or our collaboration partners' clinical studies or result in a breach of our contractual obligations, which could in turn reduce the potential commercial sales of our or our collaboration partners' products. As a result, we could incur substantial costs and damages and any product sales or royalty revenue that we would otherwise be entitled to receive could be reduced, delayed or eliminated. In some cases, we rely on contract manufacturing organizations to manufacture and supply drug product for our clinical studies and those of

our collaboration partners. Pharmaceutical manufacturing of drugs involves significant risks and uncertainties related to the demonstration of adequate stability, sufficient purification of the drug substance and drug product, the identification and elimination of impurities, optimal formulations, process and analytical methods validations, and challenges in controlling for all of these variables. We have faced and may in the future face significant difficulties, delays and unexpected expenses as we validate third party contract manufacturers required for drug supply to support our clinical studies and the clinical studies and products of our collaboration partners. Failure by us or our contract manufacturers to supply drug product in sufficient quantities that meet all applicable quality requirements could result in supply shortages for our clinical studies or the clinical studies and commercial activities of our collaboration partners. Such failures could significantly and materially delay clinical trials and regulatory submissions or result in reduced sales, any of which could significantly harm our business prospects, results of operations and financial condition.

Building and validating large scale clinical or commercial-scale manufacturing facilities and processes, recruiting and training qualified personnel and obtaining necessary regulatory approvals is complex, expensive and time consuming. In the past, we have encountered challenges in scaling up manufacturing to meet the requirements of large scale clinical trials without making modifications to the drug formulation, which may cause significant delays in clinical development. Drug and device combination products are particularly complex, expensive and time-consuming to develop due to the number of variables involved in the final product design, including ease of patient and doctor use, maintenance of clinical efficacy, reliability and cost of manufacturing, regulatory approval requirements and standards and other important factors. There continues to be substantial and unpredictable risk and uncertainty related to manufacturing and supply until such time as the commercial supply chain is validated and proven.

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

We often face very limited supply of a critical raw material that can only be obtained from a single, or a limited number of, suppliers, which could cause production delays, clinical trial delays, substantial lost revenue opportunities or contract liabilities to third parties. For example, there are only a limited number of qualified suppliers, and in some cases single source suppliers, for the raw materials included in our PEGylation and advanced polymer conjugate drug formulations. Any interruption in supply or failure to procure such raw materials on commercially feasible terms could harm our business by delaying our clinical trials, impeding commercialization of approved drugs or increasing our costs.

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

We and our contract manufacturers are required in certain cases to maintain compliance with current good manufacturing practices (cGMP), including cGMP guidelines applicable to active pharmaceutical ingredients, and with laws and regulations governing manufacture and distribution of controlled substances, and are subject to inspections by the FDA, the Drug Enforcement Administration or comparable agencies in other jurisdictions administering such requirements. We anticipate periodic regulatory inspections of our drug manufacturing facilities and the manufacturing facilities of our contract manufacturers for compliance with applicable regulatory requirements. Any failure to follow and document our or our contract manufacturers' adherence to such cGMP and other laws and governmental regulations or satisfy other manufacturing and product release regulatory requirements may disrupt our ability to meet our manufacturing obligations to our customers, lead to significant delays in the availability of products for commercial use or clinical study, result in the termination or hold on a clinical study or delay or prevent filing or approval of marketing applications for our products. Failure to comply with applicable laws and regulations

may also result in sanctions being imposed on us, including fines, injunctions, civil penalties, failure of regulatory authorities to grant marketing approval of our products, delays, suspension or withdrawal of approvals, license revocation, seizures, administrative detention, or recalls of products, operating restrictions and criminal prosecutions, any of which could harm our business. Regulatory inspections could result in costly manufacturing changes or facility or capital equipment upgrades to satisfy the FDA that our manufacturing and quality control procedures are in substantial compliance with cGMP. Manufacturing delays, for us or our contract manufacturers, pending resolution of regulatory deficiencies or suspensions could have a material adverse effect on our business, results of operations and financial condition.

