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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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, 2002
or,

o **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: 0-23556

INHALE THERAPEUTIC SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

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

150 Industrial Road
San Carlos, California 94070
(Address of principal executive offices)

650-631-3100
(Registrant's telephone number, including area code)

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required 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 o

Applicable Only to Corporate Issuers

The number of outstanding shares of the registrant's Common Stock, $0.0001 par value, was 55,422,665 as of October 31, 2002.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2002	December 31, 2001
	(unaudited)	*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 44,676	$ 30,814
Short-term investments	268,877	313,542
Accounts receivable	3,710	4,487
Other current assets	12,134	11,998
Total current assets	329,397	360,841
Property and equipment, net	142,191	142,352
Marketable equity securities	53	721
Goodwill	130,120	133,856
Other intangible assets, net	16,596	19,977
Deposits and other assets	8,177	9,494
Total assets	$ 626,534	$ 667,241
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,198	$ 7,685
Accrued research and development	7,933	10,776
Accrued general and administrative	7,709	7,075
Accrued compensation	6,371	5,977
Accrued acquisition costs	—	2,046
Other accrued liabilities	605	3,172
Interest payable	5,725	4,588
Capital lease obligation — current	956	807
Deferred revenue	16,413	17,073
Total current liabilities	50,910	59,199
Capital lease obligation — noncurrent	32,341	31,909
Accrued rent	2,014	1,921
Convertible subordinated notes and debentures	299,149	299,149
Other long-term liabilities	5,471	4,750
Commitments and contingencies		
Stockholders' equity:		
Preferred Stock, 10,000 shares authorized		
Series A, $0.0001 par value: 3,100 shares designated; no shares issued or outstanding at September 30, 2002 and December 31, 2001.	—	—
Convertible Series B, $0.0001 par value: 40 shares designated; 40 shares issued and outstanding at September 30, 2002. No shares issued or outstanding at December 31, 2001. Liquidation preference of $40,000 at September 30, 2002 and $0 at December 31, 2001.	40,000	—
Common stock, $0.0001 par value; 300,000 authorized; 55,371 shares and 55,094 shares issued and outstanding at September 30, 2002 and December 31, 2001, respectively.	6	5
Capital in excess of par value	713,737	712,039
Deferred compensation	(358)	(923)
Accumulated other comprehensive gain	1,535	1,069
Accumulated deficit	(518,271)	(441,877)
Total stockholders' equity	236,649	270,313
Total liabilities and stockholders' equity	$ 626,534	$ 667,241

(*) The balance sheet at December 31, 2001 has been derived from the audited financial statements at that date which are included in our Form 10-K for the year ended December 31, 2001 as filed with the Securities and Exchange Commission. This balance sheet does not include all the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

See accompanying notes.

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

	Three-Months Ended September 30,		Nine-Months Ended September 30,	
	2002	2001	2002	2001
Revenue:				
Contract research revenue	$ 18,800	$ 17,236	$ 58,929	$ 48,132
Product sales	4,418	5,169	13,286	5,169
Total revenue	23,218	22,405	72,215	53,301
Operating costs and expenses:				
Cost of goods sold	1,940	1,979	5,503	1,979
Research and development	38,183	34,212	116,661	98,542
General and administrative	6,551	5,762	17,507	14,200
Purchased in-process research and development	—	—	—	146,260
Amortization of other intangible assets	1,127	1,127	3,381	1,884
Amortization of goodwill	—	7,816	—	14,594
Total operating costs and expenses	47,801	50,896	143,052	277,459
Loss from operations	(24,583)	(28,491)	(70,837)	(224,158)
Other income/(expense), net	(420)	(263)	(1,107)	(603)
Interest income	2,687	5,360	7,974	20,380
Interest expense	(4,205)	(3,527)	(12,424)	(9,375)
Net loss	$ (26,521)	$ (26,921)	$ (76,394)	$ (213,756)
Basic and diluted net loss per share	$ (0.48)	$ (0.49)	$ (1.38)	$ (4.07)
Shares used in computing basic and diluted net loss per share	55,316	54,845	55,226	52,513

See accompanying notes.

INHALE THERAPEUTIC SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Increase/(Decrease) in Cash and Cash Equivalents
(in thousands)
(unaudited)

	Nine-Months Ended September 30,	
	2002	2001
Cash flows used in operating activities:		
Net loss	$ (76,394)	$ (213,756)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	9,701	8,401
Amortization of other intangible assets	3,381	1,885
Amortization of goodwill	—	14,593
Amortization of debt issuance costs	951	1,377
Amortization of deferred compensation	430	695
Issuance of common stock for retirement plans	863	—
Stock-based compensation for services rendered	595	480
Purchased in-process research and development	—	146,260
Loss on impairment of marketable equity securities	392	—
Changes in assets and liabilities:		

(Increase)/decrease in accounts receivable, other current assets, and other assets	1,975	(1,273)
Increase/(decrease) in accounts payable and other accrued liablities	(4,336)	(2,393)
Increase in deferred revenue	162	715
Net cash used in operating activities	(62,280)	(43,016)
Cash flows from investing activities:		
Purchases of short-term investments	(197,855)	(413,201)
Sales of short-term investments	83,605	88,446
Maturities of short-term investments	158,477	350,768
Acquisition of Shearwater, net of cash acquired and purchase price adjustments	3,443	(67,246)
Acquisition of Bradford, net of cash acquired	—	(14,805)
Disposal of property and equipment	39	—
Purchases of property and equipment	(12,076)	(26,559)
Net cash provided by/(used in) investing activities	35,633	(82,597)
Cash flows from financing activities:		
Proceeds from loan and capital lease financing	1,146	15,119
Payments of loan and capital lease obligations	(1,013)	(593)
Issuance of preferred stock	40,000	—
Issuance of common stock, net of issuance costs	376	5,075
Net cash provided by financing activities	40,509	19,601
Net increase/(decrease) in cash and cash equivalents	13,862	(106,012)
Cash and cash equivalents at beginning of period	30,814	136,012
Cash and cash equivalents at end of period	$ 44,676	$ 30,000

See accompanying notes.

INHALE THERAPEUTIC SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2002
(unaudited)

Note 1—Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation

We are working to become the world's leading drug delivery company by providing a portfolio of technologies and expertise that will enable our pharmaceutical and biotechnology partners to improve drug performance throughout the drug development process. To fulfill these needs, we are providing several technologies. The first technology enables inhalation of delivery of a range of drugs, including peptides, proteins and small molecules for treatment of systemic and respiratory diseases. The second technology, advanced PEGylation, is designed to enhance the efficacy and performance of most major drug classes, including macromolecules such as peptides and proteins and smaller sized molecular compounds, and other drugs. A third technology, solution enhanced dispersion by supercritical fluids (SEDS™), uses a proprietary processing method known as supercritical fluids processing to develop drug formulations for multiple types of drug delivery.

Our consolidated financial statements include the financial statements of our subsidiaries: Shearwater Corporation ("Shearwater"), Bradford Particle Design Ltd. ("Bradford"), Inhale Therapeutic Systems Deutschland Gmbh ("Inhale Germany") and Inhale Therapeutic Systems, U.K. Limited ("Inhale UK"), as well as the financial statements of a real estate partnership lessor.

We expect to continue to incur substantial and potentially increasing losses over at least the next few years as we expand our research and development efforts and testing activities, scale up manufacturing operations and further expand our late stage clinical and early commercial production facility. 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 accompanying unaudited condensed consolidated financial statements of Inhale have been prepared by management in accordance with generally accepted accounting principles for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. The condensed consolidated balance sheet as of September 30, 2002, the condensed consolidated statements of operations for the three-month periods and the nine-month periods ended September 30, 2002 and 2001, and the consolidated statements of cash flows for the nine-month periods ended September 30, 2002 and 2001 have been prepared by us without audit, but include all adjustments (consisting only of normal recurring adjustments) which we consider necessary for a fair presentation of the financial position at such dates and the operating results and cash flows for those periods. Although we believe that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in financial statements and related footnotes prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2001, as filed with the SEC.

Use of Estimates

Results for any interim period presented are not necessarily indicative of results for any other interim period or for the entire year. 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.

Reclassifications

Certain prior year amounts have been reclassified to conform to the 2002 presentation.

Principles of Consolidation

Our consolidated financial statements include the accounts of the parent company, Inhale Germany, Inhale UK, the financial statements of a real estate lessor created to finance and manage construction of our new lab and office facility, and the accounts of Bradford and Shearwater, acquired during the 2001 fiscal year. All significant intercompany accounts and transactions are eliminated in consolidation.

Significant Concentrations

Cash equivalents and short-term investments are financial instruments that potentially subject us to concentration of risk to the extent of the amounts recorded in the consolidated balance sheet. We limit our concentration of risk by diversifying our investment amount 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 not experienced significant credit losses from our accounts receivable or collaborative research agreements, and none are currently expected. We perform a regular review of our customer activity and associate credit risks and do not require collateral from our customers.

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

We are dependent on Pfizer as the source of a significant proportion of our revenue. In the event that this collaboration is terminated, our ability to develop and supply our products could be impaired, which could have a material adverse effect on our business, financial condition and results of operation.

Should the Pfizer collaboration be discontinued prior to the launch of inhaleable insulin, we will need to find alternative funding sources to replace the collaborative revenue and will need to reassess the realizability of assets capitalized. Additionally, we may have contingent payments to our contract manufacturers to reimburse them for their capital outlay to the extent that they cannot re-deploy their assets and may incur additional liabilities.

Recent Accounting Pronouncements

In June 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 provides guidance related to accounting for costs associated with disposal activities covered by SFAS No. 144 or with exit or restructuring activities previously covered by Emerging Issues Task Force Issue No. 94-3 ("EITF 94-3"), "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 supersedes EITF 94-3 in its entirety. SFAS No. 146 requires that costs related to exiting an activity or to a restructuring not be recognized until the liability is incurred. SFAS No. 146 will be applied prospectively to exit or disposal activities that are initiated after December 31, 2002.

Cash, Cash Equivalents and Short-term 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, interest bearing money market funds and repurchase agreements. All other investments are classified as short-term investments. Short-term investments consist of federal and municipal government securities, corporate bonds and 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 two years.

At September 30, 2002, all 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 as accumulated other comprehensive gain/loss. 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.

Inventories

Inventories are included in other current assets on the balance sheet and consist primarily of raw materials, work-in-process and finished goods of our Shearwater subsidiary. Inventory is stated at the lower of cost (first-in, first-out method) or market, and consists of the following (in thousands):

	September 30, 2002	December 31, 2001
Raw materials	$ 1,919	$ 1,805

Work-in process	171	513
Finished goods	2,905	883
	$ 4,995	$ 3,201

Property and Equipment

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

We have expensed certain plant design, engineering and validation costs based on our evaluation that it is unclear whether such costs are ultimately recoverable.

Goodwill

On January 1, 2002, in accordance with SFAS No 142, *Goodwill and Other Intangible Assets,* we stopped the periodic amortization of goodwill and adopted a new policy for measuring goodwill for impairment. No impairment of goodwill was recognized in connection with the adoption of this new policy. We currently operate as a single reporting unit and all of our goodwill is associated with the entire company. Under our new policy, goodwill is tested for impairment at least annually, or on an interim basis if an event occurs or circumstances change that would more-likely-than-not reduce the fair value of the reporting unit below its carrying value. Goodwill is tested for impairment using a two-step approach. The first step is to compare the fair value of the reporting unit to its carrying amount,

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

Other Intangible Assets

Acquired technology and other intangible assets with definite useful lives are amortized on a straight-line basis over a period of five years. Intangible assets are tested for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value. Other intangible assets includes proprietary technology, intellectual property, and supplier and customer relationships acquired from third parties or in business combinations.

Impairment of Long-Lived Assets

We evaluate our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets*. Recoverability of assets to be held and used, including assets to be disposed of other than by sale, are measured by a comparison of the carrying amount of any asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceed the fair value of the assets. Assets to be sold are reported at the lower of the carrying amount or fair value less cost to sell.

Comprehensive Gain/Loss

Comprehensive gain/loss is comprised of net loss and other comprehensive gain/loss for the three-month and nine-month periods ended September 30, 2002 and 2001. Other comprehensive gain/loss included unrealized gains/losses on available-for-sale securities and translation adjustments (in thousands):

	Three-Month Period Ended September 30,		Nine-Month Period Ended September 30,	
	2002	2001	2002	2001
Net loss	$ (26,521)	$ (26,921)	$ (76,394)	$ (213,756)
Change in net unrealized gains/losses on available-for-sale securities	308	90	(49)	(6,907)
Net unrealized (gain)/loss reclassified into earnings	(94)	(1)	161	(712)
Translation adjustment	31	(41)	354	9
Comprehensive loss	$ (26,276)	$ (26,873)	$ (75,928)	$ (221,366)

Stock-Based Compensation

As permitted by the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, we account for our employee stock options in accordance with Accounting Principles Board Opinion ("APB") No. 25, *Accounting for Stock Issued to Employees* and related interpretations. 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.

Stock compensation expense for options granted to non employees has been determined in accordance with SFAS 123 and Emerging Issues Task Force No. 96-18 as the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measured. The fair value of options granted to non-employees is remeasured as the underlying options vest.

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. Payments received from milestone achievements are deferred and recorded as revenue over the next period of continued development. Revenue from grants and feasibility arrangements are recognized as the related costs are incurred and collection is assured. Our research revenue consists of reimbursement of development costs, reimbursement of certain expenses, payment of clinical supplies and amortization of milestones.

Costs of contract research revenue approximate such revenue and are included in research and development expenses. Product sales are recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed and determinable, and collectability is reasonably assured. Allowances, if any, are established for estimated product returns and discounts.

Research and Development

Research and development costs are expensed as incurred and include salaries, benefits, and other operating costs. We perform research and development for others pursuant to feasibility agreements and development and license agreements. Under these 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, products developed using our technologies are commercialized with a collaborative partner. Under these development agreements, we will be reimbursed for development costs, may also be entitled to milestone payments when and if certain development milestones are achieved and are compensated for the manufacture and supply of clinical and commercial product. All of our research and development agreements are generally cancelable by the partner without significant financial penalty.

Segment Reporting

We report segments in accordance with SFAS No. 131 *Disclosures About Segments of an Enterprise and Related Information.* SFAS 131 requires the use of a management approach in identifying segments of an enterprise. We are organized and operate as one operating segment.

Our research revenue is derived primarily from clients in the pharmaceutical and biotechnology industries. Contract research revenue from one partner represented 63% and 54% of our revenue for the three-months ended September 30, 2002 and September 30, 2001, respectively, and 62% and 65%

for the nine-months ended September 30, 2002 and 2001, respectively. Product sales relate to sales by our Shearwater subsidiary of manufactured PEGylated products.

Our accounts receivable balance contains trade receivables from product sales, feasibility agreements and collaborative research agreements. At September 30, 2002, two of our partners represented 50% of our accounts receivable balance, and no one partner had a balance greater than 10% of accounts receivable balance at December 31, 2001.

Net Loss Per Share

Basic and diluted net loss per common share is computed in accordance with SFAS No. 128, *Earnings Per Share*. Accordingly, the weighted average number of common shares outstanding are used while common stock issuable upon the conversion of debt, outstanding preferred stock and common stock equivalents for stock options and warrants are not included in the per share calculation as the effect of their inclusion would be antidilutive.

Note 2—Goodwill and Other Intangible Assets

Goodwill and other intangible assets consist of the following (in thousands):

	September 30, 2002	December 31, 2001
Goodwill	$ 152,958	$ 156,694
Accumulated amortization	(22,838)	(22,838)
Net goodwill	130,120	133,856
Other intangible assets:		
Core technology	8,100	8,100
Developed product technology	2,900	2,900
Intellectual property	7,301	7,301
Supplier and customer relations	5,140	5,140
Total other intangible assets	23,441	23,441
Accumulated amortization of other intangible assets	(6,845)	(3,464)
Net other intangible assets	16,596	19,977
Net goodwill and other intangibles	$ 146,716	$ 153,833

The goodwill balance decreased from December 31, 2001, due to certain purchase price adjustments, including income tax refunds received related to our acquisition of our Shearwater subsidiary.

