INHALE THERAPEUTIC SYSTEMS INC
Form 10-K/A
October 04, 2001

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K/A
(Amendment No. 2)

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2000

OR

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

Commission File No. 0-23556

INHALE THERAPEUTIC SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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

150 Industrial Road, San Carlos, CA 94070

(Address of principal executive offices and zip code)

(650) 631-3100

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act: **Common Stock, $0.0001 par value**

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. / /

The approximate aggregate market value of voting stock held by non-affiliates of the Registrant, based upon the last sale price of the Common Stock on February 1, 2001 as reported by Nasdaq National Market was approximately $1,922,029,208. Determination of affiliate status for this purpose is not a determination of affiliate status for any other purpose.

54,892,522

(Number of shares of common stock outstanding as of September 26, 2001)

INHALE THERAPEUTIC SYSTEMS, INC.
2000 AMENDED ANNUAL REPORT ON FORM 10-K/A
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PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a)(1) Consolidated Financial Statements

The Consolidated Financial Statements required by this item, with the report of independent auditors, are submitted in a separate section beginning on page F-1 of this report.

(2) Consolidated Financial Statement Schedules

Schedules have been omitted because the information required to be set forth therein is not applicable or is shown in the Consolidated Financial Statements or notes thereto.

(3) Exhibits

The following exhibits are filed herewith or incorporated by reference:

Exhibit Number		Exhibit Index
2.1	(1)	Agreement and Plan of Merger between Inhale Therapeutic Systems, a California corporation, and Inhale Therapeutic Systems (Delaware), Inc., a Delaware corporation.
2.2	(16)	Recommended Offer, dated December 21, 2000 by Cazenove & Co. on behalf of Inhale Therapeutic Systems, Inc. for Bradford Design plc.
3.1	(1)	Certificate of Incorporation of Inhale.
3.2	(1)	Bylaws of Inhale.
3.3	(14)	Certificate of Amendment of the Amended Certificate of Incorporation.
4.1		Reference is made to Exhibits 3.1, 3.2 and 3.3.
4.2	(2)	

Exhibit Number		Exhibit Index
		Restated Investor Rights Agreement among Inhale and certain other persons named therein, dated April 29, 1993, as amended October 29, 1993.
4.3	(3)	Stock Purchase Agreement between Inhale and Pfizer Inc., dated January 18, 1995.
4.4	(9)	Form of Purchase Agreement between Inhale and the individual Purchasers, dated January 28, 1997.
4.5	(10)	Stock Purchase Agreement between Inhale and Capital Research and Management Company, dated December 8, 1998.
4.6	(12)	Purchase Agreement among Inhale and Lehman Brothers Inc., Deutsche Bank Securities Inc. and U.S. Bancorp Piper Jaffray Inc. dated October 6, 1999.
4.7	(12)	Registration Rights Agreement among Inhale and Lehman Brothers Inc., Deutsche Bank Securities Inc. and U.S. Bancorp Piper Jaffray Inc., dated October 13, 1999.
4.8	(12)	Indenture between Inhale as Issuer and Chase Manhattan Bank and Trust Company, National Association, as Trustee, dated October 13, 1999.
4.9	(12)	Form of Inhale Registration Rights Agreement, between Inhale and Selling Shareholder, dated January 25, 2000.
4.10	(13)	Purchase Agreement among Inhale and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc., and U.S. Bancorp Piper Jaffray Inc., dated February 2, 2000.
4.11	(13)	Resale Registration Rights Agreement among Registrant and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc., and U.S. Bancorp Piper Jaffray Inc., dated February 8, 2000.
4.12	(13)	Indenture between Registrant as Issuer and Chase Manhattan Bank and Trust Company, National Association, as Trustee, dated February 8, 2000.
4.13	(14)	Specimen common stock certificate.
4.14	(15)	Specimen warrants to purchase shares of common stock.

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4.15	(17)	Purchase Agreement among Inhale and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc., and U.S. Bancorp Piper Jaffray Inc., dated October 11, 2000.
4.16	(17)	Resale Registration Rights Agreement among Registrant and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities, Inc., Lehman Brothers Inc., and U.S. Bancorp Piper Jaffray Inc., dated October 17, 2000.
4.17	(17)	Indenture between Registrant, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee, dated October 17, 2000.
5.1	(18)	Opinion of Cooley Godward LLP.
10.1	(4)	Registrant's 1994 Equity Incentive Plan, as amended.
10.2	(7)	Registrant's 1994 Non-Employee Directors' Stock Option Plan, as amended.
10.3	(2)	Registrant's 1994 Employee Stock Purchase Plan, as amended.
10.4	(2)	Standard Industrial Lease between Inhale and W.F. Batton & Co., Inc., dated September 17, 1992, as amended September 18, 1992.
10.5	(2)	Addendum IV dated April 1, 1994 to Lease dated September 17, 1992, between Inhale and W.F. Batton and Marie A. Batton, dated September 17, 1992.
10.6	(6)	Amendment Agreement Number One, dated October 20, 1995, to Lease dated September 17, 1992, between Inhale and W.F. Batton & Co., Inc.
10.7	(6)	Amendment Agreement Number Two, dated November 15, 1995, to Lease, dated September 17, 1992, between Registrant and W.F. Batton and Marie A. Batton, Trustees of the W.F. Batton and Marie A. Batton Trust UTA dated January 12, 1998 ("Batton Trust").
10.8	(11)	Amendment Agreement Number Three, dated February 14, 1996, to Lease, dated September 17, 1992, between Registrant and Batton Trust.
10.9	(11)	Amendment Agreement Number Four, dated September 15, 1996, to Lease, dated September 17, 1992, between Registrant and Batton Trust.
10.10	(2)	Sublicense Agreement between Inhale and John S. Patton, dated September 13, 1991.
10.11	(5)	Stock Purchase Agreement between Inhale and Baxter World Trade Corporation, dated March 1, 1996.
10.12	(8)	Sublease and Lease Agreement, dated October 2, 1996, between Inhale and T.M.T. Associates L.L.C. ("Landlord").
10.13	(11)	First Amendment, dated October 30, 1996, to Sublease and Lease Agreement, dated October 2, 1996, between Registrant and Landlord.
10.14	(11)	Letter Agreement, dated April 9, 1997, amending Sublease and Lease Agreement, dated October 2, 1996, between Inhale and Landlord.
10.15	(11)	Third Amendment, dated April 16, 1997, to Sublease and Lease Agreement, dated October 2, 1996, between Registrant and Landlord.
10.16	(11)	Fourth Amendment, dated November 5, 1997, to Sublease and Lease Agreement, dated October 2, 1996, between Registrant and Landlord.
10.17	(13)	Sublease by and between Webvan Group, Inc., as sublessor and Registrant, as sublessee, dated November 3, 1999.