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

We or our partners may not obtain regulatory approval for drug candidates on a timely basis, or at all, or the terms of any approval (which in some countries includes pricing approval) may impose significant restrictions or limitations on use. Drug candidates must undergo rigorous animal and human testing and an extensive review process for safety and efficacy by the FDA and

equivalent foreign regulatory authorities. The time required for obtaining regulatory decisions is uncertain and difficult to predict. The FDA and other U.S. and foreign regulatory authorities have substantial discretion, at any phase of development, to terminate clinical studies, require additional clinical development or other testing, delay or withhold registration and marketing approval and mandate product withdrawals, including recalls. For example, while data from certain pre-specified subgroups in our BEACON study for ONZEALD® in 2015 was positive, the study did not achieve statistical significance for its primary endpoint and the FDA and European Medicines Agency rarely approve drugs on the basis of studies that do not achieve statistical significance on the primary endpoint. Further, regulatory authorities have the discretion to analyze data using their own methodologies that may differ from those used by us or our partners, which could lead such authorities to arrive at different conclusions regarding the safety or efficacy of a drug candidate. In addition, undesirable side effects caused by our drug candidates could cause us or regulatory authorities to interrupt, delay or halt clinical trials and could result in a more restricted label or the delay or denial of regulatory approval by regulatory authorities. For example, AstraZeneca is conducting a post-marketing, observational epidemiological study comparing MOVANTIK® to other treatments of opioid-induced constipation (OIC) in patients with chronic, non-cancer pain and the results of this study could at some point in the future negatively impact the labeling, regulatory status, and commercial potential of MOVANTIK®.

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

The NKTR-181 program is subject to important risks and uncertainties related to likelihood of FDA approval, commercial potential, and non-convertibility of NKTR-181, any of which could significantly and negatively impact the economic value of NKTR-181.

On May 31, 2018, we announced that we submitted an NDA for NKTR-181 and on July 30, 2018, we announced that the NDA for NKTR-181 for the treatment of chronic low back pain in adult patients new to opioid therapy was accepted by the FDA for review. The FDA has assigned a PDUFA target action date of May 29, 2019. While the results from the Phase 3 study of NKTR-181 were positive, and NKTR-181 has Fast Track designation, the regulatory pathway for NKTR-181 remains subject to substantial uncertainty including the amount of data required to support an approval of NKTR-181. In addition, regulations concerning and controlling the access to opioid-based pharmaceuticals are strict and there is no guarantee which scheduling category will apply to NKTR-181 if regulatory approval is achieved.

The commercial potential of NKTR-181 remains difficult to predict. The safety and efficacy compared to other available treatments, changing standards of care, third party payer reimbursement standards, scope and contents of the NKTR-181 label, patient and physician preferences, drug scheduling status, the availability of competitive alternatives that may emerge either during or after approval, the availability of generic versions of our NKTR-181, and the countries in which we receive regulatory approvals. If the market potential for NKTR-181 is lower than we anticipated, it could significantly and negatively impact the commercial potential and value of NKTR-181.

An important objective of our NKTR-181 drug development program is to create a unique opioid molecule that does not rapidly enter a patient’s central nervous system and therefore has the potential to be less susceptible to abuse than alternative opioid therapies. To date, we have conducted numerous experiments using laboratory and home-based chemistry techniques that have been unable to convert NKTR-181 into a rapidly-acting, more abusable form of opioid.

In the future, an alternative chemistry technique, process or method of administration, or combination thereof, may be discovered to enable the conversion of NKTR-181 into a more abusable opioid.

Our results of operations and financial condition depend significantly on the ability of our collaboration partners to successfully develop and market drugs and they may fail to do so.