Amortization expense related to other intangible assets totaled $1.1 million for each of the three-months ended September 30, 2002 and 2001. The estimated aggregate future amortization expense for other intangible assets remaining as of September 30, 2002 is as follows (in thousands):

Remainder of 2002	$	1,126
2003		4,507
2004		4,507
2005		4,507
2006		1,949
Total	$	16,596

Note 3—Business Acquisitions

Bradford's and Shearwater's results of operations included in the following pro forma financial information are derived from their unaudited financial statements for the year ended December 31, 2001. Bradford's financial statements have been adjusted, where appropriate, to present their financial position and results of operations in accordance with accounting principles generally accepted in the United States. The unaudited pro forma net loss and loss per share amounts do not include the charges for purchased research and development of approximately $146.3 million, due to its non-recurring nature, but includes the amortization of other intangible assets.

The unaudited pro forma results of our operations is presented for illustrative purposes only and is not necessarily indicative of the operating results or financial positions that would have occurred if the transactions had been consummated at the dates indicated, nor is it necessarily indicative of future operating results or financial position of the combined companies and should not be construed as representative of these amounts for any future dates or periods.

The following unaudited pro forma results of operations of Inhale for the nine-months ended September 30, 2001 assumes the acquisition of Bradford and Shearwater has been accounted for using the purchase method of accounting as of January 1, 2001 and assumes the purchase price has been allocated to the assets purchased and the liabilities assumed based on fair values at the date of acquisition. Pro forma results of operation include the adoption of SFAS 142 as of January 1, 2001 (unaudited, in thousands, except per share information).

	Nine-Months Ended September 30,	
	Actual 2002	Pro Forma 2001
Total revenues	$ 72,215	$ 59,616
Net loss	$ (76,394)	$ (56,289)
Net loss per share	$ (1.38)	$ (1.07)

Note 4—Contingencies

In August 2000, we entered into supply agreements with two contract manufacturers to provide for the manufacturing of our inhalation device. Under the terms of the agreements, we may be obligated to reimburse both parties for the actual undepreciated and unrecovered portion of any equipment procured or facilities established and the interest accrued for their capital overlay in the event that inhaleable insulin does not gain FDA approval to the extent that the contract manufacturers cannot re-deploy the assets. At the present time, it is not possible to estimate the loss that will occur should inhaleable insulin not be approved.

Note 5—Preferred Stock

The Company has authorized 10,000,000 shares of Preferred Stock, each share having a par value of $0.0001. Three million one hundred thousand (3,100,000) shares of Preferred Stock are designated Series A Junior Participating Preferred Stock (the "Series A Preferred Stock") and forty thousand (40,000) shares of Preferred Stock are designated as Series B Convertible Preferred Stock (the "Series B Preferred Stock").

Series A Preferred Stock

On June 1, 2001 the Board of Directors of the Company approved the adoption of a Share Purchase Rights Plan (the "Plan"). Terms of the Plan provide for a dividend distribution of one preferred share purchase right (a "Right") for each outstanding share of the Company's Common

Stock (the "Common Shares"). The Rights have certain anti-takeover effects and will cause substantial dilution to a person or group that attempts to acquire the Company on terms not approved by the Company's Board of Directors. The dividend distribution was payable on June 22, 2001 (the "Record Date") to the stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share of Series A Preferred Stock at a price of $225.00 per one one-hundredth of a share of Series A Preferred Stock (the "Purchase Price"), subject to adjustment. Each one one-hundredth of a share of Series A Preferred Stock has designations and powers, preferences and rights, and the qualifications, limitations and restrictions which make its value approximately equal to the value of a Common Share.

The Rights are not exercisable until the Distribution Date (as defined in the Certificate of Designation for the Series A Preferred Stock). The Rights will expire on June 1, 2011, unless the Rights are earlier redeemed or exchanged by the Company. Each share of Series A Preferred Stock will be entitled to a minimum preferential quarterly dividend payment of $1.00 but will be entitled to an aggregate dividend of 100 times the dividend declared per Common Share. In the event of

liquidation, the holders of the Series A Preferred Stock would be entitled to a minimum preferential liquidation payment of $100 per share, but would be entitled to receive an aggregate payment equal to 100 times the payment made per Common Share. Each share of Series A Preferred Stock will have 100 votes, voting together with the Common Shares. Finally, in the event of any merger, consolidation or other transaction in which Common Shares are exchanged, each share of Series A Preferred Stock will be entitled to receive 100 times the amount of consideration received per Common Share. Because of the nature of the Series A Preferred Stock dividend and liquidation rights, the value of one one-hundredth of a share of Series A Preferred Stock should approximate the value of one Common Share. The Series A Preferred Stock ranks junior to the Series B Preferred Stock and would rank junior to any other series of the Company's preferred stock. Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder of the Company, including, without limitation, the right to vote or to receive dividends.

Series B Convertible Preferred Stock

In connection with a strategic alliance with Enzon, Inc., we entered into a Preferred Stock Purchase Agreement pursuant to which we sold to Enzon and Enzon purchased from us forty thousand (40,000) shares of non-voting Series B Preferred Stock at a purchase price of one thousand dollars ($1,000) per share for an aggregate purchase price of forty million dollars ($40,000,000). A Certificate of Designation filed with the Secretary of State of Delaware sets forth the rights, privileges and preferences of the Series B Preferred Stock. Pursuant to the Certificate of Designation, the Series B Preferred Stock does not have voting rights. The Series B Preferred Stock is convertible, in whole or in part, into that number of shares of the Company's Common Stock (the "Conversion Shares") equal to the quotient of $1,000 per share divided by the Conversion Price. The "Conversion Price" shall initially be equal to $22.79 per share or 125% of the Closing Price and at no time can the Preferred Stock convert into shares of Common Stock at a discount to the Closing Price. The "Closing Price" equals $18.23 per share and was based upon the average of the Company's closing bid prices as listed on the Nasdaq National Market for the twenty (20) trading days preceding the date of the closing of the transaction.

The Series B Preferred Stock is convertible at the option of the holder after the first anniversary of the original issuance of the Series B Preferred Stock (the "Original Issue Date") or, if earlier, upon a Change in Control (as defined in the Certificate of Designation). Except with respect to an automatic conversion as described below, the Conversion Price shall be equal to 125% of the Closing Price until the third anniversary of the Original Issue Date. Upon the third anniversary of the Original Issue Date, the Conversion Price shall be adjusted to be equal to either (i) the Closing Price, in the event that the average of the closing bid prices of Inhale's Common Stock as quoted on the Nasdaq National Market

for the twenty (20) trading days preceding the third anniversary of the original issuance (the "Future Price") is less than or equal to the Closing Price; (ii) the Future Price (as defined above) if the Future Price is greater than the Closing Price but less than 125% of the Closing Price; or (iii) 125% of the Closing Price if the Future Price is equal to or greater than 125% of the Closing Price.

To the extent not previously converted, the Series B Preferred Stock will automatically convert into shares of Inhale Common Stock, based on the then effective Conversion Price, upon the earliest of (i) the fourth anniversary of the Original Issue Date; (ii) immediately prior to an Asset Transfer or Acquisition (as defined in the Certificate of Designation); or (iii) with the consent of the holders of a majority of the then outstanding Series B Preferred Stock immediately prior to a liquidation, dissolution or winding up of Inhale. In the event of an automatic conversion pursuant to an asset transfer, acquisition or liquidation, the adjustment mechanism described above will be applied immediately prior to the automatic conversion.

In the event of our Company's liquidation, dissolution or winding down, either voluntary or involuntary, following the payment of any distributions due the holders of any class of capital stock or series of preferred stock that ranks senior to the Series B Preferred Stock, the holders of the Series B Preferred Stock shall be entitled to receive, prior and in preference to any distribution of any of our assets or surplus funds to the holders of our Common Stock or any class of capital stock or series of preferred stock that does not rank senior to or on parity with the Series B Preferred Stock, an amount per share (as adjusted for any combinations, consolidations, stock distributions or stock dividends with respect to the Series B Preferred Stock) equal to up to $1,000.

Note 6—Agreement with Alliance Pharmaceutical

In March 2002, we announced the expansion of our agreement with Alliance Pharmaceutical Corp. regarding the PulmoSphere® particle and particle technology, aspects of which we initially acquired from Alliance in November 1999. The PulmoSphere® technology is a particle formation method designed to enhance the performance of drugs delivered via the lung in propellant-based metered-dose inhalers and dry powder inhalers. As a result of the supplemental agreement we have paid to Alliance $5.3 million in exchange for rights beyond inhaleable applications and other considerations, which was recorded as an expense in the three-months ended March 31, 2002. Under the terms of the supplemental agreement, we have the right to use the PulmoSphere® technology for alternative methods of delivery in addition to inhaleable applications. Further, Alliance assigned five new patent applications covering methods of producing microparticles to us. Alliance retains the rights to use the technology on products to be instilled directly into the lung, and obtains the rights to commercialize up to four products administered with inhalers, two of which will be royalty-free. We will pay Alliance future milestone or royalty payments on a reduced number of products developed by us or our licenses utilizing the technology. In addition we have the right to purchase chemicals used in the production process for drugs using the PulmoSphere® technology.

Note 7—Cross Platform Strategic Alliance

In January 2002, we announced a strategic alliance with Enzon that includes an agreement making us solely responsible for licensing Enzon's PEG patents, an option for Enzon to license our PEGylation patents, an agreement to explore the development of non-invasive delivery of single-chain antibody products via the pulmonary route and settlement of a patent infringement litigation originally filed by Enzon against Shearwater. As part of this broad alliance, we entered into a collaboration to develop three products using our Inhance™ inhaleables technology and/or SEDS™ technology. Under the terms of this collaboration, we will be responsible for the development of drug formulations for the agreed upon pharmaceutical agents as well as clinical and commercial manufacturing of the drug formulation and device combination. Enzon will be responsible for the clinical development and worldwide commercialization of the system. Inhale will receive research and development funding, milestone

payments as the program progresses through further clinical testing, and royalty payments once the product is commercialized. As part of this alliance, Enzon made a $40.0 million investment in our preferred stock.

Note 8—Litigation Matters

On August 30, 2002, a complaint was filed by David F. Kachensky in the Circuit Court of Madison County, Alabama, (the "Complaint") against J. Milton Harris, James R. Hudson, Jr., Shearwater Corporation and Inhale Therapeutic Systems, Inc., as the successor corporation to Shearwater, (the "Defendants"). Dr. Harris is the president of our Shearwater subsidiary. Among other things, the Complaint alleges that the Defendants breached a stock purchase/employment agreement allegedly entered into by and between certain of the Defendants and the Plaintiff prior to our acquisition of Shearwater, whereby the Defendants allegedly agreed to convey to the Plaintiff five percent (5%) of the capital stock of Shearwater outstanding as of December 1997. The Plaintiff seeks damages in the amount of approximately $15 million. On October 7, 2002, the Defendants filed answers to the Complaint denying the allegations and asserting affirmative defenses. Discovery has commenced, and no trial date has been set. The Company denies the allegations in the Complaint and intends to vigorously defend itself in the litigation.

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

Overview

We are working to become the world's leading drug delivery company by providing a portfolio of technologies and expertise that will enable our pharmaceutical and biotechnology partners to improve drug performance throughout the drug development process. We have been unprofitable since inception and expect to incur substantial operating losses over at least the next few years as we expand testing activities and manufacturing operations, and as we further expand our late stage clinical and early commercial production facility. Nonetheless, we do anticipate a decrease in unfunded research spending in the next three to five years, due to the combination of the completion of scale up and commercial readiness spending, the shifting of infrastructure spending to cost of goods sold for commercial product sales, and the anticipated partnering of Inhale-funded projects. To date, except for sales from four products using our advanced PEGylation technology, we have not sold any commercial products and do not anticipate receiving material revenue from product sales or royalties in the near future. For the period from inception through September 30, 2002, we incurred a cumulative net loss of approximately $518.3 million. The sources of our working capital have been equity offerings and convertible debt financings, financings of equipment acquisitions and tenant improvements, interest earned on investments of cash, and revenues from short-term research and feasibility agreements and development contracts. To date we have been primarily dependent upon equity and convertible debt financings to fund our working capital.

We have generally been compensated for research and development expenses during initial feasibility work performed under collaborative arrangements. In a typical collaboration, our partner will provide the drug, fund clinical and formulation development and market the resulting commercial product. We will supply the drug delivery approach and drug formulation. We will receive revenues from drug formulation manufacturing and other manufacturing activities, as well as royalties from sales of most commercial products. In addition, for products using our Inhance™ inhaleables technology, we expect to receive revenues from the supply of our device for the product along with any applicable drug processing. Partners that enter into collaborative agreements generally fund research and development through expense reimbursements and /or payments as we achieve certain key development and regulatory milestones. To achieve and sustain profitable operations, we, alone or with others, must successfully develop, obtain regulatory approval for, manufacture, introduce, market and sell products using our drug delivery and other drug delivery systems. There can be no assurance that we can generate sufficient product or contract research revenue to become profitable or to sustain profitability.

Recent Developments

In October 2002, we announced two appointments to our board of directors. Chris A. Kuebler, chairman of the board of directors and chief executive officer of Covance, Inc., and Michael Brown, chairman of the board of directors of Quantum Corporation, were elected to our board of directors, increasing the total number of board members to nine.

In October 2002, we announced that we had entered into a licensing, manufacturing and supply agreement with Celltech Group plc whereby Celltech will use Inhale's PEG technology and services for three of its proprietary pipeline products. These products include CDP 860, a PEGylated antibody fragment drug in Phase II clinical trials for cancer, as well as PEGylated antibody fragment products CDP 791 and CDP 484 in pre-clinical development for cancer and rheumatoid arthritis, respectively. Under the terms of the agreement, Inhale will provide exclusive development and manufacturing for each activated PEG in exchange for milestone and manufacturing payments and royalties on sales of successfully commercialized products.

In October 2002, we announced an agreement with InterMune to develop a PEGylated version of Infergen® (Interferon alfacon-1) (PEG-Infergen) for the treatment of chronic hepatitis C infections.

The agreement calls for Inhale to provide the PEGylation expertise and exclusive manufacturing for the reagent used in the PEGylation of Infergen. Infergen is a bio-engineered type I interferon alpha that is FDA-approved for the treatment of patients with chronic hepatitis C infections. The terms of the agreement provide that InterMune will conduct pre-clinical and clinical development of the product and commercialize it in North America and Inhale will receive milestones as the product progresses through the clinic and royalties on product sales.

In October 2002, we announced that F. Hoffmann-La Roche Ltd. ("Roche") received approval from the FDA for Pegasys® for the treatment of adults with chronic hepatitis C who have compensated liver disease and have not previously been treated with interferon alpha. In July 2002, we had previously announced that the FDA had granted priority review for Roche's combination therapy of Pegasys and Roche ribavirin tablets.

In October 2002, we announced that Eli Lilly and Company, our collaborative partner with respect to an inhaleable product for the treatment of osteoporosis (Forteo™), agreed to terminate the program for such product.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States. It 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.

We consider certain accounting policies related to revenue recognition, business combinations and accrued liabilities to be critical to our business operations and the understanding of our results of operations:

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 and biotechnology industries and consists of reimbursement of development costs, reimbursement of certain expenses, payment of clinical supplies and amortization of milestones. Payments received for milestones achieved are deferred and recorded as revenue over the next period of continued development.

Revenue from product sales is recorded when there is persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed and determinable and collectability is reasonably assured. Allowances, if any, are established for estimated product returns and discounts. Because we have only recently begun selling a limited number of products through the acquisition of our subsidiaries, we do not have substantial experience in establishing allowances for returns and discounts.

Business Combinations

Purchased In-Process Research and Development ("IPR&D")

IPR&D expense is determined based on an analysis using risk-adjusted cash flows expected to be generated by products that may result from in-process technologies purchased in connection with acquisitions or business combinations. This analysis includes forecasting future cash flows that are

expected to result from the progress made on each in-process project prior to the purchase dates. Cash flows are estimated by first forecasting, on a product-by-product basis, net revenues expected from the sales of the first generation of each in-process project and risk adjusting these revenues to reflect the probability of advancing to the next stage of the FDA approval process. The forecast data in the analysis is based on internal product level forecast information maintained by management in the ordinary course of managing the business. The inputs used by management in analyzing IPR&D is based on assumptions, which management believes to be reasonable but which are inherently uncertain and unpredictable. These assumptions may be incomplete or inaccurate, and no assurance can be given that unanticipated events and circumstances will not occur. Appropriate operating expenses are deducted from forecasted net revenues or on a product-by-product basis to establish a forecast of net returns on the completed portion of the in-process technology. Finally, net returns are discounted to a present value using discount rates that incorporate the weighted average cost of capital relative to the biotech industry and our company as well as product specific risks associated with the purchased in-process research and development products. The product specific risk factors include the product's phase of development, type of molecule under development, likelihood of regulatory approval, manufacturing process capability, scientific rationale, preclinical safety and efficacy data, target product profile, and development plan. In addition to the product specific risk factors, a discount rate is used for the purchase valuation, which represents a considerable risk premium to our weighted average cost of capital. The valuations used to estimate IPR&D require us to use significant estimates and assumptions that if changed, may result in a different valuation for IPR&D.