10.18	(15)	Registrant's 2000 Equity Incentive Plan
10.19	(15)	Registrant's Stock Option Agreement issued in accordance with Inhale's 2000 Equity Incentive Plan.

10.20	(15)	Agreement for the Contribution of 201 Industrial Road Project made and entered into as of September 14, 2000 by and among Inhale, Inhale 201 Industrial Road, L.P., a California limited partnership and Bernardo Property Advisors, Inc., a California corporation.
10.21	(15)	Agreement of Limited Partnership of Inhale 201 Industrial Road., L.P., a California limited partnership made and entered into September 14, 2000, by and among SCIMED PROP III, Inc., a California corporation, as general partner, 201 Industrial Partnership, a California general partnership, as limited partner, and Inhale, as limited partner.
10.22	(15)	Build-To-Suit Lease made and entered into as of September 14, 2000 by and between Inhale 201 Industrial Road, L.P., a California limited partnership, as Landlord, and Inhale, as Tenant.
10.23	(15)	Amendment to Lease dated October 3, 2000 by and between Inhale 201 Industrial Road, L.P., a California limited partnership, as Landlord, and Inhale, as Tenant.
10.24	(15)	Parking Lease Agreement entered into as of September 14, 2000 by and between Inhale 201 Industrial Road, L.P., a California limited partnership, as Landlord, and Inhale, as Tenant.
10.25	(18)	Registrant's 2000 Non-Officer Equity Incentive Plan
10.26	(18)	Registrant's Stock Option Agreement issued in accordance with Inhale's 2000 Non-Officer Equity Incentive Plan
10.27	(19)	Manufacturing and Supply Agreement among Inhale, Tech Group North America, Bespak Europe, LTD.
23.1	(20)	Consent of Ernst & Young LLP, independent auditors.

(1) Incorporated by reference to the indicated exhibit in Inhale's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998.

(2) Incorporated by reference to the indicated exhibit in Inhale's Registration Statement on Form S-1 (No. 33-75942), as amended.

(3) Incorporated by reference to the indicated exhibit in Inhale's Registration Statement on Form S-1 (No. 33-89502), as amended.

(4) Incorporated by reference to Inhale's Registration Statement on Form S-8 (No. 333-59735).

(5) Incorporated by reference to the indicated exhibit in Inhale's Quarterly Report on Form 10-Q for the quarter ended March 31, 1996.

(6) Incorporated by reference to the indicated exhibit in Inhale's Annual Report on Form 10-K for the year ended December 31, 1995.

(7) Incorporated by reference to the indicated exhibit in Inhale's Quarterly Report on Form 10-Q for the quarter ended June 30, 1996.

(8) Incorporated by reference to the indicated exhibit in Inhale's Quarterly Report on Form 10-Q for the quarter ended September 30, 1996.

(9) Incorporated by reference to Inhale's Registration Statement on Form S-3 (No. 333-20787).

(10) Incorporated by reference to the indicated exhibit in Inhale's Registration Statement on Form S-3 (No. 333-68897), as amended.

(11) Incorporated by reference to the indicated exhibit in Inhale's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998.

(12)

Incorporated by reference to the indicated exhibit in Inhale's Registration Statement on Form S-3 (No. 333-94161), as amended.

(13) Incorporated by reference to the indicated exhibit in Inhale's Annual Report on Form 10-K for the year ended December 31, 1999.

(14) Incorporated by reference to the indicated exhibit in Inhale's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000.

(15) Incorporated by reference to the indicated exhibit in Inhale's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000.

(16) Incorporated by reference to the indicated exhibit in Inhale's Current Report on Form 8-K, filed on January 11, 2001.

(17) Incorporated by reference to Inhale's Registration Statement on Form S-3 (No. 333-53678), filed on January 12, 2001.

(18) Incorporated by reference to Inhale's Registration Statement on Form S-8 (No. 333-54078), filed on January 19, 2001.

(19) Previously filed.

(20) Filed herewith.

(b) Reports on Form 8-K.

The following Reports on Form 8-K were filed during the quarter ended December 31, 2000:

(i) A Report on Form 8-K dated December 21, 2000 pertaining to Inhale's offer to acquire all of the outstanding share capital of Bradford Particle Design, plc, a United Kingdom company.

(ii) A Report on Form 8-K dated October 27, 2000 pertaining to the initial purchasers' exercise of their $30 million over-allotment option granted pursuant to a purchase agreement dated October 11, 2000 with respect to Inhale's 3.5% convertible subordinated notes due 2007.

(iii) A Report on Form 8-K dated October 12, 2000 pertaining to Inhale's entering into a purchase agreement providing for the sale to certain initial purchasers of $200 million aggregate principal amount of convertible subordinated notes ($250 million if the over-allotment option exercised in full.)

(iv) A Report on Form 8-K dated October 9, 2000 pertaining to Inhale's intention to issue $150 million aggregate principal amount of convertible subordinated notes ($172.5 million if an over-allotment option is exercised in full).

(v) A Report on Form 8-K dated October 6, 2000 pertaining to Inhale's entering into a build-to-suit lease transaction.

(c) See Exhibits listed under Item 14(a)(3).

(d) Not applicable. See Item 14(a)(2).

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Registrant has duly caused this amended report to be signed on our behalf by the undersigned, thereunto duly authorized, on the 4th day of October 2001.

INHALE THERAPEUTIC SYSTEMS, INC.

By: /s/ AJIT S. GILL

Ajit S. Gill
Chief Executive Officer,
President and Director

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Pursuant to the requirements of the Securities Exchange Act of 1934, this amended report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
* Robert B. Chess	Chairman	October 4, 2001
/s/ AJIT S. GILL Ajit S. Gill	Chief Executive Officer, President and Director *(Principal Executive Officer)*	October 4, 2001
* Brigid A. Makes	Vice President, Finance and Administration, Chief Financial Officer and Assistant Secretary *(Principal Financial and Accounting Officer*	October 4, 2001
* John S. Patton	Vice President, Research and Director	October 4, 2001
* James B. Glavin	Director	October 4, 2001
* Melvin Perelman	Director	October 4, 2001
* Irwin Lerner	Director	October 4, 2001
*	Director	October 4, 2001

Signature	Title	Date
Roy A. Whitfield		

*By: /s/ AJIT S. GILL

Ajit S. Gill
Attorney-in-fact

INHALE THERAPEUTIC SYSTEMS, INC.
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REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Inhale Therapeutic Systems, Inc.