Under our collaboration agreements with various pharmaceutical or biotechnology companies (other than the BMS Collaboration Agreement), our collaboration partner is generally solely responsible for:

- designing and conducting large scale clinical studies;
- preparing and filing documents necessary to obtain government approvals to sell a given drug candidate; and/or
- marketing and selling the drugs when and if they are approved.

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

- we have very little control over the timing and level of resources that our collaboration partners dedicate to commercial marketing efforts such as the amount of investment in sales and marketing personnel, general marketing campaigns, direct-to-consumer advertising, product sampling, pricing agreements and rebate strategies with government and private payers, manufacturing and supply of drug product, and other marketing and selling activities that need to be undertaken and well executed for a drug to have the potential to achieve commercial success;
- collaboration partners with commercial rights may choose to devote fewer resources to the marketing of our partnered drugs than they devote to their own drugs or other drugs that they have in-licensed;
- we have very little control over the timing and amount of resources our partners devote to development programs in one or more major markets;
- disagreements with partners could lead to delays in, or termination of, the research, development or commercialization of product candidates or to litigation or arbitration proceedings;
- disputes may arise or escalate in the future with respect to the ownership of rights to technology or intellectual property developed with partners;
- we do not have the ability to unilaterally terminate agreements (or partners may have extension or renewal rights) that we believe are not on commercially reasonable terms or consistent with our current business strategy;
- partners may be unable to pay us as expected; and
- partners may terminate their agreements with us unilaterally for any or no reason, in some cases with the payment of a termination fee penalty and in other cases with no termination fee penalty.

Given these risks, the success of our current and future collaboration partnerships is highly unpredictable and can have a substantial negative or positive impact on our business. If the approved drugs fail to achieve commercial success or the drugs in development fail to have positive late stage clinical outcomes sufficient to support regulatory approval in major markets, it could significantly impair our access to capital necessary to fund our research and development efforts for our proprietary drug candidates. If we are unable to obtain sufficient capital resources to advance our drug candidate pipeline, it would negatively impact the value of our business, results of operations and financial condition.

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

As of September 30, 2018, we had cash and investments in marketable securities valued at approximately $2.0 billion and had debt of $250.0 million in principal of senior secured notes. Our cash and investments balance at September 30, 2018 reflects $1.85 billion received from our collaboration with BMS. As described above and in Note 6 to our Condensed Consolidated Financial Statements, in February 2018, we entered into the BMS Collaboration Agreement under which BMS paid us a non-refundable upfront cash payment of $1.0 billion on April 3, 2018. We also entered into the Share Purchase Agreement under which BMS purchased $850.0 million of shares of our common stock on April 3, 2018. While we believe that our cash position will be sufficient to meet our liquidity requirements through at least the next 12 months, our future capital requirements will depend upon numerous unpredictable factors, including:

- the cost, timing and outcomes of clinical studies and regulatory reviews of our proprietary drug candidates that we have licensed to our collaboration partners —important examples include NKTR-214 in collaboration with BMS and NKTR-358 licensed to Lilly;
- the commercial launch and sales levels of products marketed by our collaboration partners for which we are entitled to royalties and sales milestones—importantly, the level of success in marketing and selling MOVANTIK® by AstraZeneca in the U.S. and ADYNOVATE® by Baxalta (a wholly-owned subsidiary of Shire plc) globally, as well as MOVENTIG® (the naloxegol brand name in the EU) by Kirin in the EU;

- if and when we receive potential milestone payments and royalties from our existing collaborations if the drug candidates subject to those collaborations achieve clinical, regulatory or commercial success;
- the progress, timing, cost and results of our clinical development programs;

- the success, progress, timing and costs of our efforts to implement new collaborations, licenses and other transactions that increase our current net cash, such as the sale of additional royalty interests held by us, term loan or other debt arrangements, and the issuance of securities;
- the number of patients, enrollment criteria, primary and secondary endpoints, and the number of clinical studies required by the regulatory authorities in order to consider for approval our drug candidates and those of our collaboration partners;