Impairment of Goodwill and Other Intangible Assets

In July 2001, the Financial Accounting Standards Board ("FASB") issued two statements as a result of its deliberations on the business combinations project: Statement of Financial Accounting Standards ("SFAS") No. 141 on *Business Combinations* and SFAS 142 on *Goodwill and Other Intangible Assets.* SFAS 141 was effective for any business combinations initiated after June 30, 2001 and also include the criteria for the recognition of intangible assets separately from goodwill. SFAS 142 was effective for fiscal years beginning after December 15, 2001 and requires that goodwill not be amortized, but rather be subject to an impairment test at least annually. Separately identified and recognized intangible assets resulting from business combinations completed before July 1, 2001 that do not meet the new criteria for separate recognition of intangible assets will be subsumed into goodwill upon adoption. In addition, the useful lives of recognized intangible assets acquired in transactions completed before July 1, 2001 will be reassessed and the remaining amortization periods adjusted accordingly. Effective January 1, 2002, consistent with the new business combination accounting rules, assembled workforce was reclassified as goodwill and is subject to an impairment assessment. 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 other intangible assets are impaired. To date, no such impairment losses have been recorded. The goodwill balance decreased from December 31, 2001 due to certain purchase price adjustments related to our acquisition of Shearwater. Other intangible assets have been amortized on a straight line basis for the three-months and nine-months ended September 30, 2002.

In accordance with the new accounting standard adopted on January 1, 2002, the totals for the three-month and the nine-month periods ended September 30, 2002 do not include amortization of goodwill and are comprised solely of amortization of other intangible assets. Had amortization of goodwill been continued beyond January 1, 2002, we would have recognized an additional $7.9 million and $23.7 million in amortization expense during the three-months and nine-months ended September 30, 2002. The total for the three-months and nine-months ended September 30, 2001 includes $1.1 million and $1.9 million of amortization expense of other intangible assets and $7.8 million and $14.6 million of amortization of goodwill.

Accrued Liabilities

Certain accrued liabilities reflect management's best estimates based on our specific historical experience and understanding of industry practice. We record a reserve for these matters when an adverse outcome is probable and the amount of the potential liability is reasonably estimable.

Results of Operations

Revenue for the three-months ended September 30, 2002 was $23.2 million compared to $22.4 million for the three-months ended September 30, 2001, an increase of 4%. Revenue for the nine-months ended September 30, 2002 was $72.2 million compared to $53.3 million for the nine-months ended September 30, 2001, an increase of 35%. The increase in revenue was primarily due to increased funding of partnered projects and the addition of PEGylation product sales by our Shearwater subsidiary. Pfizer represented approximately 63% and 62% of our revenues for the three-months and nine-months ended September 30, 2002. Product sales through our Shearwater subsidiary accounted for 19% and 18% of revenues in the three-months and nine-months ended September 30, 2002. Contract research revenue for the three-months and nine-months ended September 30, 2002 and 2001 also included reimbursed research and development expenses as well as the amortization of deferred up-front signing and progress payments received from our collaborative partners. Contract revenues are expected to fluctuate from year to year, and future contract revenues cannot be predicted accurately. The level of contract revenues depends in part upon future success in obtaining new collaborative agreements, timely completion of feasibility studies, the continuation of existing collaborations and achievement of milestones under current and future agreements. Product sales are dependent upon regulatory approval of new products for sale and adoption of current products in the market and cannot be accurately predicted.

Cost of goods sold is associated with product sales and was $1.9 million for the three-months ended September 30, 2002 based on product sales of $4.4 million from our Shearwater subsidiary during the quarter. Cost of goods sold for the nine-months ended September 30, 2002 was $5.5 million based on product sales of $13.3 million. For the three-months and nine-months ended September 30, 2001, costs of goods sold were $2.0 million based on product sales of $5.2 million, reflecting our acquisition of Shearwater in June 2001.

Research and development expenses were $38.2 million for the three-months ended September 30, 2002, as compared to $34.2 million for the three-months ended September 30, 2001. The 12% increase in 2002 as compared to 2001 was primarily attributable to increased spending associated with partner-funded projects. Research and development expenses for the nine-months ended September 30, 2002 and 2001 were $116.7 million and $98.5 million, an increase of 18%. The additional expenses were attributable to the increased spending on partner-funded programs and the operating expenses of our Shearwater subsidiary. In addition, we made a one-time payment of $5.3 million to Alliance for the rights beyond inhaleable applications for PulmoSphere® technology and other considerations in the three-months ended March 31, 2002. We expect unfunded research and development spending to decrease over the next three to four years due to the combination of shifting of scale up of commercial operations and spending to cost of goods sold for inhaled insulin, and the anticipated partnering of Inhale funded projects.

General and administrative expenses were $6.6 million for the three-months ended September 30, 2002 as compared to $5.8 million for the three-months ended September 30, 2001. The 14% increase in general and administrative expenses was primarily due to increased support associated with our manufacturing and development efforts, including administrative staffing, business development and marketing. General and administrative expenses were $17.5 million for the nine-months ended September 30, 2002 as compared to $14.2 million for the nine-months ended September 30, 2001. The

23% increase was primarily due to incremental support associated with our manufacturing and development efforts, including administrative staffing, business development and marketing, as well as the operating expenses of our Shearwater subsidiary.

IPR&D represents that portion of the purchase price of an acquisition related to research and development activities which: (i) have not demonstrated their technological feasibility, and (ii) have no alternative future uses. During the three-months and nine-months ended September 30, 2002 we did not incur any IPR&D charges. During the nine-months ended September 30, 2001, we incurred charges of $146.3 million related to our acquisitions of Bradford and Shearwater.

In June 2001, we completed our acquisition of Shearwater in exchange for approximately 4.0 million shares or options to acquire shares of our common stock and cash of $72.5 million. Of the total purchase consideration of $192.2 million, $108.6 million was allocated to the assets acquired based on their fair value on the date of acquisition, including $94.6 million in goodwill and other intangible assets. Approximately $83.6 million of the purchase price was allocated to IPR&D, which was determined to have no alternative future use and was charged as an expense during the three-months ended June 30, 2001.

In January 2001, we acquired all of the outstanding share capital of Bradford Particle Design in exchange for approximately 3.75 million in newly issued shares of our common stock and approximately $20.4 million in cash. Of the total purchase consideration of $152.1 million, $89.4 million was allocated to the assets acquired based on their fair value on the date of acquisition, including $80.1 million in goodwill and other intangible assets. Approximately $62.7 million of the purchase price was allocated to IPR&D, which was determined to have no alternative future use and was charged as an expense in the three-months ended March 31, 2001.

Amortization of other intangible assets expenses were unchanged at $1.1 million for the three-months ended September 30, 2002 as compared to the three-months ended September 30, 2001. For the nine-months ended September 30, 2002 and 2001, amortization of other intangible assets expenses were $3.4 million and $1.9 million, respectively. The increase in amortization and other intangible assets expenses in the nine-month period ended September 30, 2002 as compared to 2001, was associated with the amortization of intangible assets in connection with the acquisition of our Shearwater subsidiary in the second half of 2001.

There was no amortization of goodwill for the three-months and nine-months ended September 30, 2002 as compared to $7.8 million and $14.6 million for the three-months and nine-months ended September 30, 2001. The decrease was associated with the adoption of new accounting standards on January 1, 2002 with respect to business combinations. Goodwill and certain other intangible assets are no longer amortized and are subject to an impairment test at least annually. The useful lives of recognized intangible assets acquired in transactions will regularly be reassessed and the remaining amortization periods adjusted accordingly. Since January 1, 2002, we have periodically evaluated 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 other intangible assets are impaired. No impairment charges have been recorded for the three-months or nine-months ended September 30, 2002.

Other income/(expense), net, was ($0.4) million and ($0.3) million for the three-months ended September 30, 2002 and 2001, respectively. For the nine-months ended September 30, 2002 and 2001, other income/(expense), net, was ($1.1) million and ($0.6) million, respectively. The increase from 2001 to 2002 can primarily be attributed to a ($0.4) million realized loss on our marketable equity securities due to impairment.

Interest income was $2.7 million for the three-months ended September 30, 2002, as compared to $5.4 million for the three-months ended September 30, 2001. Interest income was $8.0 million during

the nine-months ended September 30, 2002, compared to $20.4 million earned during the nine-months ended September 30, 2002. The 50% and 61% decrease in interest income in the three-months and nine-months ended September 30, 2002 from the same period in 2001, respectively, were primarily due to our lower cash and investment balances and lower interest rates in the first nine-months of 2002 as compared to the same periods in 2001.

Interest expense was $4.2 million for the three-months ended September 30, 2002, as compared to $3.5 million for the three-months ended September 30, 2001. Interest expense was $12.4 million and $9.4 million, respectively, for the nine-months ended September 30, 2002 and 2001. The 19% and 33% increase in interest expense for the three-months and nine-months ended September 30, 2002, from comparable periods ended September 30, 2001, relates primarily to the interest expense on our capital lease obligation associated with our build-to-suit lease.

Liquidity and Capital Resources

We have financed our operations primarily through public and private placements of our debt and equity securities, revenues from development contracts and short-term research and feasibility agreements, financing of equipment acquisitions and tenant improvements, and interest income earned on our investments of cash. We do not utilize off-balance sheet financing arrangements as a source of liquidity or financing. At September 30, 2002, we had cash, cash equivalents and short-term investments of approximately $313.6 million.

Our operations used cash of $62.3 million in the nine-months ended September 30, 2002 as compared to $43.0 million for the corresponding period in 2001. The net operating loss for the nine-month period ended September 30, 2002 as compared to the corresponding period in 2001, differed from cash used in operations due to several factors. For the nine-months period ended September 30, 2001, our net loss of $213.8 million included non-cash expenses of $146.3 million of purchased in-process research and development associated with our acquisitions of Bradford and Shearwater. In addition we recorded $14.6 million in amortization of goodwill expense for the nine-month period ended September 30, 2001. Depreciation expense increased to $9.7 million for the nine-months ended September 30, 2002 from $8.4 million for the nine-months ended September 30, 2001, due to the inclusion of Shearwater and the build-to-suit lease with our real estate partnership lessor. Amortization of other intangible assets increased to $3.4 million for the nine-months ended September 30, 2002 as compared to $1.9 million for the nine-months ended September 30, 2001, due to the acquisition of Shearwater in the second half of 2001. The change in accounts receivable, other current assets and other assets for the nine-month period ended September 30, 2002 as compared to the nine-month period ended September 30, 2001 is primarily due to the increase in inventory of our Shearwater subsidiary. The change in accounts payable and other accrued liabilities for the nine-months ended September 30, 2002, as compared to the corresponding period in 2001 was primarily related to a $3.0 million payment to Enzon to cover expenses incurred in connection with defending litigation involving our branched PEG patents. The change in deferred revenue for the nine-months ended September 30, 2002 as compared to the nine-months ended September 30, 2001 was primarily due to the timing of partner payments in 2001.

Cash flows provided by investing activities were $35.6 million for the nine-months ended September 30, 2002 as compared to $82.6 million cash used for the nine-months ended September 30, 2001. Cash flows for the nine-months ended September 30, 2002, were generated primarily by the sale and maturity of investment securities. These cash proceeds were either re-invested or used in operations. The change in cash flows relating to investing activities for the nine-months ended September 30, 2002, compared to the nine-months ended September 30, 2001 was primarily attributable to an increase in cash requirements to support the acquisitions of Shearwater and Bradford in 2001. For the nine-months ended September 30, 2002, we received $3.4 million in income tax refunds related to Shearwater, which has been treated as an adjustment to purchase price. In connection with our

acquisition of Shearwater in September 2001, we paid net cash of $67.2 million for the nine-months ended September 30, 2001, which represents cash paid to Shearwater shareholders of $72.5 million, net of Shearwater's cash balance of $5.3 million. The remainder of the Shearwater acquisition was non-cash in nature. Also, in connection with our acquisition of Bradford, we paid net cash of $14.8 million for the nine-months ended September 30, 2001, which represents cash paid to Bradford shareholders of $20.4 million, net of Bradford cash balance of $5.6 million. The remainder of the Bradford acquisition was non-cash in nature. We purchased property and equipment of approximately $12.1 million and $26.6 million during the nine-months ended September 30, 2002 and 2001, respectively. The decrease in purchased property and equipment in 2002 as compared to 2001, reflects completion of the second phase of construction of a new San Carlos lab and office facility, offset by continued investment in our commercial manufacturing facilities, including device manufacturing at third-party contract manufacturers, and expansion of our San Carlos powder processing facilities.

Cash flows provided from financing activities were $40.5 million for the nine-months ended September 30, 2002 as compared to $19.6 million for the nine-months ended September 30, 2001. The cash inflow in 2002 was primarily related to our strategic alliance with Enzon that included a $40.0 million investment in our preferred stock (see Consolidated Financial Statements Note 7—Cross Platform Strategic Alliance). In 2001 we received $15.1 million from the loan and capital lease financing of our real estate lessor for the construction of our San Carlos lab and office facility.

We believe that research and development expenses should continue at current levels or higher through at least the next couple of years. Research and development expenses are associated with three general categories: (i) collaborative agreements under which spending is reimbursed by our partners; (ii) spending attributed to internally funded programs, and (iii) commercial readiness and infrastructure costs associated with commercial operations for our drug and third-party device manufacturing. We expect our cash requirements to continue at a comparable rate due to expected activities in these areas. Research and development costs will be dependent upon the number of collaborative agreements we are engaged in, the number of Inhale funded projects and the timing of our transition to commercial manufacturing of our San Carlos, Shearwater and Bradford operations.

Given our current cash requirements, we believe that we will have sufficient cash to meet our operating expense requirements for the next three years. We plan to continue to invest in our growth and the need for cash will be dependent upon the timing of these investments. Our capital needs will depend on many factors, including continued scientific progress in our research and development arrangements, progress with preclinical and clinical trials, the time and costs involved in obtaining regulatory approvals, the costs of developing and the rate of scaling up each manufacturing operation of our technologies, the timing and cost of our late stage clinical and early commercial production facility, the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims, the need to acquire licenses to new technologies and the status of competitive products. Of our convertible subordinated notes and debentures, $7.8 million and $291.4 million mature in 2006 and 2007, respectively. To satisfy our long-term needs, we intend to seek additional funding, as necessary, from corporate partners and from the sale of securities. Because we are an early stage biotechnology company, we do not qualify to issue investment grade debt or have access to certain credit facilities. As a result, any financing we undertake will likely involve the issuance of equity, convertible debt instruments or high-yield debt to fund our working capital. To date we have been primarily dependent upon equity and convertible debt financings for capital and have incurred substantial debt as a result of our issuances of subordinated notes and debentures that are convertible into our common stock. Our substantial debt, the market price of our securities and the general economic climate, among other factors, could have material consequences for the Company's financial position and could affect our sources of short-term and long-term funding. There can be no assurance that additional funds, if and when required, will be available to us on favorable terms, if at all.

RISK FACTORS

The following risk factors should be read carefully in connection with evaluating our business. Any of the following risks could materially and adversely affect our business, operating results or financial condition.

If our drug delivery technologies are not commercially feasible, then our revenues and results of operations will be impacted negatively.

We are in an early stage of development with respect to most of our products. There is a risk that our technologies will not be commercially feasible. Even if these drug delivery technologies are commercially feasible, they may not be commercially accepted across a range of large and small molecule drugs. We have tested 12 drug formulations using our inhaleables technology in humans, but many of our potential formulations have not been tested in clinical trials. We are currently using our advanced PEGylation technology platform we recently acquired through our acquisition of Shearwater in the development of 35 drugs. While we have incorporated our PEGylation technology in four products that the FDA approved for marketing and in one product that our partner has submitted for approval to the FDA through an NDA, and there are two other products using our PEGylation technologies in pivotal trials, many of the drug formulations with which we are incorporating this technology are in the early stages of feasibility or preclinical testing or in human clinical trials. Our SEDS™ supercritical fluids technology is also primarily in an early stage of feasibility. This technology represents a new method of manufacturing drug particles and is still in research and development, with only one formulation having entered human clinical testing.