We have audited the accompanying consolidated balance sheets of Inhale Therapeutic Systems, Inc. as of December 31, 2000 and 1999, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Inhale Therapeutic Systems, Inc. at December 31, 2000 and 1999, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States.

/s/ ERNST & YOUNG LLP

Palo Alto, California
January 23, 2001

INHALE THERAPEUTIC SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share information)

	December 31, 2000	December 31, 1999
ASSETS		
Current assets:		
Cash and cash equivalents	$ 136,012	$ 33,430
Short-term investments	348,829	104,755
Accounts receivable	7,234	1,756
Other current assets	968	7,377
Total current assets	493,043	147,318
Property and equipment, net	110,457	63,852
Marketable equity securities.	9,140	6,328
Other assets	16,900	9,308
	$ 629,540	$ 226,806
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 6,501	$ 13,374
Accrued liabilities	12,861	5,244
Interest payable	4,910	1,605
Deferred revenue	4,913	4,811
Capital lease obligation current portion	977	
Tenant improvement loan current portion	41	45
Total current liabilities	30,203	25,079
Capital lease obligation	15,269	
Tenant improvement loan	4,849	4,895
Convertible subordinated debentures and notes	299,149	108,450
Other long-term liabilities	2,187	1,753
Commitments		
Stockholders' equity:		
Preferred stock, 10,000 shares authorized, no shares issued or outstanding		
Common stock, $0.0001 par value; 300,000 shares authorized; 47,374 shares and 34,452 shares issued and outstanding at December 31, 2000 and 1999, respectively	5	3
Capital in excess of par value	465,593	181,153
Deferred compensation	(1,827)	(1,530)
Accumulated other comprehensive gain	5,981	1,469
Accumulated deficit	(191,869)	(94,466)
Total stockholders' equity	277,883	86,629
	$ 629,540	$ 226,806

See accompanying notes

INHALE THERAPEUTIC SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share information)

	Years ended December 31,		
	2000	**1999**	**1998**
Contract research revenue	$ 51,629	$ 41,358	$ 21,795
Operating costs and expenses:			
Research and development	101,544	64,083	35,398
General and administrative	13,932	7,869	8,387
Acquired in-process research and development	2,292	9,890	
Total operating costs and expenses	117,768	81,842	43,785
Loss from operations	(66,139)	(40,484)	(21,990)
Other income	995		
Debt conversion premium, net	(40,687)		
Interest income	20,566	4,111	3,904
Interest expense	(12,138)	(2,075)	(270)
Net loss	$ (97,403)	$ (38,448)	$ (18,356)
Basic and diluted net loss per share	$ (2.32)	$ (1.13)	$ (0.58)
Shares used in computing basic and diluted net loss per share	41,998	34,016	31,438

See accompanying notes

INHALE THERAPEUTIC SYSTEMS, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In thousands)

	Common Stock						
	Shares	**Par Value**	**Capital in Excess of Par Value**	**Deferred Compensation**	**Accumulated Other Comprehensive Gain**	**Accumulated Deficit**	**Total Stockholders' Equity**
Balance at December 31, 1997	31,084	$3	$135,270	$(538)	$20	$(37,662)	$97,093
Issuance of common stock in private placement, net of issuance costs of $1,997	2,400		35,202				35,202
Issuance of common stock and stock options in connection with licensing agreement	12		284				284
	352		1,514				1,514

	Common Stock				**Accumulated Other Comprehensive Gain**		
Common stock issued upon exercise of stock options							
Deferred compensation			576	(576)			
Amortization of deferred compensation				183			183
Unrealized loss on available-for-sale securities					(39)		(39)
Net loss						(18,356)	(18,356)
Comprehensive loss							(18,395)
Balance at December 31, 1998	33,848	3	172,846	(931)	(19)	(56,018)	115,881
Issuance of common stock for technology acquisition	360		5,000				5,000
Common stock issued upon exercise of stock options, net of costs	244		1,545				1,545
Compensation in connection with stock options granted to consultants			798				798
Deferred compensation			964	(964)			
Amortization of deferred compensation				365			365
Unrealized gain on available-for-sale securities					1,488		1,488
Net loss						(38,448)	(38,448)
Comprehensive loss							(36,960)
Balance at December 31, 1999	34,452	3	181,153	(1,530)	1,469	(94,466)	86,629
Common stock issued upon exercise of stock options, net of costs	2,177	2	17,320				17,322
Compensation in connection with stock granted to employees	57		1,900				1,900
Compensation in connection with stock options granted to consultants			3,196				3,196
Conversion of convertible subordinated debt into common shares, net of costs	10,688		260,862				260,862
Deferred compensation			1,162	(1,162)			
Amortization of deferred compensation				865			865
Unrealized gain on available-for-sale securities					4,512		4,512
Net loss						(97,403)	(97,403)
Comprehensive loss							(92,891)
Balance at December 31, 2000	47,374	$ 5	$ 465,593	$ (1,827)	$ 5,981	$ (191,869)	$ 277,883

See accompanying notes

INHALE THERAPEUTIC SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Increase/(Decrease) in Cash and Cash Equivalents
(In thousands)

	Years ended December 31,		
	2000	**1999**	**1998**
Cash flows used in operating activities			
Net loss	$ (97,403)	$ (38,448)	$ (18,356)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	9,259	6,828	3,415
Amortization of deferred compensation	865	365	183
Gain on sale of assets	(159)	61	
Issuance of common stock for services	5,096	798	
Issuance of common stock and stock options in connection with licensing agreements			284
Debt conversion premium, net	40,687		
Acquired in-process research and development	2,292	9,890	
Changes in assets and liabilities:			
Decrease in accounts receivable, other current assets, and other assets	(964)	(8,004)	(876)
Increase (decrease) in accounts payable and accrued liabilities	4,483	12,724	(1,546)
Increase (decrease) in deferred revenue	102	452	(2,327)
Net cash used in provided by operating activities	(35,742)	(15,334)	(19,223)
Cash flows used in investing activities			
Acquisition of technology	(2,292)	(15,288)	
Purchases of short-term investments	(462,278)	(122,481)	(219,414)
Sales of short-term investments	13,643	28,658	65,189
Maturities of short-term investments	206,261	47,174	182,309
Purchases of property and equipment, net	(53,850)	(20,502)	(34,584)
Other investing activities, net	(1,232)		
Net cash used in investing activities	(299,748)	(82,439)	(6,500)
Cash flows from financing activities			
Issuance of convertible subordinated debentures and notes, net	445,241	104,806	
Payments of loan and capital lease obligations	(50)	(64)	(181)
Proceeds from capital lease financing	16,246		
Payments of debt conversion premium, net	(40,687)		
Issuance of common stock, net of issuance costs	17,322	1,545	36,716
Net cash provided by financing activities	438,072	106,287	36,535
Net increase in cash and cash equivalents	102,582	8,514	10,812
Cash and cash equivalents at beginning of year	33,430	24,916	14,104
Cash and cash equivalents at end of year	$ 136,012	$ 33,430	$ 24,916