Other companies have tested many of the underlying drug compounds contained in our drug formulations in humans using alternative delivery routes or technologies. Our potential products require extensive research, development and preclinical and clinical testing. Our potential products also may involve lengthy regulatory reviews before they can be sold. We do not know if, and cannot assure that, any of our potential products will prove to be safe and effective, accomplish the objectives that we and our collaborative partners are seeking through the use of our technologies, meet regulatory standards or continue to meet such standards if already approved. There is a risk that we and our collaborative partners may not be able to produce any of our potential products in commercial quantities at acceptable costs, or market them successfully. Failure to achieve commercial feasibility, demonstrate safety, achieve clinical efficacy, obtain regulatory approval or, together with partners, successfully market products will negatively impact our revenues and results of operations.

If our research and development efforts are delayed or unsuccessful, then we may be delayed or unsuccessful in commercializing our products and our business will suffer.

Except for our products that have already been approved by the FDA or submitted for approval by the FDA, our product candidates are still in research and development, including preclinical testing and clinical trials. Preclinical testing and clinical trials are long, expensive and uncertain processes. It may take us or our collaborators several years to complete this testing, and failure can occur at any stage in the process. Success in preclinical testing and early clinical trials does not ensure that later clinical trials will be successful. A number of companies in the pharmaceutical and biotechnology industries have suffered significant setbacks in later stage clinical trials, even after promising results in earlier trials.

Any clinical trial may fail to produce results satisfactory to us, our collaborative partners or the FDA. Preclinical and clinical data can be interpreted in different ways, which could delay, limit or prevent regulatory approval or commercialization. Negative or inconclusive results or adverse medical events during a clinical trial could cause a clinical trial to be repeated or a program to be terminated. We typically rely on collaborative partners and third-party clinical investigators to conduct clinical trials of our products and, as a result, we may face additional delaying factors outside our control.

We do not know if any of our research and development efforts, including preclinical testing or clinical trials will adhere to our planned schedules or be completed on a timely basis or at all. Typically, there is a high rate of attrition for product candidates in preclinical and clinical trials.

If our drug delivery technologies do not satisfy certain basic feasibility requirements, then our products may not be competitive.

We may not be able to achieve the total system efficiency for our products developed with our inhaleables technology needed to be competitive with alternative routes of delivery or formulation technologies. We determine total system efficiency by the amount of drug loss during manufacture, in the delivery system, and in reaching the ultimate site at which the drug exhibits its activity.

In the case of pulmonary delivery for systemic efficiency, deep lung bioavailability is the percentage of a drug that is absorbed into the bloodstream when that drug is delivered directly to the lungs as compared to when the drug is delivered by injection. Relative bioavailability is the initial screen for whether deep lung delivery using our inhaleables technology of any drug is commercially feasible. We would not consider a drug to be a good candidate for development and commercialization using our inhaleables technology if drug loss is excessive at any one stage or cumulatively in the manufacturing and delivery process.

Our ability to efficiently attach PEG polymer chains to a drug molecule is the initial screen as to whether drug formulations using our advanced PEGylation technology are commercially feasible. We would not consider a drug formulation using our advanced PEGylation technology if we could not efficiently attach a PEG polymer chain to such drug without destroying or impairing the drug's activity.

For our supercritical fluids technology, solubility characteristics of a drug and the solvents, which may be incorporated in the manufacturing process, provide the initial screen for whether drug formulations using this technology are commercially feasible. We would not consider a drug to be a good candidate for this technology if its solubility characteristics were such that the application of our technology results in very low efficiency in manufacturing of drug powders.

If our drug formulations are not stable, then we will not be able to commercialize our products.

We may not be able to identify and produce powdered or other formulations of drugs that retain the physical and chemical properties needed to work effectively with our delivery device for deep lung delivery using our inhaleables technology or through other methods of drug delivery using our other drug delivery technologies. Formulation stability is the physical and chemical stability of the drug over time and under various storage, shipping and usage conditions. Formulation stability will vary with each drug formulation and the type and amount of ingredients that are used in the formulation. Since our drug formulation technology is new and largely unproven, we do not know if our drug formulations will retain the needed physical and chemical properties and performance of the

drugs. Problems with formulated drug powder stability in particular would negatively impact our ability to develop and market products using our inhaleables or SEDS™ technologies or obtain regulatory approval of such products.

If our drug delivery technologies are not safe, then we may not obtain regulatory approval of our products or adequately develop or market our products.

We or our collaborative partners may not be able to prove potential products using our drug delivery technologies are safe. Our products require lengthy laboratory, animal and human testing. Most of our products are in preclinical testing or the early stage of human testing. Since most of our products are in an early stage of testing and have not completed clinical trials, we cannot be certain that these products, and our technology that developed these products, are safe or will not produce unacceptable adverse side effects. The safety of our formulations will vary with each drug and the

ingredients used in our formulation. If any product is found not to be safe, the product will not be approved for marketing or commercialization.

If product liability lawsuits are brought against us, we may incur substantial liabilities.

The testing, marketing and sale of medical products entail an inherent risk of product liability. If product liability costs exceed our liability insurance coverage, we may incur substantial liabilities. Whether or not we were ultimately successful in product liability litigation, such litigation would consume substantial amounts of our financial and managerial resources, and might result in adverse publicity, all of which would impair our business. We may not be able to maintain our clinical trial insurance or product liability insurance at an acceptable cost, if at all, and this insurance may not provide adequate coverage against potential claims or losses.

If our inhaleable drug delivery technologies do not provide consistent doses of medicine, then we will not be able to develop, obtain regulatory approval for and commercialize our products.

We may not be able to provide reproducible dosing of stable formulations of drug compounds. Reproducible dosing is the ability to deliver a consistent and predictable amount of drug into the bloodstream over time both for a single patient and across patient groups. Reproducible dosing of drugs using our inhaleables technology requires the development of:

- an inhalation or other device that consistently delivers predictable amounts of dry powder to the deep lung;
- accurate unit dose packaging of dry powder; and
- moisture resistant packaging.

Since our inhaleable drug delivery technologies are still in development and are yet to be commercialized, we cannot be certain that we will be able to develop reproducible dosing of any potential product. The failure to do so means that we would not consider such a product as a good candidate for development and commercialization.

If our collaborative partners that we depend on to obtain regulatory approvals and commercialization of our products are not successful, or if such collaboration fails, then our product development or commercialization of our products may be delayed or unsuccessful.

Because we are in the business of developing technology for delivering drugs to the lungs and producing improved drug formulations for other routes of delivery, and licensing these technologies to companies that make and sell drugs, we do not have the people and other resources to do the following things:

- synthesize bulk drugs to be used as medicines;
- design and conduct large scale clinical studies;
- prepare and file documents necessary to obtain government approval to sell a given drug product; or
- market and sell our products when and if they are approved.

When we sign a collaborative development agreement or license agreement to develop a product with a drug or biotechnology company, the drug or biotechnology company agrees to do some or all of the things described above.

Reliance on collaborative relationships poses a number of risks, including:

- we will not be able to control whether and the extent to which our collaborative partners will devote sufficient resources to our programs or products;
- disputes may arise in the future with respect to the ownership of rights to technology and/or intellectual property developed with collaborative partners;
- disagreements with collaborative partners could lead to delays in or termination of the research, development or commercialization of product candidates, or result in litigation or arbitration;
- contracts with our collaborative partners may fail to provide significant protection or may fail to be effectively enforced if one of these partners fails to perform; collaborative partners have considerable discretion in electing whether to pursue the development of any additional products and may pursue alternative technologies or products either on their own or in collaboration with our competitors;

- collaborative partners with marketing rights may choose to devote fewer resources to the marketing of our products than they do to products of their own development;

- there are risks related to the ability of our distributors and corporate partners to pay us; and

- collaborative partners may have the unilateral right to terminate their agreements with us for any or no reason.

Given these risks, there is a great deal of uncertainty regarding the success of our current and future collaborative efforts.

In October 2001, Eli Lilly and Company, our collaborative partner with respect to a Phase I program for an inhaleable product for the treatment of osteoporosis, Fortéo™, notified us that the program will not be funded in 2002. Lilly further notified us earlier this year that it did not plan to fund program work in 2003 and both companies mutually agreed to terminate the program in October 2002. In January 2002, Biogen, our collaborative partner with respect to a Phase I program for an inhaleable product for the treatment of multiple sclerosis, announced that it does not plan to further develop inhaleable Avonex® for multiple sclerosis at this time and formally terminated the program for such product effective as of September 2002. If other significant collaborations are suspended or terminated, our ability to successfully commercialize certain of our other proposed products would also be negatively impacted. If these efforts fail, our product development or commercialization of products could be delayed.

If we fail to establish future successful collaborative relationships, then our financial results may suffer and our product development efforts may be delayed or unsuccessful.

We intend to seek future collaborative relationships with pharmaceutical and biotechnology partners to fund some of our research and development expenses and to develop and commercialize potential products. Further, we anticipate that the timing of drug development programs under existing collaborative agreements with our partners will continue to affect our revenues from such agreements. We may not be able to negotiate acceptable collaborative arrangements in the future, and any arrangements we do negotiate may not be successful. If we fail to establish additional collaborative relationships, we will be required to undertake research, development, marketing and manufacturing of our proposed products at our own expense or discontinue or reduce these activities.

If we or our partners do not obtain regulatory approval for our products on a timely basis, then our revenues and results of operations may be affected negatively.

There is a risk that we or our partners will not obtain regulatory approval for our unapproved products on a timely basis, or at all. Our unapproved products must undergo rigorous animal and

human testing and an extensive FDA mandated or equivalent foreign authorities review process. This process generally takes a number of years and requires the expenditure of substantial resources and the time required for completing such testing and obtaining such approvals is uncertain. The FDA and other U.S. and foreign regulatory agencies also have substantial discretion to terminate clinical trials, require additional testing, delay or withhold registration and marketing approval and mandate product withdrawals including recalls. The FDA has approved for marketing four products with our advanced PEGylation technology for specific uses in the United States. Further, one additional product with PEGylation has been approved in Europe and other countries. In addition, our partners have submitted for approval to the FDA one NDA using our PEGylation technology and we plan to manufacture and market other potential products. Even though our partners have obtained regulatory approval for four products, these products and our manufacturing processes are subject to continued review by the FDA and other regulatory authorities. Even if our partners receive regulatory approval of a product, the approval may limit the indicated uses for which our partners may market the product. In addition, our partners' marketed products, our manufacturing facilities and we, as the manufacturer in certain instances, will be subject to continual review and periodic inspections. Later discovery from such review and inspection of previously unknown problems may result in restrictions on our partners' products or on us, including withdrawal of our partners' products from the market. The failure to obtain timely regulatory approval of our partners' products, any product marketing limitations or a product withdrawal would negatively impact our revenues and results of operations.

In addition, we may encounter delays or rejections based upon changes in FDA regulations or policies, including policy relating to current good manufacturing practice compliance, or "cGMP", during the period of product development. We may encounter similar delays in other countries.

In October 2002, Pfizer, our collaborative partner in the development of inhaleable insulin for the treatment of Type 1 and Type 2 diabetes announced that they will complete additional long-term studies well underway for Exubera®, their inhaled insulin development program, and that they are continuing discussions with the FDA regarding the timing of a related NDA submission. Any delay in the filing of this NDA may result in a delay in the approval of the NDA by the FDA, if such approval is received at all. Any material delay in the regulatory approval of this product or failure to receive regulatory approval of this product would negatively impact our results of operations.

If our technologies cannot be integrated successfully to bring products to market, then our ability to develop, and our partners' ability to obtain approval or market our products, may be delayed or unsuccessful.

We may not be able to integrate all of the relevant technologies to provide complete drug delivery and formulation systems. In particular, our development of drugs using our inhaleables technology relies upon several different but related technologies:

- dry powder formulations;

- dry powder processing technology;

- dry powder packaging technology; and

- deep lung delivery devices.

Our other drug delivery development efforts may face similar challenges relating to the integration of drug formulation, processing, packaging and delivery device technologies. At the same time we must:

- establish collaborations with partners;
- perform laboratory and clinical testing of potential products; and
- scale-up our manufacturing processes.

We must accomplish all of these steps without delaying any aspect of technology development. Any delay in one component of product or business development could delay our ability to develop, and our partners' ability to obtain approval or market products using our delivery and formulation technologies.

If we are not able to manufacture our products in commercially feasible quantities or at commercially feasible costs, then our products will not be successfully commercialized.

Advanced PEGylation and SEDS™ Technologies

Except for the four approved PEGylation products and one product pending approval with our advanced PEGylation technology, all of the drug formulations with which we are incorporating the advanced PEGylation and SEDS™ technologies are in various stages of feasibility testing or human clinical trials. At this time, our existing facilities are large enough for most commercial scale manufacturing to meet current demand. In the future, we may have to expand our facilities if we are not able to scale-up to large clinical trials or commercial manufacturing for products incorporating either of these technologies in a timely manner or at a commercially reasonable cost. Our failure to solve any of these problems could delay or prevent late stage clinical testing and commercialization of our products and could negatively impact our revenues and results of operations.

Inhaleables Technology

Powder Processing. We have no experience manufacturing powder processing products for commercial purposes. With respect to drugs using our inhaleables technology, we have only performed powder processing on the scale needed for testing formulations, and for early stage and larger clinical trials. We may encounter manufacturing and control problems as we attempt to scale-up powder processing facilities. We may not be able to achieve such scale-up in a timely manner or at a commercially reasonable cost, if at all. Our failure to solve any of these problems could delay or prevent some late stage clinical testing and commercialization of our products and could negatively impact our revenues and results of operations.

To date, we rely primarily on one particular method of powder processing. There is a risk that this technology will not work with all drugs or that the cost of drug production will preclude the commercial viability of certain drugs. Additionally, there is a risk that any alternative powder processing methods we may pursue will not be commercially practical for aerosol drugs or that we will not have, or be able to acquire the rights to use, such alternative methods.

Powder Packaging. Our fine particle powders and small quantity packaging utilized for drugs using our inhaleables technology require special handling. We have designed and qualified automated filling equipment for small and moderate quantity packaging of fine powders. We face significant technical challenges in scaling-up an automated filling system that can handle the small dose and particle sizes of our powders in commercial quantities. There is a risk that we will not be able to scale-up our automated filling equipment in a timely manner or at commercially reasonable costs. Any failure or delay in such scale-up would delay product development or bar commercialization of products using our inhaleables technology and would negatively impact our revenues and results of operations.

Inhalation Device. We face many technical challenges in developing our inhalation devices to work with a broad range of drugs, to produce such a device in sufficient quantities and to adapt the device to different powder formulations. Our device is still in clinical testing and production scale-up work is underway. Further design and development work is underway to enable commercial manufacturing and additional work may be required to optimize the device for regulatory approval, field reliability or other issues that may be important to its commercial success. Additional design and development work may lead to a delay in regulatory approval, efforts to seek regulatory approval for any product that incorporates the device or the time the device could be ready for commercial launch. In addition, we are attempting to develop a smaller inhalation device, which presents particular

technical challenges. There is a risk that we will not successfully achieve any of these challenges. Our failure to overcome any of these challenges would negatively impact our revenues and results of operations.

For late stage clinical trials and initial commercial production, we intend to use one or more contract manufacturers to produce our drug delivery devices. There is a risk that we will not be able to maintain arrangements with our contract manufacturers or effectively scale-up production of our drug delivery devices through contract manufacturers. Our failure to do so would negatively impact our revenues and results of operations. Because our manufacturing processes and those of our contract manufacturers are very complex and subject to lengthy governmental approval processes, alternative qualified production sources or capacity may not be available on a timely basis or at all. Disruptions or delays in our manufacturing processes or those of our contract manufacturers for existing or new products could result in increased costs, loss of revenues or market share, or damage to our reputation.

We depend on sole or exclusive suppliers for our inhalation device, bulk drugs and PEG polymer chains and if such suppliers fail to provide when required, then our product development efforts may be delayed or unsuccessful.