See accompanying notes

INHALE THERAPEUTIC SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2000

Note 1 Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation

Inhale Therapeutic Systems, Inc. was incorporated in the State of California in July 1990 and reincorporated in the State of Delaware in July 1998. Inhale's mission is to be the pre-eminent supplier of drug delivery solutions. During 2000, we created two wholly-owned subsidiaries: Inhale Therapeutic Systems Deutschland GmbH, incorporated in the Federal Republic of Germany; and Inhale Therapeutic Systems UK Limited, incorporated in the United Kingdom and consolidated the financial statements of a special purpose entity lessor. Since inception, we have been engaged in the development of systems for the pulmonary delivery of macromolecule drug therapies for systemic and local lung applications.

Our Board of Directors approved a two-for-one split which was effected as a 100% common stock dividend on August 22, 2000 for stockholders of record as of August 1, 2000. The stockholders also increased the number of authorized shares of common stock to 300 million at the 2000 Annual Meeting of the stockholders. All share and per share amounts in these consolidated financial statements have been retroactively restated to reflect the split.

We expect increasing losses over the next several years as research and development and manufacturing scale-up efforts continue, and as we expand our facilities for manufacturing operations. We plan to continue to finance ourselves primarily through issuances of equity or debt securities, research and development contract revenue, and in the longer term, revenue from product sales and royalties.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements of Inhale Therapeutic Systems, Inc. include the accounts of the Company, its wholly owned subsidiaries and the financial statements of a special purpose entity described in Note 6. All significant intercompany balances and transactions have been eliminated.

Cash, Cash Equivalents and Investments

We consider all highly liquid investments with a maturity from date of purchase of three months or less to be cash equivalents. Cash and cash equivalents include demand deposits held in banks and interest bearing money market funds. All other liquid investments are classified as short-term investments. Short-term investments consist of federal and municipal government securities, repurchase agreements or corporate commercial paper with A1 or P1 short-term ratings and A+ or better long-term ratings with remaining maturities at date of purchase of greater than 90 days and less than one year. We limit our concentration of risk by diversifying our investments among a variety of industries and issuers. Our professional portfolio managers adhere to this investment policy as approved by our Board of Directors. We have experienced no material losses on our investments.

At December 31, 2000, all short-term investments are designated as available-for-sale and are carried at fair value, with material unrealized gains and losses, if any, reported in stockholders' equity. The amortized cost of securities is adjusted for amortization of material premiums and accretion of discounts to maturity. Such amortization, if any, is included in interest income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities, if any, are included in interest income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest income.

The following is a summary of operating cash and available-for-sale securities as of December 31, 2000:

	Cost	Net Unrealized Gains	Estimated Fair Value
		(in thousands)	
Obligations of U.S. government agencies	$ 299,604	$ 1,013	$ 300,617
U.S. corporate commercial paper	147,482	496	147,978
Repurchase agreements, secured by U.S. Government securities	11,261		11,261
Cash and other debt securities	24,984	1	24,985
Equity securities	4,669	4,471	9,140
	$ 488,000	$ 5,981	$ 493,981
Amounts included in cash and cash equivalents	$ 135,873	$ 139	$ 136,012
Amounts included in short-term investments	347,458	1,371	348,829
Amounts included in marketable equity securities	4,669	4,471	9,140
	$ 488,000	$ 5,981	$ 493,981

The following is a summary of operating cash and available-for-sale securities as of December 31, 1999:

	Cost	Net Unrealized Gains	Estimated Fair Value
		(in thousands)	
Obligations of U.S. government agencies	$ 81,692	$ 108	$ 81,800
U.S. corporate commercial paper	41,081	33	41,114
Repurchase agreements, secured by U.S. Government securities	3,845		3,845
Cash and other debt securities	11,426		11,426
Equity securities	5,000	1,325	6,328
	$ 143,044	$ 1,466	$ 144,513
Amounts included in cash and cash equivalents	$ 33,376	$ 54	$ 33,430
Amounts included in short-term investments	104,668	87	104,755
Amounts included in marketable equity securities	5,000	1,328	6,328
	$ 143,044	$ 1,469	$ 144,513

We have determined the estimated fair value amounts by using available market information. The gross realized losses and gains on the sale of available-for-sale debt securities during the years ended

December 31, 2000 and 1999 were not material. At December 31, 2000 and 1999, the average portfolio duration was approximately six months and five months, respectively, and the contractual maturity of any single investment did not exceed eighteen months at December 31, 2000 (eleven months at December 31, 1999).

We own common stock in Alliance Pharmaceutical Corp. and we account for this equity investment as an available-for-sale long-term marketable security. In 1999, due to restrictions on the sale of this stock, we carried that portion of our investment in Alliance that could be sold within one year at market value, with material unrealized gains and losses, if any, reported in stockholders' equity; that portion which could not be sold within one year was carried at cost. As there were no restrictions on the sale of Alliance stock at December 31, 2000, all shares held at that date were reported at market value with unrealized gains and losses reported in stockholders' equity.

Property and Equipment

Property and equipment consist of the following at December 31:

	2000	1999
	(in thousands)	
Laboratory and other equipment	$ 34,553	$ 18,280
Building and leasehold improvements	55,476	35,458
Land	7,422	7,422
Construction in progress	34,732	17,701
Property and equipment at cost	132,183	78,861
Less accumulated amortization and depreciation	(21,726)	(15,009)
Property and equipment, net	$ 110,457	$ 63,852

Property and equipment are stated at cost. Major improvements are capitalized, while maintenance and repairs are expensed when incurred. Laboratory and other equipment is depreciated using the straight-line method over estimated useful lives of three to seven years. Leasehold improvements and building subject to build-to-suit lease are amortized using the straight-line method over the shorter of an estimated useful life of fifteen years or the term of the lease.

At December 31, 2000, Building and leasehold improvements included $14.9 million related to a build-to-suit lease with a special purpose entity (See Note 6). Accumulated amortization of the building under lease was approximately $0.1 million in the year ending December 31, 2000.