We have agreed to subcontract the manufacture of our inhalation device before commercial production of our first inhaleable technology product. We have identified contract manufacturers that we believe have the technical capabilities and production capacity to manufacture our inhalation device and which can meet the requirements of cGMP. We are not certain that we will be able to maintain satisfactory contract manufacturing on commercially acceptable terms, if at all. Our dependence on third parties for the manufacture of our inhalation devices may negatively impact our cost of goods and our ability to develop and commercialize products using our inhaleables technology on a timely and competitive basis.

We obtain the bulk drugs we use to manufacture the drugs using our drug delivery and formulation technologies from sole or exclusive sources of supply. For example, with respect to our source of bulk insulin, we have entered into a collaborative agreement with Pfizer which has, in turn, entered into an agreement with Aventis Pharma to manufacture biosynthetic recombinant insulin. Under the terms of their agreement, Pfizer and Aventis Pharma agreed to construct a jointly owned manufacturing plant in Frankfurt, Germany. Until needed, Pfizer will provide us with insulin from Aventis Pharma's existing plant.

We have also entered into an exclusive agreement with one supplier for a significant portion of the PEG polymer chains we use in our products that incorporate PEGylation technology. NOF Corporation is our predominant supplier of pharmaceutical grade PEGylation materials pursuant to an exclusive supply agreement with NOF that provides for the supply of these materials. If our sole or exclusive source suppliers fail to provide either bulk drugs or PEGylation materials in sufficient quantities when required, our revenues and results of operations will be negatively impacted.

If the market does not accept products using our drug delivery technologies, then our revenues and results of operations will be adversely affected.

The commercial success of our potential products depends upon market acceptance by health care providers, third-party payors like health insurance companies and Medicare and patients. Our products under development use new drug delivery technologies and there is a risk that our potential products will not be accepted by the market. Market acceptance will depend on many factors, including:

- the safety and efficacy of products demonstrated in our clinical trials;
- favorable regulatory approval and product labeling;
- the frequency of product use;

- the availability of third-party reimbursement;
- the availability of alternative technologies; and
- the price of our products relative to alternative technologies.

There is a risk that health care providers, patients or third-party payors will not accept product using our drug delivery and formulation technologies. If the market does not accept our potential products, our revenues and results of operations would be significantly and negatively impacted.

If our products are not cost effective, then government and private insurance plans may not pay for them.

In both domestic and foreign markets, sales of our products under development will depend in part upon the availability of reimbursement from third-party payors, such as government health administration authorities, managed care providers, private health insurers and other organizations. In addition, such third-party payors are increasingly challenging the price and cost effectiveness of medical products and services. Significant uncertainty exists as to the reimbursement status of newly approved health care products. Legislation and regulations affecting the pricing of pharmaceuticals may change before regulatory agencies approve our proposed products for marketing. Adoption of such legislation and regulations could further limit reimbursement for medical products. A government or third-party payor decision to not provide adequate coverage and reimbursements for our products would limit market acceptance of such products.

If our competitors develop and sell better drug delivery and formulation technologies, then our products or technologies may be uncompetitive or obsolete and our revenues and results of operations will be adversely affected.

We are aware of other companies engaged in developing and commercializing pulmonary drug delivery and formulation systems, as well as drug delivery technologies similar to the SEDS™ technology and the advanced PEGylation technology we are developing. Some of our competitors with regard to inhaleables technology include AeroGen, Inc., Alkermes, Inc. and Aradigm Corporation. Aerogen and Aradigm are developing liquid drug delivery systems, and Alkermes is working on a dry powder delivery system. Our competitors with regard to advanced PEGylation technology include Valentis, Inc., Mountain View Pharmaceuticals, Inc. and SunBio PEG-SHOP, as well as several pharmaceutical and biotechnology companies with in-house PEGylation expertise. Some of our competitors with regard to SEDS™ technology include Alkermes, Battelle Memorial Institute, Ethypharm SA, Ferro Corp., Lavipharm SA and RxKinetics. Some of these companies license or provide the technology to other companies, while others are developing the technology for internal use. Many of these companies have greater research and development capabilities, experience, manufacturing, marketing, financial and managerial resources than we do and represent significant competition for us. Acquisitions of or collaborations with competing drug delivery companies by large pharmaceutical or biotechnology companies could enhance our competitors' financial, marketing and other resources. Accordingly, our competitors may succeed in developing competing technologies, obtaining regulatory approval for products or gaining market acceptance before us. Developments by others could make our products or technologies uncompetitive or obsolete. Our competitors may introduce products or processes competitive with or superior to ours.

If any of our patents are invalid or pending patents do not issue or following issuance are deemed not valid, then we may lose key intellectual property right protection. If our products infringe on third-party's rights, then we will suffer adverse effects on our ability to develop and commercialize products as well as our revenues and results of operations.

We have filed patent applications covering certain aspects of our inhalation devices, powder processing technology, powder formulations and deep lung route of delivery for certain molecules as well as for our advanced PEGylation and SEDS™ supercritical fluids technologies, and we plan to file additional patent applications. We currently have 357 issued U.S. and foreign patents that cover certain aspects of our technology and we have a number of patent applications pending. There is a risk that many of the patents applied for will not issue, or that any patents that issue or have issued will not be held valid and enforceable. Enforcing our patent rights would be time consuming and costly.

Our access or our partners' access to the drugs to be formulated using our technologies will affect our ability to develop and commercialize our technology. Many drugs, including powder formulations of certain drugs that are presently under development by us, and our drug formulation technologies are subject to issued and pending U.S. and foreign patents that may be owned by competitors. We know that there are issued patents and pending patent applications relating to the formulation and delivery of large and small molecule drugs, including several for which we are developing deep lung or other delivery formulations using our various technologies. This situation is highly complex, and the ability of any one company, including us, to commercialize a particular drug is unpredictable.

We intend generally to rely on the ability of our partners to provide access to the drugs that we formulate for deep lung and other forms of delivery. There is a risk that our partners will not be able to provide access to such drug candidates. Even if our partners provide such access, there is a risk that third parties will accuse, and possibly a court or a governmental agency will determine, our partners or us to be infringing a third-party's patent rights, and we will be prohibited from working with the drug or be found liable for damages that may not be subject to indemnification. Any such restriction on access to drug candidates or liability for damages would negatively impact our revenues and results of operations.

We may incur material litigation costs which may adversely affect our business and results of operations.

We are party to various litigation matters including, several which relate to our patent and intellectual property rights. We cannot predict with certainty the eventual outcome of any pending litigation or potential future litigation, and we might have to incur substantial expense in defending these or future lawsuits or indemnifying third parties with respect to the results of such litigation.

If earthquakes and other catastrophic events strike, our business may be negatively affected.

Our corporate headquarters, including a substantial portion of our research and development operations, are located in the Silicon Valley area of Northern California, a region known for seismic activity. A significant natural disaster such as an earthquake could have a material adverse impact on our business, operating results, and financial condition. Certain of our other facilities and our collaborative partners located elsewhere may also be subject to catastrophic events such as hurricanes and tornadoes, any of which could have a material adverse effect on our business, operating results, and financial condition.

The recent energy crisis in California could disrupt our business and the businesses of our suppliers, contract manufacturers and collaborative partners, and could increase our expenses.

In the recent past, the western United States (and California in particular) has experienced episodes of diminished electrical power supply, and it is possible that this situation could worsen in the

near future. As a result of these episodes, certain of our operations or facilities may continue to be subject to "rolling blackouts" or other unscheduled interruptions of electrical power. The prospect of such unscheduled interruptions may continue for the foreseeable future, and we are unable to predict their occurrence or duration. Certain of our contract manufacturers and collaborative partners are also located in this area and their operations may also be materially and adversely affected by such interruptions, which in turn could have a material adverse effect on our business or results of operations.

Investors should be aware of industry-wide risks which are applicable to us and may affect our revenues and results of operations.

In addition to the risks associated specifically with us described above, investors should also be aware of general risks associated with drug development and the pharmaceutical and biotechnology industries. These include, but are not limited to:

- changes in and compliance with government regulations;
- handling and disposal of hazardous materials;
- workplace health and safety requirements;
- hiring and retaining qualified people; and
- insuring against product liability claims.

If we fail to manage our growth effectively, our business may suffer.

Our ability to offer commercially viable products, achieve our expansion objectives, manage our growth effectively and satisfy our commitments under our collaboration agreements depends on a variety of factors, all of which must be successfully managed. Key factors include our ability to develop products internally, enter into strategic partnerships with collaborators, attract and retain skilled employees and effectively expand our internal organization to accommodate anticipated growth including integration of any potential businesses that we may acquire. If we are unable to manage some or all of these factors effectively, our business could grow too slowly or too quickly to be successfully sustained, thereby resulting in material adverse effects on our business, financial condition and results of operations.

If we do not effectively integrate personnel and operations relating to our acquisitions of Bradford Particle Design and Shearwater, our business and management may suffer disruptions.

Our acquisitions of Bradford Particle Design and Shearwater may present unique risks related to our business. We may not be able to successfully assimilate the additional personnel, operations, acquired technology and products into our business. In particular, we need to assimilate and retain key management, research and engineering personnel. Key personnel from acquired companies such as Bradford Particle Design and Shearwater often decide to pursue other opportunities. In addition, there may be complications if we attempt to integrate any of the technology acquired from these companies with our other technologies, and it is uncertain whether we may accomplish this easily or at all. These integration difficulties could disrupt our ongoing business, distract management and employees or increase expenses. Acquisitions are inherently risky, and we may also face unexpected costs, which may adversely affect operating results in any quarter. Additionally, because Bradford Particle Design is a UK company, we will face additional risks related to cross-border acquisitions and international operations, including foreign legal and regulatory restrictions and potential economic instability. Due diligence conducted in connection with either acquisition may not have uncovered all the potential problems or liabilities we may have assumed in these transactions. Any of these risks could have a

significant impact on our ability to continue our research and development efforts, and regulatory and commercialization efforts on a competitive and timely basis.

We cannot predict the impact of recent actions and comments by the Securities and Exchange Commission regarding valuation methodologies related to business combinations and as such, we may need to restate our financial statements which may alter our operating results.

The Securities and Exchange Commission has been reviewing registrants' valuation methodologies of in-process research and development related to business combinations. The valuations we placed on Bradford Particle Design and Shearwater included certain assumptions about the technology, development and future operations of these businesses. These assumptions also determined in large part how we reflected these acquisitions in our financial statements. While we believe that we are in compliance with all of the existing rules and related guidance applicable to our business operations, if the SEC does not agree with our valuation

methodologies, or if the assumptions taken at the time of the valuation are not achieved, we may be required to restate our financial statements. In addition, the SEC may change these rules or issue new guidance applicable to our business in the future. There can be no assurance that the SEC will not seek to reduce the amount of in-process research and development previously expensed by us or require us to make an adjustment related to our valuation assumptions. This would result in the restatement of our previously filed financial statements and could have a material adverse effect on our operating results and financial condition for periods subsequent to the acquisitions.

If we acquire additional companies, products or technologies, we may face risks similar to those faced in our other acquisitions.

We may continue to acquire or make investments in complementary companies, products or technologies. We may not realize the anticipated benefits of any other acquisition or investment. If we acquire another company, we will likely face some or all of the same risks, uncertainties, earnings and disruptions as discussed above with respect to the Bradford and Shearwater acquisitions. We may face risks relating to difficult integrations of personnel, technology and operations, uncertainty whether any integration will be successful and whether earnings will be negatively affected, and potential distractions to our management with respect to these acquisitions. In addition, our earnings may suffer because of acquisition-related costs.

We expect to continue to lose money for the next few years and may not reach profitability if our products do not generate sufficient revenue.

We have never been profitable and, through September 30, 2002 we have an accumulated deficit of approximately $518.3 million. We expect to continue to incur substantial and potentially increasing losses over at least the next few years as we expand our research and development efforts, testing activities and manufacturing operations, and as we further expand our late stage clinical and early commercial production facility. Most of our potential products are in the early stages of development. Except for the approved advanced PEGylation technology products, we have generated no revenues from product sales. Our revenues to date have consisted primarily of payments under short-term research and feasibility agreements and development contracts. To achieve and sustain profitable operations, we must, alone or with others, successfully develop, obtain regulatory approval for, manufacture, introduce, market and sell products using our drug delivery technologies. There is risk that we will not generate sufficient product or contract research revenue to become profitable or to sustain profitability.

If we cannot raise additional capital our financial condition may suffer.

We anticipate that our existing capital resources will enable us to maintain currently planned operations through the next three years**.** However, this expectation is based on our current operating plan, which may change as a result of certain factors, and may result in additional funding requirements sooner than anticipated. In addition, we may choose to raise additional capital due to market conditions or strategic considerations, even if we believe we have sufficient funds for our current or future operating plans. To the extent that additional capital is raised through the sale of equity or convertible debt securities, the issuance of such securities could result in dilution to our stockholders.

We have no material credit facility or other material committed sources of capital. To the extent operating and capital resources are insufficient to meet future requirements, we will have to raise additional funds to continue the development and commercialization of our technologies. Such funds may not be available on favorable terms, or at all. In particular, our substantial leverage may limit our ability to obtain additional financing. In addition, as an early stage biotechnology company, we do not qualify to issue investment grade debt and therefore any financing we do undertake will likely involve the issuance of equity, convertible debt instruments or high-yield debt. These sources of capital may not be available to us in the event additional financing is required. If adequate funds are not available on reasonable terms, we may be required to curtail operations significantly or to obtain funds by entering into financing, supply or collaboration agreements on unattractive terms. Our inability to raise capital could negatively impact our business.

We expect our stock price to remain volatile.

Our stock price is volatile. In the last twelve-month period ending October 31, 2002, based on closing prices on the Nasdaq National Market, our stock price ranged from $4.13 to $19.47. We expect it to remain volatile. A variety of factors may have a significant effect on the market price of our common stock, including:

- clinical trial results or product development delays or delays in product approval or launch;
- announcement or termination of collaborative relationships by us or our competitors;
- fluctuations in our operating results;
- developments in patent or other proprietary rights;
- announcements of technological innovations or new therapeutic products;
- governmental regulation;
- public concern as to the safety of drug formulations developed by us or others; and
- general market conditions

Any litigation brought against us as a result of this volatility could result in substantial costs and a diversion of our management's attention and resources, which could negatively impact our financial condition, revenues and results of operations.

If we do not generate sufficient cash flow through increased revenues or raising additional capital, then we may not be able to meet our debt obligations.

As of September 30, 2002, we had approximately $339.0 million in long-term obligations. Our substantial indebtedness has and will continue to impact us by:

- increasing our interest expense and related debt service costs;
- making it more difficult to obtain additional financing; and

- constraining our ability to react quickly in an unfavorable economic climate.

Currently, we are not generating sufficient cash flow to satisfy the annual debt service payments on our outstanding subordinated convertible notes and debentures. This may require us to use a portion of the proceeds from the sales of these securities to pay interest or borrow additional funds or sell additional equity to meet our debt service obligations. If we are unable to satisfy our debt service requirements, substantial liquidity problems could result, which would negatively impact our future prospects. As of September 30, 2002 we had cash, cash equivalents and short-term investments valued at approximately $313.6 million.

Anti-takeover provisions in our charter documents and under Delaware law may make it more difficult to remove our management. Further, these provisions may make it more difficult to acquire a large portion of our securities, to initiate a tender offer or a proxy contest or to acquire us, even though such events may be beneficial to our stockholders.

Provisions of our certificate of incorporation and bylaws could make it more difficult for a third party to remove our management. Further, these provisions may make it more difficult to acquire a large portion of our securities, to initiate a tender offer or a proxy contest or acquire us, even if doing so would benefit our stockholders. Among other things, these provisions:

- authorize the issuance of "blank check" preferred stock that could be issued by our Board of Directors to increase the number of outstanding shares and thwart a takeover attempt; and

- limit who may call a special meeting of stockholders.

On June 1, 2001, our Board of Directors adopted a preferred share purchase rights plan, commonly known as a "poison pill." The provisions described above, our preferred share purchase rights plan and provisions of the Delaware General Corporation Law relating to business combinations with interested stockholders may discourage, delay or prevent a third party from removing our management. Further, they may discourage, delay or prevent a third party from acquiring a large portion of our securities, initiating a tender offer or proxy contest or acquiring us, even if our stockholders might receive a premium for their shares in the acquisition over then current market prices.

This report includes forward-looking statements and if these statements are incorrect or inaccurate, our actual results may differ.