Goodwill and Other Intangible Assets

Intangible assets are included in other assets in the balance sheet and consisted of the following at December 31:

	2000	1999	Remaining Life
	(in thousands)		(months)
Goodwill	$ 2,238	$ 2,030	70
Intellectual property	3,544	3,171	70
	5,782	5,201	
Less accumulated amortization	(813)	(48)	
	$ 4,969	$ 5,153	

Goodwill and other intangible assets arise from an acquisition accounted for under the purchase method (See Note 3) and are amortized on the straight-line basis over an estimated 7-year useful life of the assets. We periodically evaluate whether changes have occurred that would require revision of the remaining estimated useful life of these assets or otherwise render the assets unrecoverable. If such an event occurred, we would determine whether the goodwill or intangibles are impaired. To date, no impairment losses have been recorded.

Comprehensive Gain/Loss

Comprehensive gain/loss is comprised of net loss and other comprehensive gain. Other comprehensive gain includes certain changes in equity that are excluded from net income. Specifically, unrealized holding gains and losses on our available-for-sale securities, which were reported separately in stockholders' equity, are included in accumulated other comprehensive gain. Comprehensive income for years ended December 31, 2000, 1999, and 1998 has been reflected in the Consolidated Statements of Stockholders' Equity.

Revenue Recognition

Contract revenue from collaborative research agreements is recorded when earned based on the performance requirements of the contract. Revenue from non-refundable upfront license fees and certain guaranteed payments where we continue involvement through collaborative development are deferred and recognized as revenue over the period of continued involvement. Revenue from grants and feasibility arrangements are recognized as the related costs are incurred. Our research revenue is derived primarily from clients in the pharmaceutical industry. Contract research revenue from three partners represented 69%, 13% and 9% of our revenue in 2000. Three partners accounted for 71%, 10% and 9% of our revenue in 1999 and 51%, 22% and 18% of our revenue in 1998. Costs of contract research revenue approximate such revenue and are included in research and development expenses.

Stock-Based Compensation

As permitted by the provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("FAS 123"), we continue to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations in accounting for our employee stock option plans. Under APB 25, if the exercise price of our employee stock options

equals or exceeds the fair market value of the underlying stock on the date of grant as determined by the closing price of our common stock as quoted on the Nasdaq stock market, no compensation expense is recognized. See Note 7 for pro forma disclosures required by FAS 123.

Research and Development Agreements

We perform research and development for others pursuant to feasibility agreements and development and license agreements. Under the feasibility agreements, we are generally reimbursed for the cost of work performed. Feasibility agreements are designed to evaluate the applicability of our technologies to a particular molecule and therefore are generally completed in less than one year. Under our development and license agreements, the partner companies generally receive an exclusive license to develop, use and sell a dry powder formulation and a suitable delivery device to be developed by us for one of the partner's macromolecule drugs. Under these development agreements, we will be reimbursed for development costs and may also be entitled to milestone payments when and if certain development milestones are achieved. All of our research and development agreements are generally cancelable by the partner without significant financial penalty to the partner.

Accounting for Income Taxes

We account for income taxes under Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("FAS 109"). Under FAS 109, the liability method is used in accounting for income taxes.

Net Loss Per Share

In accordance with Financial Accounting Standard No. 128, basic and diluted net loss per share has been computed using the weighted average number of shares of common stock outstanding during the period, less shares subject to repurchase. Had we been in a net income position, diluted earnings per share would have included the following outstanding options, warrants and convertible debentures:

	Years Ended December 31,		
	2000	1999	1998
	(in thousands)		
Warrants	56	40	40
Options	10,064	9,106	6,326
Convertible debentures and notes	6,644	6,776	

	Years Ended December 31,		
	16,764	15,922	6,366

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," which is required to be adopted in years beginning after June 15, 2000. Because our use of derivatives is minimal, management does not anticipate that the adoption of the new Statement will have a significant effect on earnings or the financial position of the Company.

Reclassification

Certain prior year amounts have been reclassified to conform to the 2000 presentation.

Note 2 Collaborative Research and Development Agreements

We perform research and development for others pursuant to feasibility agreements and development and license agreements. Under the feasibility agreements, we are generally reimbursed for the cost of work performed. Feasibility agreements are designed to evaluate the applicability of our technologies to a particular molecule and therefore are generally completed in less than one year. Under our development and license agreements, the partner companies receive an exclusive license to develop, use and sell a dry powder formulation and a suitable delivery device to be developed by us for one of the partner's macromolecule drugs. Under these development agreements, we will be reimbursed for development costs and may also be entitled to milestone payments when and if certain development milestones are achieved. All of our research and development agreements are generally cancelable by the partner without significant financial penalty to the partner.

In February 1999, we entered into a collaborative agreement with Biogen Inc. ("Biogen") to develop pulmonary delivery for Biogen's AVONEX®, a drug used in the treatment of Multiple Sclerosis. Under the terms of the agreement, we will receive royalties on product sales, an up-front signing fee, and up to an estimated $25.0 million in research and development funding and potential progress payments. Biogen will provide bulk AVONEX® to us for formulation into a dry powder which is stable at room temperature. We will manufacture and package the dry powder and supply inhalation devices. Biogen will be responsible for clinical trials, marketing and commercialization. We recognized revenue of $4.7 million under this agreement in 2000 ($2.2 million in 1999).

In December 1997, we entered into a collaboration agreement with Eli Lilly and Company to develop pulmonary delivery for an undisclosed protein based on our deep-lung drug delivery system for macromolecules. Under this agreement we recognized revenue of $3.1 million, $1.2 million and $0.9 million in 2000, 1999 and 1998, respectively. In September 2000, Lilly announced that it had decided to discontinue development of this therapeutic product, which is currently in preclinical. As a result we are free to develop the product further independently or in collaboration with another partner.

In January 1997, we entered into a collaborative agreement with Lilly to develop an inhalable formulation of Fortéo , a version of parathyroid hormone, PTH 1-34, used in the treatment of osteoporosis. Under the terms of the agreement, we will receive funding of up to $20.0 million of initial fees, research and development and progress payments. Lilly will receive global commercialization rights for the pulmonary delivery of the products while we receive royalties on any marketed products. We will manufacture packaged powders for and supply devices to Lilly. Under this agreement, we recognized revenue of $3.8 million in 1998. In late 1998, unexpected observations from a long-term test in rats of the injectable version of parathyroid hormone led Lilly to suspend further clinical development of the injectable and pulmonary versions of Fortéo pending further analysis. In September 2000, we announced the reinitiation of the Fortéo development program with Lilly.

In December 1996, we entered into a collaborative agreement with Aventis Behring L.L.C.to develop a pulmonary formulation of alpha-1 proteinase inhibitor to treat patients with alpha-1 antitrypsin deficiency, or genetic emphysema. Under the terms of the collaboration, Aventis Behring will receive commercialization rights worldwide excluding Japan and we will receive royalties on product sales, an up-front signing fee and up to an estimated $15.0 million in research and development funding and

milestone payments. Aventis Behring will manufacture the active ingredient for use in our delivery device. We will manufacture and package the dry powder and supply inhalation devices to Aventis Behring for commercialization and marketing. Under this agreement, we recognized revenue of $6.8 million, $3.9 million and $1.6 million in 2000, 1999 and 1998, respectively.

In March 1996, we entered into a collaboration agreement with Baxter Healthcare Corporation to use our dry powder pulmonary delivery system as a technology platform for developing and launching therapeutic products. In connection with the collaboration, Baxter made a $20.0 million equity investment in Inhale at a 25% premium to the market price of Inhale stock at the time of the investment. Baxter received worldwide commercialization rights in exchange for up to an estimated $60 million in research and development funding and milestone payments for four molecules. In October 1998, we announced that we had reached an agreement with Baxter to amend our collaborative agreement to facilitate signing a new corporate partner to fund further development and commercialization of the undisclosed compound that had been the focus since April, 1998. Baxter's obligations under this amendment expired in September, 1999. As a result, rights to the compounds reverted to us and are now available for other partnering opportunities. We recognized revenue associated with this program of $4.3 million and $4.0 million in 1999 and 1998, respectively.

In January 1995, we entered into a collaborative development and license agreement with Pfizer Inc. ("Pfizer") to develop pulmonary delivery for inhaled insulin based on our deep-lung delivery system for macromolecules. Under the terms of the agreement, we will receive funding consisting of initial fees, research and development and progress payments. Upon execution of the agreement Pfizer purchased $5.0 million of Inhale common stock. In addition, in October 1996, Pfizer purchased an additional $5.0 million of Inhale common stock. Pfizer will receive global commercialization rights for the pulmonary delivery of the products while we receive royalties on any marketed products. We will manufacture inhaled insulin for, and supply devices to Pfizer. Under this agreement we recognized revenue of $35.7 million, $29.5 million and $11.1 million in 2000, 1999 and 1998, respectively.

Costs associated with research and development activities attributable to these agreements are expected to approximate the revenues recognized.

Note 3 Technology Acquisitions

PulmoSphere Technology

In November 1999, we concluded an agreement with Alliance Pharmaceutical Corp. to acquire Alliance's PulmoSphere particle and particle processing technology for use in respiratory drug delivery. Under the terms of the agreement, we received the rights to PulmoSphere technology, other related assets and Alliance stock valued at $5.0 million in exchange for $15.0 million in cash and $5.0 million of Inhale stock. The purchase price, including $0.4 million of acquisition costs, has been allocated to assets acquired and to in-process research and development, which has been charged as an expense on the Statement of Operations for the year ended December 31, 1999. The Company's investment in Alliance

and the assets acquired in connection with the PulmoSphere acquisition are recorded at their fair market value at acquisition as follows:

Property and equipment, net	$ 200
Acquired in-process research and development charged to operations in 1999	9,890
Intellectual property, net	3,171
Assembled workforce	96
Goodwill	2,030
Total cash purchase consideration	15,387
Common stock of Alliance	5,000
Total purchase consideration	$ 20,387

Goodwill and other intangible assets are being amortized over seven years.

The purchased research and development was identified and valued through extensive interviews and discussions with appropriate management and scientific personnel and the analysis of data provided by Alliance regarding the PulmoSphere technology, its stage of development at the time of acquisition, the importance of the technology to our overall development plan, and the projected incremental cash flows from the projects when completed and any associated risks. Associated risks include the uncertainties in overcoming significant technological risks, acquiring FDA approval and establishing commercial viability.

Other Purchased Technology

In April 2000, the Company recorded a $2.3 million charge for acquired in-process research and development ("IPR&D") costs. The acquisition was recorded as a purchase and a portion of the purchase price was allocated to IPR&D, which was immediately expensed. At the date of the acquisition, the in-process technology had no alternative future use and did not qualify for capitalization.

Note 4 Other Assets

Other Assets consist of the following at December 31:

	2000	1999
	(in thousands)	
Debt issuance costs, net	$ 8,579	$ 3,514
Intellectual property, net	3,091	3,172
Goodwill, net	1,878	1,982
Deposits and other assets	3,352	640
Total other assets	$ 16,900	$ 9,308

Debt issuance costs are associated with our outstanding series of convertible subordinated notes and debentures (See Note 5) and are amortized over the term of the related debt. Intellectual property and goodwill arise from an acquisition accounted for under the purchase method (See Note 3) and are amortized on the straight-line basis over the estimated useful life of the assets. Deposits and other assets at December 31, 2000 included $1.9 million in long-term receivables ($0.5 million in 1999) and $1.5 million in other assets.

Note 5 Convertible Subordinated Debentures & Notes

In October 2000, we received approximately $222.7 million in net proceeds from the issuance of $230.0 million aggregate principal amount of convertible subordinated notes to certain qualified institutional buyers pursuant to an exemption under the Securities Act of 1933, as amended. Interest on the notes accrues at a rate of 3.5% per year, subject to adjustment in certain circumstances. The notes will mature in 2007 and are convertible into shares of our common stock at a conversion price of $50.46 per share, subject to adjustment under certain circumstances. The notes are redeemable in part or in total at any time before October 17, 2003 at $1,000 per $1,000 principal amount plus additional securities that are payable in cash or shares of common stock, of $105.00 per $1,000 principal amount, plus accrued and unpaid interest, if any, to the redemption date, if the closing price of our common stock has exceeded 150% of the conversion price then in effect for at least 20 trading days within a period of 30 consecutive trading days. The additional securities to induce the debt conversion are charged as a period expense and are classified as debt conversion premium in the statement of operations. The notes are also redeemable in part or in total at any time after October 17, 2003 at certain redemption prices dependent upon the date of redemption if the closing price of our common stock has exceeded 120% of the conversion price then in effect for at least 20 trading days within a period of 30 consecutive trading days. Interest is payable semi-annually on April 17 and October 17. The notes are unsecured obligations, which rank junior in right of payment to all of our existing and future senior debt.

Also, in October 2000, we entered into privately negotiated agreements with certain holders of our outstanding 5.0% convertible subordinated notes due 2007 and sold in February 2000 providing for the conversion of our notes into common stock in exchange for a cash payment. To date, we have secured agreements that provide for the conversion of $168.6 million aggregate principal amount of these outstanding 5.0% convertible subordinated notes into approximately 4.4 million shares of common stock for cash payments of approximately $25.5 million. These payments were expensed in the current period as a debt conversion premium. Approximately $61.4 million of these 5.0% convertible subordinated notes remain outstanding at December 31, 2000.