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in reported market risks since December 31, 2001.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. Under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, we have, as of a date within 90 days before the filing date of this quarterly report (the "Evaluation Date") evaluated the effectiveness of our "disclosure controls and procedures." Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective in ensuring that information required to be disclosed in such reports is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Controls. There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their last evaluation.

Limitations on the Effectiveness of Controls. The company's management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls 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 error or mistake. 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, control 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

On August 30, 2002, a complaint was filed by David F. Kachensky in the Circuit Court of Madison County, Alabama, (the "Complaint") against J. Milton Harris, James R. Hudson, Jr., Shearwater Corporation and Inhale Therapeutic Systems, Inc., as the successor corporation to Shearwater, (the "Defendants"). Dr. Harris is the president of our Shearwater subsidiary. Among other things, the Complaint alleges that the Defendants breached a stock purchase/employment agreement allegedly entered into by and between certain of the Defendants and the Plaintiff prior to our acquisition of Shearwater, whereby the Defendants allegedly agreed to convey to the Plaintiff five percent (5%) of the capital stock of Shearwater outstanding as of December 1997. The Plaintiff seeks damages in the amount of approximately $15 million. On October 7, 2002, the Defendants filed answers to the Complaint denying the allegations and asserting affirmative defenses. Discovery has commenced, and no trial date has been set. The Company denies the allegations in the Complaint and intends to vigorously defend itself in the litigation.

Item 2. Changes in Securities and Use of Proceeds

In July 2002, we completed the second of two installment payments totaling an aggregate of $1,050,000 in cash and common stock to McKinsey & Company, Inc. United States ("McKinsey") in connection with certain consulting services (the "Consulting Services") provided to us by McKinsey from April through July 2002. In consideration for professional fees and expenses rendered in connection with the Consulting Services, we paid McKinsey an aggregate total of $525,000 in cash and issued an aggregate of 67,640 shares of common stock to AFAC Equity L.P., ("AFAC") an affiliated partnership. Under the terms of the consulting arrangement, McKinsey and its affiliates also have certain registration rights whereby we may be required to register the common stock acquired in the event that we file a registration statement with the SEC in connection with an underwritten public offering of its common stock. AFAC relied upon the exemption from registration afforded by Regulation D and made certain representations and warranties regarding its intent to acquire the common stock for investment only and not with a view to distribution, and also represented that it was an "accredited investor" as that term is defined under Rule 501 of Regulation D. Appropriate legends are affixed to the certificates representing the shares of common stock acquired.

Item 3. Defaults upon Senior Securities—None

Item 4. Submission of Matters to a Vote of Security Holders—None

Item 5. Other Information

In accordance with Section 10A(i)(2) of the Securities Exchange Act of 1934, as added by Section 202 of the Sarbanes-Oxley Act of 2002, we are responsible for listing the non-audit services approved by the Audit Committee of the Board of Directors to be performed by Ernst & Young LLP, our external auditor. Non-audit services are defined as services other than those provided in connection with an audit or a review of the financial statements of the company. The Audit Committee has approved engagements of Ernst & Young for the following non-audit services: (1) tax compliance services; (2) tax planning services; (3) tax consulting services; (4) audit services related to the our employee benefit plans; and (5) accounting consulting services.

Item 6. Exhibits and Reports on Form 8-K

(a) The following exhibits are filed here with or incorporated by reference:

Exhibit Number	Exhibit Index
2.1(1)	Agreement and Plan of Merger by and between Inhale Therapeutic Systems, a California corporation, and Inhale Therapeutic Systems (Delaware), Inc., a Delaware corporation.
2.2(15)	Recommended Offer, dated December 21, 2000, by Cazenove & Co. on behalf of Inhale Therapeutic Systems, Inc. for Bradford Particle Design plc.
2.3(20)	Agreement and Plan of Merger and Reorganization, dated May 22, 2001, by and among Inhale Therapeutic Systems, Inc., Shearwater Corporation, Square Acquisition Corp., J. Milton Harris and Puffinus, L.P.
2.4(20)	Amendment to Agreement and Plan of Merger and Reorganization, dated June 21, 2001, by and among Inhale Therapeutic Systems, Inc., Shearwater Corporation, Square Acquisition Corp., J. Milton Harris and Puffinus, L.P.
3.1(1)	Certificate of Incorporation of Inhale Therapeutic Systems, Inc.
3.2(1)	Bylaws of Inhale Therapeutic Systems, Inc.
3.3(13)	Certificate of Amendment of the Amended Certificate of Incorporation of Inhale Therapeutic Systems, Inc.
3.4(19)	Certificate of Designation of Series A Junior Participating Preferred Stock of Inhale Therapeutic Systems, Inc.
3.5(24)	Certificate of Designation of Series B Convertible Preferred Stock of Inhale Therapeutic Systems, Inc.
4.1	Reference is made to Exhibits 3.1, 3.2, 3.3., 3.4 and 3.5.
4.2(2)	Restated Investor Rights Agreement, dated April 29, 1993, as amended October 29, 1993, by and among Inhale Therapeutic Systems, Inc. and certain other persons named therein.
4.3(3)	Stock Purchase Agreement, dated January 18, 1995, by and between Inhale Therapeutic Systems, Inc. and Pfizer Inc.
4.4(8)	Form of Purchase Agreement, dated January 28, 1997, by and among Inhale Therapeutic Systems, Inc. and the individual Purchasers.
4.5(9)	Stock Purchase Agreement, dated December 8, 1998, by and between Inhale Therapeutic Systems, Inc. and Capital Research and Management Company.
4.6(11)	Purchase Agreement, dated October 6, 1999, by and among Inhale Therapeutic Systems, Inc., Lehman Brothers Inc., Deutsche Bank Securities Inc. and U.S. Bancorp Piper Jaffray Inc.

4.7(11)	Resale Registration Rights Agreement, dated October 13, 1999, by and among Inhale Therapeutic Systems, Inc., Lehman Brothers Inc., Deutsche Bank Securities Inc. and U.S. Bancorp Piper Jaffray Inc.
4.8(11)	Indenture, dated October 13, 1999, by and between Inhale Therapeutic Systems, Inc., as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.9(11)	Form of Inhale Registration Rights Agreement, dated January 25, 2000, by and between Inhale Therapeutic Systems, Inc. and Selling Shareholder.
4.10(12)	Purchase Agreement, dated February 2, 2000, by and among Inhale Therapeutic Systems, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc. and U.S. Bancorp Piper Jaffray Inc.

4.11(12)	Resale Registration Rights Agreement, dated February 8, 2000, by and among Inhale Therapeutic Systems, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc. and U.S. Bancorp Piper Jaffray Inc.
4.12(12)	Indenture, dated February 8, 2000, by and between Inhale Therapeutic Systems, Inc., as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.13(13)	Specimen common stock certificate.
4.14(14)	Specimen warrants to purchase shares of common stock.
4.15(16)	Purchase Agreement, dated October 11, 2000, by and among Inhale Therapeutic Systems, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc. and U.S. Bancorp Piper Jaffray Inc.
4.16(16)	Resale Registration Rights Agreement, dated October 17, 2000, by and among Inhale Therapeutic Systems, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities, Inc., Lehman Brothers Inc. and U.S. Bancorp Piper Jaffray Inc.
4.17(16)	Indenture, dated October 17, 2000, by and between Inhale Therapeutic Systems, Inc., as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee.
4.18(19)	Rights Agreement, dated as of June 1, 2001, by and between Inhale Therapeutic Systems, Inc. and Mellon Investor Services LLC.
4.19(19)	Form of Right Certificate.
4.20(24)	Stock Purchase Agreement, dated January 7, 2002, by and between Inhale Therapeutic Systems, Inc. and Enzon, Inc.
4.21(27)	Common Stock Purchase Agreement, dated June 7, 2002, by and between Inhale Therapeutic Systems, Inc. and AFAC Equity L.P.
4.22(27)	Common Stock Purchase Agreement, dated July 9, 2002, by and between Inhale Therapeutic Systems, Inc. and AFAC Equity L.P.
10.1(6)	Inhale Therapeutic Systems, Inc.'s 1994 Non-Employee Directors' Stock Option Plan, as amended.
10.2(2)	Inhale Therapeutic Systems, Inc.'s 1994 Employee Stock Purchase Plan, as amended and restated.
10.3(2)	Standard Industrial Lease, dated September 17, 1992, as amended September 18, 1992, by and between Inhale Therapeutic Systems, Inc. and W.F. Batton & Co., Inc.
10.4(2)	Addendum IV to Lease dated September 17, 1992, dated April 1, 1994, by and among Inhale Therapeutic Systems, Inc., W.F. Batton and Marie A. Batton.
10.5(5)	Amendment Agreement Number One to Lease dated September 17, 1992, dated October 20, 1995, by and between Inhale Therapeutic Systems, Inc. and W.F. Batton & Co., Inc.
10.6(5)	Amendment Agreement Number Two to Lease dated September 17, 1992, dated November 15, 1995, by and among Inhale Therapeutic Systems, Inc., 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").
10.7(10)	Amendment Agreement Number Three to Lease dated September 17, 1992, dated February 14, 1996, by and between Inhale Therapeutic Systems, Inc. and Batton Trust.
10.8(10)	Amendment Agreement Number Four to Lease dated September 17, 1992, dated September 15, 1996, by and between Inhale Therapeutic Systems, Inc. and Batton Trust.
10.9(2)	Sublicense Agreement, dated September 13, 1991, by and between Inhale Therapeutic Systems, Inc. and John S. Patton.

10.10(4)	Stock Purchase Agreement, dated March 1, 1996, by and between Inhale Therapeutic Systems, Inc. and Baxter World Trade Corporation.
10.11(7)	Sublease and Lease Agreement, dated October 2, 1996, by and between Inhale Therapeutic Systems, Inc. and T.M.T. Associates L.L.C. ("Landlord").
10.12(10)	First Amendment to Sublease and Lease Agreement dated October 2, 1996, dated October 30, 1996, by and between Inhale Therapeutic Systems, Inc. and Landlord.
10.13(10)	Letter Agreement amending Sublease and Lease Agreement dated October 2, 1996, dated April 9, 1997, by and between Inhale Therapeutic Systems, Inc. and Landlord.
10.14(10)	Third Amendment to Sublease and Lease Agreement dated October 2, 1996, dated April 16, 1997, by and between Inhale Therapeutic Systems, Inc. and Landlord.
10.15(10)	Fourth Amendment to Sublease and Lease Agreement dated October 2, 1996, dated November 5, 1997, by and between Inhale Therapeutic Systems, Inc. and Landlord.
10.16(12)	Sublease, dated November 3, 1999, by and between Webvan Group, Inc., as sublessor, and Inhale Therapeutic Systems, Inc., as sublessee.
10.17(14)	Inhale Therapeutic Systems, Inc.'s 2000 Equity Incentive Plan, as amended.
10.18(14)	Inhale Therapeutic Systems, Inc.'s Stock Option Agreement issued in accordance with Inhale Therapeutic Systems, Inc.'s 2000 Equity Incentive Plan, as amended.
10.19(14)	Agreement for the Contribution of 201 Industrial Road Project, made and entered into as of September 14, 2000, by and among Inhale Therapeutic Systems, Inc., Inhale 201 Industrial Road, L.P., a California limited partnership and Bernardo Property Advisors, Inc., a California corporation.
10.20(14)	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 Therapeutic Systems, Inc., as limited partner.
10.21(14)	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 Therapeutic Systems, Inc., as Tenant.
10.22(14)	Amendment to Lease, dated October 3, 2000, by and between Inhale 201 Industrial Road, L.P., a California limited partnership, as Landlord, and Inhale Therapeutic Systems, Inc., as Tenant.
10.23(14)	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 Therapeutic Systems, Inc., as Tenant.
10.24(23)	Inhale Therapeutic Systems, Inc.'s 2000 Non-Officer Equity Incentive Plan.
10.25(17)	Inhale Therapeutic Systems, Inc.'s Stock Option Agreement issued in accordance with Inhale Therapeutic Systems, Inc.'s 2000 Non-Officer

	Equity Incentive Plan.
10.26+(18)	Manufacturing and Supply Agreement by and among Inhale Therapeutic Systems, Inc., Tech Group North America and Bespak Europe, LTD.
10.27(21)	The Bradford Particle Design plc Approved Employee Share Option Scheme.
10.28(21)	Form of The Bradford Particle Design plc Approved Employee Share Option Scheme Option Certificate.
10.29(21)	The Bradford Particle Design plc Unapproved Employee Share Option Scheme.
10.30(21)	Form of The Bradford Particle Design plc Unapproved Employee Share Option Scheme Option Certificate.
10.31(21)	Form of Agreement Granting an Enterprise Management Incentives Option.
10.32(21)	Agreement Granting Options, dated November 5, 1999, by and between Mr. Joseph F. Bohan and Bradford Particle Design plc.

10.33(21)	Agreement Granting Options, dated October 27, 2000, by and between Mr. Joseph F. Bohan and Bradford Particle Design plc.
10.34(22)	Shearwater Corporation 1996 Nonqualified Stock Option Plan.
10.35(22)	Amendment, effective May 22, 1998, to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation.
10.36(22)	Second Amendment, effective February 26, 2000, to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation.
10.37(22)	Third Amendment, effective October 5, 2000, to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation.
10.38(22)	Fourth Amendment, effective June 22, 2001, to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation.
10.39(22)	Form of Shearwater Corporation Nonqualified Stock Option Agreement.
10.40(22)	Form of June 2001 Amendment to Shearwater Corporation Nonqualified Stock Option Agreement.
10.41(25)	Inhale Therapeutic Systems, Inc. 401(k) Retirement Plan.
10.42(25)	Non-Standardized Adoption Agreement No. 001 for use with Inhale Therapeutic Systems, Inc. 401(k) Retirement Plan.
10.43(26)	Inhale Therapeutic Systems, Inc., Employee Stock Purchase Plan, as amended and restated.
10.44+(27)	Letter Agreement, dated July 31, 2002, by and between Inhale Therapeutic Systems, Inc., and Douglas H. Altschuler.
99.1 (27)	Certification of Officers Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

+ Confidential treatment with respect to specific portions are omitted and filed separately with the SEC.

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

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

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

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

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

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

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

(8) Incorporated by reference to Inhale Therapeutic Systems, Inc.'s Registration Statement on Form S-3 (No. 333-20787).

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

(10) Incorporated by reference to the indicated exhibit in Inhale Therapeutic Systems, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 1999.

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

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

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

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

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

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

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

(18) Incorporated by reference to Inhale Therapeutic Systems, Inc.'s Annual Report on Form 10-K, as amended, for the year ended December 31, 2000.

(19) Incorporated by reference to Inhale Therapeutic Systems, Inc.'s Current Report on Form 8-K, filed on June 4, 2001.

(20) Incorporated by reference to Inhale Therapeutic Systems, Inc.'s Current Report on Form 8-K, filed on July 10, 2001.

(21) Incorporated by reference to Inhale Therapeutic Systems, Inc.'s Registration Statement on Form S-8 (No. 333-55032), filed on February 6, 2001.

(22) Incorporated by reference to Inhale Therapeutic Systems, Inc.'s Registration Statement on Form S-8 (No. 333-67342), filed on August 10, 2001.

(23) Incorporated by reference to Inhale Therapeutic Systems, Inc.'s Registration Statement on Form S-8 (No. 333-71936), filed on October 19, 2001.

(24) Incorporated by reference to Inhale Therapeutic Systems, Inc.'s Current Report on Form 8-K, filed on January 8, 2002.

(25) Incorporated by reference to Inhale Therapeutic Systems, Inc.'s Registration Statement on Form S-8 (No. 333-76638), filed on January 11, 2002.

(26) Incorporated by reference to the indicated exhibit in Inhale Therapeutic Systems, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002.

(27) Filed herewith.

(b) Reports on Form 8-K for the three-month period ending September 30, 2002:

None.

SIGNATURES

Pursuant to the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Carlos, County of San Mateo, State of California on November 14, 2002.

By: /s/ AJIT S. GILL

Ajit S. Gill
Chief Executive Officer, President and Director

By: /s/ BRIGID A. MAKES

Brigid A. Makes
Vice President, Finance and Administration, Chief Financial Officer and Assistant Secretary

OFFICER CERTIFICATION
PURSUANT TO SECTION 302(A)
OF THE SARBANES-OXLEY ACT OF 2002

I, Ajit S. Gill, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Inhale Therapeutic Systems, Inc. ("registrant");

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in the quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ AJIT S. GILL

Ajit S. Gill
Chief Executive Officer, President and Director

OFFICER CERTIFICATION
PURSUANT TO SECTION 302(A)
OF THE SARBANES-OXLEY ACT OF 2002

I, Brigid A. Makes, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Inhale Therapeutic Systems, Inc. ("registrant");

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in the quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ BRIGID A. MAKES

Brigid A. Makes
Vice President, Finance and Administration,
Chief Financial Officer and Assistant Secretary

QuickLinks

Exhibit 4.21

INHALE THERAPEUTIC SYSTEMS, INC.