In February 2000, we received approximately $222.4 million in net proceeds from the issuance of $230.0 million aggregate principal amount of convertible subordinated notes to certain qualified institutional buyers pursuant to an exemption under Rule 144A of the Securities Act of 1933, as amended. Interest on the notes accrues at a rate of 5.0% per year, subject to adjustment in certain circumstances. The notes will mature in 2007 and are convertible into shares of our common stock at a conversion price of $38.355 per share, subject to adjustment in certain circumstances. The notes are redeemable in part or in total at any time before February 8, 2003 at a debt conversion premium of $137.93 per $1000 principal amount, less any interest actually paid on the notes before the call for redemption, if the closing price of our common stock has exceeded 150% of the conversion price then in effect for at least 20 trading days within a period of 30 consecutive trading days. We can redeem some or all of the notes at any time after February 8, 2003. Interest is payable semi-annually on August 8 and February 8. The notes are unsecured subordinated obligations which rank junior in right of payment to all of our existing and future Senior Debt.

Also in February 2000, we entered into privately negotiated agreements with certain holders of our outstanding 6$^3/_4$% convertible subordinated debentures sold in October and November 1999, providing for the conversion of approximately $100.7 million aggregate principal amount of the outstanding debentures into approximately 6.3 million shares of common stock for net payments of approximately $15.2 million. These payments were expensed in the current period as a debt conversion premium. Approximately $7.8 million of these 6$^3/_4$% convertible subordinated debentures remain on the books at December 31, 2000. These debentures will mature in 2007 and are convertible into shares of our common stock at a conversion price of $16.01 per share, subject to adjustment in certain circumstances. The debentures are redeemable in part or in total at our option on or after October 13, 2002. Interest is payable semi-annually on April 13 and October 13. The debentures are unsecured subordinated obligations which rank junior in right of payment to all of our existing and future Senior Debt.

Costs relating to the issuances of these notes and debentures are recorded as long-term assets and are amortized over the term of the debt. As of December 31, 2000, we had approximately $299 million in outstanding convertible subordinated debentures with a fair market value of approximately $338 million. The fair market was valued through quoted market prices.

Note 6 Commitments, Long-term Debt and Tenant Improvement Loan

Facilities Lease & Financing

We lease our office and laboratory facilities under several arrangements expiring through the year 2012. Rent expense was approximately $3.1 million, $2.5 million and $1.8 million for the years ended December 31, 2000, 1999 and 1998, respectively.

In November 1997, we received from the landlord of our facility in San Carlos, California a loan of $5.0 million to fund a portion of the cost of improvements made to the facility. The loan bears interest at 9.46% per annum, and principal and interest payments are payable monthly over the ten-year loan term with a balloon payment of $4.5 million due November 2007. The loan is classified on the balance sheet as a tenant improvement loan.

Future noncancelable commitments under operating leases and the tenant improvement loan at December 31, 2000 are as follows:

	Operating Leases	Tenant Improvement Loan
	(in thousands)	
Years ending December 31,		
2001	$ 2,000	$ 503
2002	2,492	503
2003	2,336	503
2004	2,273	503
2005	2,342	503
2006 and thereafter	16,879	5,467
Total minimum payments required	$ 28,322	$ 7,981
Less amount representing interest		(3,091)
Present value of future payments		4,890
Less current portion		(41)

	Operating Leases	Tenant Improvement Loan
Non-current portion		$ 4,849

Build-to-suit Lease

In October 2000, we entered into a build-to-suit lease transaction with a special purpose entity to finance and manage construction of a San Carlos research and office facility. We contributed land and existing construction in progress to the special purpose entity and leased to property back for a period of 16 years. In addition, all costs related to the construction paid by us prior to the October transaction were reimbursed to us, and are recorded as a component of our capital lease financing obligations. Due to our continuing involvement in the special purpose entity and other provisions of the agreement, the special purpose entity is consolidated in our financial statements, as a capital lease obligation.

The future minimum lease payments under the terms of this lease agreement are as follows:

	(in thousands)
Years ending December 31,	
2001	$ 3,792
2002	5,508
2003	5,619
2004	5,731
2005	5,846
2006 and thereafter	73,976
Total minimum payments required	$ 100,472

Note 7 Stockholders' Equity

Common Stock

Employee Stock Purchase Plan

In February 1994**,** our Board of Directors adopted the Employee Stock Purchase Plan (the "Purchase Plan"). Under the Purchase Plan, 300,000 shares of common stock have been reserved for purchase by our employees pursuant to section 423(b) of the Internal Revenue Code of 1986. As of December 31, 2000, no shares of common stock have been issued under the Purchase Plan.

Stock Option Plans

2000 Equity Incentive Plan

Our 1994 Equity Incentive Plan was adopted by the Board of Directors on February 10, 1994 and was amended and restated in its entirety and renamed the "2000 Equity Incentive Plan" on April 19, 2000. The purpose of the 2000 Equity Incentive Plan is to attract and retain qualified personnel, to provide additional incentives to our employees, officers, consultants and employee directors and to promote the success of our business. Pursuant to the 2000 Equity Incentive Plan, we may grant or issue incentive stock options to employees and officers and non-qualified stock options, rights to acquire restricted stock and stock bonuses to consultants, employees, officers and employee directors. Options granted to non-employees are recorded at fair value based on the fair value measurement criteria of FAS 123.

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

The 2000 Equity Incentive Plan may be amended at any time by the Board, although certain amendments would require shareholder approval. The 2000 Equity Incentive Plan will terminate on February 9, 2010 unless earlier terminated by the Board.

Non-employee Directors' Stock Option Plan

On February 10, 1994, our Board of Directors adopted the Non-employee Directors' Stock Option Plan under which options to purchase up to 400,000 shares of our common stock at the then fair market value may be granted to our non-employee directors.

2000 Non-officer Equity Incentive Plan

Our 1998 Non-officer Equity Incentive Plan was adopted by the Board of Directors in on August 18, 1998 and was amended and restated in its entirety and renamed the "2000 Non-officer Equity Incentive Plan" on June 6, 2000 (the "2000 Plan"). The purpose of the 2000 Plan is to attract and retain qualified personnel, to provide additional incentives to employees and consultants and to promote the success of our business. Pursuant to the 2000 plan, we may grant or issue non-qualified stock options, rights to acquire

restricted stock and, stock bonuses to employees and consultants who are neither Officers nor Directors of Inhale.

The maximum term of a stock option under the 2000 Plan is ten years. The exercise price of stock options, and the purchase price of restricted stock granted under the 2000 Plan are determined by the Board of Directors. The 2000 Non-officer Equity Incentive Plan may be amended by the Board of Directors at any time.