AND

AFAC EQUITY, L.P.

COMMON STOCK PURCHASE AGREEMENT

June 7, 2002

INHALE THERAPEUTIC SYSTEMS, INC.
COMMON STOCK PURCHASE AGREEMENT

THIS COMMON STOCK PURCHASE AGREEMENT (this "Agreement") is made as of June 7, 2002, by and between **INHALE THERAPEUTIC SYSTEMS, INC.**, a Delaware corporation with its principal office at 150 Industrial Road, San Carlos, California 94070 (the "Company"), and **AFAC EQUITY L.P**. a Delaware limited partnership with its offices c/o McKinsey & Company, Inc. United States at 55 East 52nd Street, 27th Floor, New York, New York 10022 ("AFAC" or, the "Purchaser").

RECITALS

WHEREAS, the Company and McKinsey & Company, Inc. United States, an affiliate of AFAC ("McKinsey") have entered into that certain Confidentiality Agreement dated April 9, 2002 and that certain letter agreement dated May 23, 2002 with respect to the performance of certain consulting services by McKinsey (collectively, the "Related Agreements"); and

WHEREAS, in connection with the Related Agreements, the Company desires to issue to AFAC and AFAC desires to acquire from the Company shares of common stock of the Company, on the terms and subject to the conditions set forth in this Agreement.

NOW, THEREFORE, in consideration of the foregoing recitals and the mutual covenants and agreements contained herein, the parties hereto, intending to be legally bound, do hereby agree as follows:

1. PURCHASE OF COMMON STOCK.

1.1. Agreement to Sell and Purchase. At the Closing (as hereinafter defined), the Company will sell to AFAC and AFAC will purchase from the Company Thirty-Two Thousand Two Hundred Eighty-Eight (32,288) shares of the common stock of the Company (the "Common Stock") in exchange for services rendered by McKinsey.

1.2. Closing; Closing Date. The completion of the sale and purchase of the Common Stock (the "Closing") shall be held at 9:00 a.m. (Pacific Time) on the date hereof (the "Closing Date"), at the offices of Cooley Godward LLP, 3175 Hanover Street, Palo Alto, California, or at such other time and place as the Company and the Purchasers may agree.

1.3. Delivery. At the Closing, subject to the terms and conditions hereof, the Company will deliver to AFAC a stock certificate dated as of the Closing Date.

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2. REPRESENTATIONS AND WARRANTIES OF THE COMPANY.

Except as otherwise specifically disclosed to the Purchasers in writing on the date hereof, the Company hereby represents and warrants to the Purchasers as follows:

2.1. Authorization. All corporate action on the part of the Company, its officers, directors and shareholders necessary for the authorization, execution and delivery of this Agreement and the Registration Rights Agreement by and between the Company and AFAC dated as of the date hereof in the form set forth as Exhibit A (the "Registration Rights Agreement") has been taken. The Company has the requisite corporate power to enter into this Agreement and the Registration Rights Agreement and carry out and perform its obligations under the terms of this Agreement and the Registration Rights Agreement. At the Closing, the Company will have the requisite corporate power to issue and sell the Common Stock. This Agreement and the Registration Rights Agreement have been duly authorized, executed and delivered by the Company and, upon due execution and delivery by the Purchasers, this Agreement and the Registration Rights Agreement will be valid and binding agreements of the Company, except as enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally or by equitable principles.

2.2. Organization, Good Standing and Qualification. The Company is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware and has all requisite corporate power and authority to carry on its business as now conducted and as proposed to be conducted. The Company is duly qualified to transact business and is in good standing in each jurisdiction in which the failure so to qualify would have a material adverse effect on its business or properties.

2.3. Valid Issuance of Common Stock. The Common Stock, when issued, sold and delivered in accordance with the terms hereof will be duly and validly authorized and issued, fully paid and nonassessable.

2.4. Offering. Assuming the accuracy of the representations of the Purchasers in Section 3.3 of this Agreement on the date hereof and on the Closing Date, the offer, issue and sale of the Common Stock are and will be exempt from the registration and prospectus delivery requirement of the Securities Act and have been or will be registered or qualified (or are or will be exempt from registration and qualification) under the registration, permit or qualification requirements of all applicable state securities laws.

3. REPRESENTATIONS AND WARRANTIES OF THE PURCHASERS.

Purchaser hereby represents and warrants to the Company as follows:

3.1. Legal Power. Purchaser has the requisite corporate power and authority to enter into this Agreement and the Registration Rights Agreement, to carry out and perform its obligations under the terms of this Agreement and the Registration Rights Agreement. All action on Purchaser's part required for the lawful execution and delivery of this Agreement and the Registration Rights Agreement have been or will be effectively taken prior to the Closing.

3.2. Due Execution. This Agreement and the Registration Rights Agreement have been duly authorized, executed and delivered by the Purchaser, and, upon due execution and delivery by the Company, this Agreement and Registration Rights Agreement will be valid and

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binding agreements of Purchaser, except as enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally or by equitable principles.

3.3. Investment Representations. In connection with the sale and issuance of the Common Stock, Purchaser makes the following representations to the Company:

(a) Investment for Own Account. Purchaser is acquiring the Common Stock for its own account, not as nominee or agent, for investment and not with a view to, or for resale in connection with, any distribution or public offering thereof within the meaning of the Securities Act.

(b) Transfer Restrictions; Legends. Purchaser understands that (i) the Common Stock has not been registered under the Securities Act; (ii) the Common Stock is being offered and sold pursuant to an exemption from registration and that the Common Stock must be held by Purchaser indefinitely, and that Purchaser must, therefore, bear the economic risk of such investment indefinitely, unless a subsequent disposition thereof is registered under the Securities Act or is exempt from such registration; (iii) each certificate representing the Common Stock will be endorsed with the following legends:

> THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR UNDER THE SECURITIES LAWS OF CERTAIN STATES. THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE ACT AND THE APPLICABLE STATE SECURITIES LAWS, PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM. THE ISSUER OF THESE SECURITIES MAY REQUIRE AN OPINION OF COUNSEL IN FORM AND SUBSTANCE SATISFACTORY TO THE ISSUER TO THE EFFECT THAT ANY PROPOSED TRANSFER OR RESALE IS IN COMPLIANCE WITH THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS.

and (iv) the Company will instruct any transfer agent not to register the transfer of the Common Stock (or any portion thereof) unless the conditions specified in the foregoing legend are satisfied, until such time as a transfer is made, pursuant to the terms of this Agreement, and in compliance with Rule 144 under the Securities Act or pursuant to a registration statement or, if the opinion of counsel referred to above is to the further effect that such legend is not required in order to establish compliance with any provisions of the Securities Act or this Agreement, or other satisfactory assurances of such nature are given to the Company. Unless otherwise required by applicable securities laws, the Company shall be obligated, at the request of Purchaser, to cause the transfer agent to reissue unlegended certificates with respect to the Common Stock if (A) Purchaser shall have obtained an opinion of counsel reasonably acceptable to the Company to the effect that the Common Stock with respect to which unlegended certificates are to be issued may lawfully be disposed of without registration, qualification or

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legend; or (B) the Common Stock can be sold without restriction as to the number of securities sold under Rule 144(k). Further, the Company will instruct the transfer agent to remove the legend on Common Stock (A) upon the sale of such Common Stock pursuant to an effective registration statement, provided the transfer agent and Company have received evidence or assurances of such sale in a form satisfactory to the transfer agent and the Company or (ii) upon the sale of such Common Stock pursuant to Rule 144 under the Securities Act, provided the transfer agent and the Company have received evidence or assurances from Purchaser of compliance with Rule 144 in a form satisfactory to the transfer agent and the Company.

(c) Financial Sophistication. Purchaser has such knowledge and experience in financial or business matters that it is capable of evaluating the merits and risks of the investment in connection with the transactions contemplated in this Agreement.

(d) Accredited Investor Status. Purchaser is an "accredited investor" as such term is defined in Rule 501(a) of the rules and regulations promulgated under the Securities Act.

3.4. No Brokers. No broker, finder or investment banker is entitled to any brokerage, finder's or other fee or commission in connection with the transactions contemplated by this Agreement based on arrangements made by Purchaser.

4. CONDITIONS TO CLOSING.

4.1. Conditions to Obligations of Purchasers at Closing. AFAC's obligation to purchase the Common Stock at the Closing is subject to the fulfillment to the Purchaser's satisfaction, on or prior to the Closing, of all of the following conditions, any of which may be waived by Purchaser:

(a) Representations and Warranties True; Performance of Obligations. The representations and warranties made by the Company in Section 2 hereof shall be true and correct in all material respects on the Closing Date with the same force and effect as if they had been made on and as of said date and the Company shall have performed and complied with all obligations and conditions herein required to be performed or complied with by it on or prior to the Closing.

(b) Registration Rights Agreement. The Company shall have executed and delivered the Registration Rights Agreement in the form attached hereto as Exhibit A.

(c) Qualifications, Legal Investment. All authorizations, approvals, or permits, if any, of any governmental authority or regulatory body of the United States or of any state that are required in connection with the lawful sale and issuance of the Common Stock shall have been duly obtained and shall be effective on and as of the Closing. No stop order or other order enjoining the sale of the Common Stock shall have been issued and no proceedings for such purpose shall be pending or, to the knowledge of the Company, threatened by the SEC, or any commissioner of corporations or similar officer of any state having jurisdiction over this

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transaction. At the time of the Closing, the sale and issuance of the Common Stock shall be legally permitted by all laws and regulations to which Purchaser and the Company are subject.

4.2. Conditions to Obligations of the Company. The Company's obligation to issue and sell the Common Stock at the Closing is subject to the fulfillment to the Company's satisfaction, on or prior to the Closing of the following conditions, any of which may be waived by the Company:

(a) Representations and Warranties True. The representations and warranties made by Purchaser in Section 3 hereof shall be true and correct in all material respects on the Closing Date with the same force and effect as if they had been made on and as of said date.

(b) Performance of Obligations. Purchaser shall have performed and complied with all agreements and conditions herein required to be performed or complied with by them on or before the Closing.

(c) Registration Rights Agreement. Purchaser shall have executed and delivered the Registration Rights Agreement in the form attached hereto as Exhibit A.

(d) Qualifications, Legal Investment. All authorizations, approvals, or permits, if any, of any governmental authority or regulatory body of the United States or of any state that are required in connection with the lawful sale and issuance of the Common Stock shall have been duly obtained and shall be effective on and as of the Closing. No stop order or other order enjoining the sale of the Common Stock shall have been issued and no proceedings for such purpose shall be pending or, to the knowledge of the Company, threatened by the SEC, or any commissioner of corporations or similar officer of any state having jurisdiction over this transaction. At the time of the Closing, the sale and issuance of the Common Stock shall be legally permitted by all laws and regulations to which the Purchaser and the Company are subject.

5. MISCELLANEOUS.

5.1. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California, without regard to the choice of law provisions thereof, and the federal laws of the United States.

5.2. Successors and Assigns. Except as otherwise expressly provided herein, the provisions hereof shall inure to the benefit of, and be binding upon, the successors, assigns, heirs, executors, and administrators of the parties hereto.

5.3. Entire Agreement. This Agreement, the Registration Rights Agreement, the Related Agreements and the exhibits hereto and thereto, and the other documents delivered pursuant hereto, constitutes the full and entire understanding and agreement among the parties with regard to the subjects hereof and no party shall be liable or bound to any other party in any manner by any representations, warranties, covenants, or agreements except as specifically set

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forth herein or therein. Nothing in this Agreement, express or implied, is intended to confer upon any party, other than the parties hereto and their respective successors and assigns, any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided herein.

5.4. Severability. In the event any provision of this Agreement shall be invalid, illegal, or unenforceable, it shall to the extent practicable, be modified so as to make it valid, legal and enforceable and to retain as nearly as practicable the intent of the parties, and the validity, legality, and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

5.5. Amendment and Waiver. Except as otherwise provided herein, any term of this Agreement may be amended and the observance of any term of this Agreement may be waived (either generally or in a particular instance, either retroactively or prospectively, and either for a specified period of time or indefinitely), with the written consent of the Company and Purchaser. Any amendment or waiver effected in accordance with this Section shall be binding upon any holder of any securities purchased under this Agreement, each future holder of all such securities, and the Company.

5.6. Notices. Unless otherwise provided, any notice required or permitted under this Agreement shall be given in writing and shall be deemed effectively given upon personal delivery to the party to be notified or upon delivery by confirmed facsimile transmission, nationally recognized overnight courier service, or upon deposit with the United States Post Office, by registered or certified mail, postage prepaid and addressed to the party to be notified at the address first indicated for such party above, or at such other address as such party may designate by ten (10) days' advance written notice to the other parties.

5.7. Fees and Expenses. The Company and Purchaser shall bear their own expenses and legal fees incurred on their behalf with respect to this Agreement and the transactions contemplated hereby. Each party hereby agrees to indemnify and to hold harmless of and from any liability the other party for any commission or compensation in the nature of a finder's fee to any broker or other person or firm (and the costs and expenses of defending against such liability or asserted liability) for which such indemnifying party or any of its employees or representatives are responsible.

5.8. Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed an original, but all of which together shall constitute one instrument.

IN WITNESS WHEREOF, the foregoing Common Stock Purchase Agreement is hereby executed as of the date first above written.

THE COMPANY:

INHALE THERAPEUTIC SYSTEMS, INC.

By: /s/ AJIT S. GILL
Name: Ajit S. Gill
Title: Chief Executive Officer and President

Address: 150 Industrial Road
San Carlos, CA 94070

THE PURCHASER:

AFAC EQUITY, L.P.

By: /s/ BRIAN M. FEUER

Name: Brian M. Feuer

Title: Attorney-in-Fact

Address: c/o McKinsey & Company
55 East 52nd Street, 27th Floor
New York, NY 10022

EXHIBIT A

EXHIBIT A

REGISTRATION RIGHTS AGREEMENT

THIS REGISTRATION RIGHTS AGREEMENT is made as of the 7TH day of June, 2002, by and between Inhale Therapeutic Systems, Inc., a Delaware corporation (the "**Company**") and AFAC Equity, L.P., a Delaware limited partnership (the "**Investor**").

RECITALS

WHEREAS, the Company and McKinsey & Company, Inc. United States, an affiliate of the Investor ("**McKinsey**") are parties to a certain confidentiality agreement effective as of April 9, 2002 and a letter agreement dated May 23, 2002 (collectively, the "**Consulting Agreement**"); and

WHEREAS, the Company and Investor are parties to that certain Common Stock Purchase Agreement dated as of the date hereof the "**Purchase Agreement**") pursuant to which the Company shall issue Thirty-Two Thousand Two Hundred Eighty-Eight (32,288) shares of Company common stock (the "Shares") to the Investor in partial consideration of services provided by McKinsey to the Company; and

WHEREAS, the Purchase Agreement provides that the Company and the Investor will enter into a registration rights agreement in form and substance reasonably satisfactory to both parties;

NOW, THEREFORE, in consideration of the mutual promises and covenants set forth herein, the parties hereto agree as follows:

1. Registration Rights.

1.1 Definitions. For purposes of this Section 1:

(a) The term "**Act**" means the Securities Act of 1933, as amended.

(b) The term "**Holder**" means any person owning Registrable Securities or any assignee thereof in accordance with Section 1.9 hereof.

(c) The term "**1934 Act**" means the Securities Exchange Act of 1934, as amended.

(d) The terms "**register**," "**registered**," and "**registration**" refer to a registration effected by preparing and filing a registration statement or similar document in compliance with the Act, and the declaration or ordering of effectiveness of such registration statement or document.

(e) The term "**Registrable Securities**" means (i) the Shares and (ii) any Common Stock of the Company issued as (or issuable upon the conversion or exercise of any warrant, right or other security that is issued as) a dividend or other distribution with respect to, or in exchange for, or in replacement of, the Shares. Notwithstanding the foregoing, Registrable Securities shall not include (i) any securities sold by a person to the public either pursuant to a registration statement or Rule 144 or sold in a private transaction in which the transferor's rights under Section 1 of this Agreement are not assigned; (ii) any securities for which the rights of a Holder have terminated pursuant to Section 1.10 herein.