A summary of activity under the 2000 Equity Incentive Plan, the Non-employee Directors' Stock Option Plan and the 2000 Non-officer Equity Incentive Plan is as follows:

		Options Outstanding		
	Options Available For Grant	**Number of Shares**	**Exercise Price Per Share**	**Weighted-Average Exercise Price Per Share**
	(in thousands, except per share information)			
Balance at December 31, 1997	1,914	4,702	$ 0.01-17.63	$ 6.74
Shares authorized	3,100			
Options granted	(2,138)	2,138	0.01-17.07	14.08
Options exercised		(348)	0.03-11.38	4.35
Options canceled	166	(166)	2.78-17.63	10.95
Balance at December 31, 1998	3,042	6,326	0.01-17.63	9.24
Shares authorized	2,500			
Options granted	(3,150)	3,150	0.01-20.94	13.58
Options exercised		(248)	0.01-17.06	6.3
Options canceled	122	(122)	5.01-17.06	13.23
Balance at December 31, 1999	2,514	9,106	0.01-20.94	10.76
Shares authorized	5,500			
Options granted	(4,283)	4,283	0.01-61.63	33.62
Shares awarded	(57)			
Options exercised		(2,173)	0.01-42.50	8.40

		Options Outstanding		
Options canceled	280	(280)	7.25-60.88	28.07
Balance at December 31, 2000	3,954	10,936	$ 0.01-61.63	$ 19.79

At December 31, 2000, 1999 and 1998, options were exercisable to purchase 2.9 million, 3.0 million and 2.1 million shares at weighted-average exercise prices of $11.27, $7.46 and $5.68 per share, respectively.

Weighted average fair value of options granted during the year ended December 31, 2000, 1999 and 1998, was $34.20, $14.17 and $14.21, respectively. The following table provides information regarding Inhale's stock option plans as of December 31, 2000.

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number**	**Weighted-Average Exercise Price Per Share**	**Weighted-Average Remaining Contractual Life (in years)**	**Number**	**Weighted-Average Exercise Price Per Share**
	(in thousands)			**(in thousands)**	
$0.01-0.03	227	$ 0.01	8.0	47	$ 0.02
0.11-1.39	103	0.63	2.9	103	0.63
2.78-9.81	1,827	6.50	5.1	1,225	5.64
10.94-38.53	7,453	19.18	8.5	1,524	16.35
40.19-61.63	1,326	46.37	9.6	25	42.78
$0.01-61.63	10,936	$ 19.79	7.9	2,924	$ 11.27

In 2000, the Company granted approximately 0.1 million options to employees and consultants with exercise prices below the market price of the stock on the grant date. The weighted-average exercise price and weighted-average fair value of these options as of December 31, 2000 were $20.07 and $26.61, respectively.

Pro forma information regarding net income and earnings per share is required by FAS 123, which also requires that the information be determined as if we had accounted for our employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	2000	**1999**	**1998**
Risk-free interest rate	6.4%	5.6%	4.8%
Dividend yield	0.0%	0.0%	0.0%
Volatility factor	0.688	0.600	0.700
Weighted average expected life	5 years	5 years	5 years

The Black-Scholes options valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in our opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our employee stock options. However, we have presented the pro forma net loss and pro forma basic and diluted net loss per common share using the assumptions noted above.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period, generally five years. Our pro forma information follows (in thousands except for earnings per share):

	Years ended December 31,		
	2000	1999	1998
Pro forma net loss	$ (122,989)	$ (48,077)	$ (24,325)
Pro forma basic and diluted net loss per common share	$ (2.93)	$ (1.42)	$ (0.78)

Warrants

During the year ended 2000, we issued six warrants to purchase a total of 16,000 shares of common stock. Some of the warrants bear an exercise price of $45.88 per share, expire in 10 years and are fully vested. Other warrants are exercisable under certain circumstances at a price to be determined and expire six years from the date on which any vested shares become exercisable. Total charges recorded during 2000 as a result of these issuances was approximately $0.1 million.

Stock Compensation

We recorded deferred compensation of approximately $1.2 million during the year ended December 31, 2000. Deferred compensation of $0.1 million had been recorded in the year ended December 31, 1999. These amounts represent the difference between the exercise price and the deemed fair market value of certain of our stock options granted in these periods and are being amortized to expense over the three-year vesting period of the options.

Reserved Shares

A total of 14.9 million shares of common stock have been reserved for issuance at December 31, 2000 for equity incentive plans and warrant exercises.

Note 8 Income Taxes

As of December 31, 2000, we had federal and state net operating loss carryforwards of approximately $156.2 million and $30.8 million, respectively. We also had federal and state research and other tax credit carryforwards of approximately $3.1 million and $2.6 million, respectively. The federal and state net operating loss and credit carryforwards will expire at various dates beginning through 2020 if not utilized.

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

Significant components of our deferred tax assets for federal and state income taxes as of December 31 are as follows:

	2000	1999
	(in thousands)	
Deferred tax assets:		
Net operating loss carryforwards	$ 55,000	$ 28,500
Research and other credits	4,900	3,700
Capitalized research expenses	3,400	1,600
Deferred revenue	1,900	1,900
Depreciation	1,000	1,300
Other	1,900	2,100

	2000	1999
Total deferred tax assets	68,100	39,100
Valuation allowance for deferred tax assets	(68,100)	(39,100)
Net deferred tax assets	$	$

Because of our lack of earnings history, the deferred tax assets have been fully offset by a valuation allowance. The valuation allowance increased by $29.0 million and $14.5 million during the years ended December 31, 2000 and 1999, respectively.

Note 9 Statement of Cash Flows Data

	Years Ended December 31,		
	2000	1999	1998
	(in thousands)		
Supplemental disclosure of cash flows information:			
Interest paid	$ 7,031	$ 470	$ 270
Supplemental schedule of non-cash investing and financing activities:			
Deferred compensation related to the issuance of stock options	$ 1,162	$ 964	$ 576
Issuance of common stock in connection with technology	$	$ 5,000	$
Issuance of common stock and options in connection with licensing agreement	$	$	$ 284

Note 10 Subsequent Events (unaudited)

In January 2001, we acquired all of the capital shares of Bradford Particle Design plc, a United Kingdom company, for approximately 3.75 million in newly issued shares of our common stock and approximately $20 million in cash. Bradford Particle Design plc's supercritical fluid processing technology reduces what is commonly now a multi-stage powder manufacturing process to a single step while improving product purity and consistency. A formal valuation by an independent third party is currently in process which will result in a charge reflecting purchased in-process research and development in connection with the acquisition.

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