(f) The number of shares of "Registrable Securities" outstanding shall be determined by the number of shares of Common Stock outstanding that are, and the number of shares of Common Stock issuable pursuant to then exercisable or convertible securities that are, Registrable Securities.

(g) The term "**SEC**" shall mean the Securities and Exchange Commission.

1.2 Company Registration.

(a) If (but without any obligation to do so) the Company proposes (i) to register for its own account any of its common stock under the Act in connection with an underwritten public offering of such securities (other than a registration relating solely to the sale of securities to participants in a Company stock plan or a registration relating to a corporate reorganization, merger or other transaction under Rule 145 of the Act) (a "**Company Offering**"); or (ii) to register the offering of its common stock by stockholders of the Company other than the Holders ("**Other Selling Stockholders**") other than in connection with a Company Offering or a registration relating solely to the sale of securities to participants in a Company stock plan or a registration relating to a corporate reorganization, merger or other transaction under Rule 145 of the Act (a "**Secondary Offering**"), the Company shall, at such time, promptly give each Holder written notice of such Company Offering or Secondary Offering, as applicable. Upon the written request of each Holder given within fifteen (15) days after mailing of such notice by the Company in accordance with Section 2.5, the Company shall, subject to the provisions of Section 1.2(b) and other restrictions set forth herein, cause to be registered under the Act all of the Registrable Securities that each such Holder has requested to be registered. Notwithstanding the foregoing, the Company shall have no obligation to notify the Holders, cause to be registered any Registrable Securities, or undertake any other obligation in connection with this Agreement in connection with (i) any proposed Company Offering in which the proposed maximum offering price to the public exceeds **[80% of Purchase Price]** (as adjusted for stock splits, combinations, dividends and the like occurring after the date hereof); or (ii) any Secondary Offering made pursuant to that certain Preferred Stock Purchase Agreement dated January 7, 2002 by and between the Company and Enzon, Inc.

(b) Underwriting Requirements. In connection with any offering in which the Holder would otherwise be permitted to include Registrable Securities pursuant to this Section 1.2 involving an underwriting of shares of the Company's capital stock, the Company shall not be required under this Section 1.2 to include any of the Holders' securities in such underwriting unless they accept the terms of the underwriting as agreed upon between the Company and the underwriters selected by it (or by other persons entitled to select the underwriters) and enter into an underwriting agreement in customary form with an underwriter or underwriters selected by the Company, and then only in such quantity as the underwriters determine in their sole discretion will not jeopardize the success of the offering by the Company. If the total amount of securities, including Registrable Securities, requested by stockholders to be included in such offering exceeds the amount of securities sold other than by the Company that the underwriters determine in their sole discretion is compatible with the success of the offering, then the Company shall be required to include in the offering only that number of such securities, including Registrable Securities, that the underwriters determine in their sole discretion will not jeopardize the success of the offering (the securities so included to be apportioned pro rata among the selling Holders according to the total amount of securities entitled to be included therein owned by each selling Holder or in such other proportions as shall mutually be agreed to by such selling Holders), but in no event shall the amount of securities of the selling Holders included in the offering be reduced below fifteen percent (15%) of the total amount of securities included in such offering. For purposes of the preceding parenthetical concerning apportionment, for any selling stockholder that is a Holder of Registrable Securities and that is a partnership or corporation, the partners, retired partners and stockholders of such Holder, or the estates and family members of any such partners and retired partners and any trusts for the benefit of any of the foregoing persons shall be deemed to be a single "selling Holder," and any pro rata reduction with respect to such "selling Holder" shall be based upon the aggregate amount of Registrable Securities owned by all such related entities and individuals.

1.3 Obligations of the Company. Whenever required under this Section 1 to effect the registration of any Registrable Securities, the Company shall, as expeditiously as reasonably possible:

(a) prepare and file with the SEC a registration statement with respect to such Registrable Securities and use its best efforts to cause such registration statement to become effective, and, upon the request of the Holders of a majority of the Registrable Securities registered thereunder, keep such registration statement effective until, with respect to a Company Offering, the distribution of securities by the Company contemplated in the registration statement is completed, or, with respect to a Secondary Offering, the earlier of (i) the completion of the distribution contemplated in the registration statement by the Other Selling Stockholders; (ii) the termination of all Other Selling Stockholders' rights to require registration pursuant to such registration statement or (iii) the date 120 days following the initial effective date of such registrations statement. Notwithstanding any other provision of this Agreement, the Holders understand and acknowledge that there may be periods during which the Company may determine, in good faith, based on the advice of counsel, that it is in the best interest of the Company and its stockholders to defer disclosure of non-public information until such information has reached a more advanced stage and that during such periods sales of Registrable Securities and the effectiveness of any registration statement covering Registrable Securities, may be suspended or delayed. The Holders agree that upon receipt of any notice from the Company of the development of any material non-public information, each Holder will forthwith discontinue its disposition of Registrable Securities pursuant to any such registration statement until such Holder's receipt of copies of an appropriately supplemented or amended prospectus and, if so directed by the Company, each Holder will use reasonable commercial efforts to deliver to the Company all copies, of the prospectus relating to such Registerable Shares current at the time of receipt of such notice;

(b) prepare and file with the SEC such amendments and supplements to such registration statement and the prospectus used in connection with such registration statement as may be necessary to comply with the provisions of the Act with respect to the disposition of all securities covered by such registration statement;

(c) furnish to the Holders such numbers of copies of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Act, and such other documents as they may reasonably request in order to facilitate the disposition of Registrable Securities owned by them;

(d) use reasonable commercial efforts to register and qualify the securities covered by such registration statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Holders, provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions;

(e) notify each Holder of Registrable Securities covered by such registration statement at any time when a prospectus relating thereto is required to be delivered under the Act or the happening of any event as a result of which the prospectus included in such registration statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances then existing;

(f) cause all such Registrable Securities registered pursuant to this Section 1 to be listed on each securities exchange on which similar securities issued by the Company are then listed;

(g) provide a transfer agent and registrar for all Registrable Securities registered pursuant to this Section 1 and a CUSIP number for all such Registrable Securities, in each case not later than the effective date of such registration; and

(h) use reasonable commercial efforts to furnish, at the request of any Holder requesting registration of Registrable Securities pursuant to this Section 1, on the date that such Registrable Securities are delivered to the underwriters for sale in connection with a registration pursuant to this Section 1, if such securities are being sold through underwriters, (i) an opinion, dated such date, of the counsel representing the Company for the

purposes of such registration, in form and substance as is customarily given to underwriters in an underwritten public offering, addressed to the underwriters, and (ii) a letter dated such date, from the independent certified public accountants of the Company, in form and substance as is customarily given by independent certified public accountants to underwriters in an underwritten public offering, addressed to the underwriters.

1.4 Information from Holder. It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Section 1 with respect to the Registrable Securities of any selling Holder that such Holder shall furnish to the Company such information regarding itself, the Registrable Securities held by it, and the intended method of disposition of such securities as shall be required to effect the registration of such Holder's Registrable Securities.

1.5 Expenses of Registration. All expenses other than underwriting discounts, commissions and fees and disbursements of counsel for the Selling Holders incurred in connection with registrations, filings or qualifications pursuant to Section 1.2, including (without limitation) all registration, filing and qualification fees, printers' and accounting fees, fees and disbursements of counsel for the Company shall be borne by the Company.

1.6 Delay of Registration. No Holder shall have any right to obtain or seek an injunction restraining or otherwise delaying any such registration as the result of any controversy that might arise with respect to the interpretation or implementation of this Section 1.

1.7 Indemnification. In the event any Registrable Securities are included in a registration statement under this Section 1:

(a) To the extent permitted by law, the Company will indemnify and hold harmless each Holder, the partners or officers, directors and stockholders of each Holder, any underwriter (as defined in the Act) for such Holder and each person, if any, who controls such Holder or underwriter within the meaning of the Act or the 1934 Act, against any losses, claims, damages or liabilities (joint or several) to which they may become subject under the Act, the 1934 Act or any state securities laws, insofar as such losses, claims, damages, or liabilities (or actions in respect thereof) arise out of or are based upon any of the following statements, omissions or violations (collectively, a "**Violation**"): (i) any untrue statement or alleged untrue statement of a material fact contained in such registration statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto, (ii) the omission or alleged omission to state therein a material fact required to be stated therein, or necessary to make the statements therein not misleading, or (iii) any violation or alleged violation by the Company of the Act, the 1934 Act, any state securities laws or any rule or regulation promulgated under the Act, the 1934 Act or any state securities laws; and the Company will reimburse each such Holder, underwriter or controlling person for any legal or other expenses reasonably incurred by them in connection with investigating or defending any such loss, claim, damage, liability or action; *provided, however*, that the indemnity agreement contained in this subsection l.7(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Company (which consent shall not be unreasonably withheld), nor shall the Company be liable in any such case for any such loss, claim, damage, liability or action to the extent that it arises out of or is based upon a Violation that occurs in reliance upon and in conformity with written information furnished expressly for use in connection with such registration by any such Holder, underwriter or controlling person.

(b) To the extent permitted by law, each selling Holder will indemnify and hold harmless the Company, each of its directors, each of its officers who has signed the registration statement, each person, if any, who controls the Company within the meaning of the Act, any underwriter, any other Holder selling securities in such registration statement and any controlling person of any such underwriter or other Holder, against any losses, claims, damages or liabilities (joint or several) to which any of the foregoing persons may become subject, under the Act, the 1934 Act or any state securities laws, insofar as such losses, claims, damages or liabilities (or actions in respect thereto) arise out of or are based upon any Violation, in each case to the extent (and only to the extent) that such Violation occurs in reliance upon and in conformity with written information furnished by such Holder expressly for use in connection with such registration; and each such Holder will reimburse any person intended to be indemnified pursuant to this subsection l.7(b), for any legal or other expenses reasonably incurred by such person in connection with investigating or defending any such loss, claim, damage, liability or action; *provided, however*, that the indemnity agreement contained in this subsection l.7(b) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Holder (which consent shall not be unreasonably withheld), provided that in no event shall any indemnity under this subsection l.7(b) exceed the gross proceeds from the offering received by such Holder.

(c) Promptly after receipt by an indemnified party under this Section 1.7 of notice of the commencement of any action (including any governmental action), such indemnified party will, if a claim in respect thereof is to be made against any indemnifying party under this Section 1.7, deliver to the indemnifying party a written notice of the commencement thereof and the indemnifying party shall have the right to participate in, and, to the extent the indemnifying party so desires, jointly with any other indemnifying party similarly noticed, to assume the defense thereof with counsel mutually satisfactory to the parties; *provided, however*, that an indemnified party (together with all other indemnified parties that may be represented without conflict by one counsel) shall have the right to retain one separate counsel, with the fees and expenses to be paid by the indemnifying party, if representation of such indemnified party by the counsel retained by the indemnifying party would be inappropriate due to actual or potential differing interests between such indemnified party and any other party represented by such counsel in such proceeding. The failure to deliver written notice to the indemnifying party within a reasonable time of the commencement of any such action, if prejudicial to its ability to defend such action, shall relieve such indemnifying party of any liability to the indemnified party under this Section 1.7, but the omission so to deliver written notice to the indemnifying party will not relieve it of any liability that it may have to any indemnified party otherwise than under this Section 1.7.

(d) If the indemnification provided for in this Section 1.7 is held by a court of competent jurisdiction to be unavailable to an indemnified party with respect to any loss, liability, claim, damage or expense referred to herein, then the indemnifying party, in lieu of indemnifying such indemnified party hereunder, shall contribute to the amount paid or payable by such indemnified party as a result of such loss, liability, claim, damage or expense in such proportion as is appropriate to reflect the relative fault of the indemnifying party on the one hand and of the indemnified party on the other in connection with the statements or omissions that resulted in such loss, liability, claim, damage or expense, as well as any other relevant equitable considerations. The relative fault of the indemnifying party and of the indemnified party shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission to state a material fact relates to information supplied by the indemnifying party or by the indemnified party and the parties' relative intent, knowledge, access to information, and opportunity to correct or prevent such statement or omission.

(e) The obligations of the Company and Holders under this Section 1.7 shall survive the completion of any offering of Registrable Securities in a registration statement under this Section 1, and otherwise.

1.8 Rule 144 Reporting. With a view to making available to the Holders the benefits of Rule 144 promulgated under the Act and any other rule or regulation of the SEC that may at any time permit a Holder to sell securities of the Company to the public without registration, the Company agrees to:

(a) file with the SEC in a timely manner all reports and other documents required of the Company under the Act and the 1934 Act; and

(b) furnish to any Holder, so long as the Holder owns any Registrable Securities, forthwith upon request (i) a written statement by the Company that it has complied with the reporting requirements of SEC Rule 144 (at any time after ninety (90) days after the effective date of the first registration statement filed by the Company for an offering of its securities to the general public), the Act and the 1934 Act (at any time after it has become subject to such reporting requirements), (ii) a copy of the most recent annual or quarterly report of the Company and such other reports and documents so filed by the Company, and (iii) such other information as may be reasonably requested in availing any Holder of any rule or regulation of the SEC that permits the selling of any such securities without registration or pursuant to such form.

1.9 Assignment of Registration Rights. The rights to cause the Company to register Registrable Securities pursuant to this Section 1 may be assigned (but only with all related obligations) by a Holder only to an affiliate of the Investor or McKinsey (an "**Affiliate**"), provided: (a) the Company is, within a reasonable time after such transfer, furnished with written notice of the name and address of such Affiliate and the securities with respect to which such registration rights are being assigned; (b) such Affiliate agrees in writing to be bound by and subject to the terms and conditions of this Agreement, including without limitation the provisions of Section 1.10 below; and (c) such assignment shall be effective only if immediately following such transfer the further disposition of such securities by the transferee or assignee is restricted under the Act.

1.10 Termination of Registration Rights. The Company's obligations under this Section 1 to effect the registration of any Registrable Securities shall terminate as to any Holder at such time as all the Registrable Securities held by such Holder are eligible for sale under Rule 144.

2. Miscellaneous.

2.1 Successors and Assigns. Except as otherwise provided herein, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective successors and assigns of the parties (including transferees of any shares of Registrable Securities). Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

2.2 Governing Law. This Agreement shall be governed by, and construed and enforced in accordance with the internal laws of the State of California, without reference to conflicts of law provisions thereof.

2.3 Counterparts. This Agreement may be executed by facsimile and in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

2.4 Titles and Subtitles. The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

2.5 Notices. Unless otherwise provided, any notice required or permitted under this Agreement shall be given in writing and shall be deemed effectively given upon personal delivery to the party to be notified or upon delivery by confirmed facsimile transmission, nationally recognized overnight courier service, or upon deposit with the United States Post Office, by registered or certified mail, postage prepaid and addressed to the party to be notified at the address indicated for such party on the signature page hereof, or at such other address as such party may designate by ten (10) days' advance written notice to the other parties.

2.6 Expenses. If any action at law or in equity is necessary to enforce or interpret the terms of this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees, costs and necessary disbursements in addition to any other relief to which such party may be entitled.

2.7 Entire Agreement: Amendments and Waivers. This Agreement, the Purchase Agreement, the Consulting Agreement and the agreements referenced therein constitute the full and entire understanding and agreement among the parties with regard to the subjects hereof and thereof. Any term of this Agreement may be amended and the observance of any terms of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively), only with the written consent of the Company and the holders of at least two–thirds of the Registrable Securities. Any amendment or waiver effected in accordance with this paragraph shall be binding upon each holder of any Registrable Securities each future holder of all such Registrable Securities, and the Company.

2.8 Severability. If one or more provisions of this Agreement are held to be unenforceable under applicable law, such provision shall be excluded from this Agreement and the balance of the Agreement shall be interpreted as if such provision were so excluded and shall be enforceable in accordance with its terms.

2.9 Aggregation of Stock. All shares of Registrable Securities held or acquired by affiliated entities or persons shall be aggregated together for the purpose of determining the availability of any rights under this Agreement.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

THE COMPANY:

INHALE THERAPEUTIC SYSTEMS, INC.

By: /s/ AJIT S. GILL
Name: Ajit S. Gill
Title: Chief Executive Officer and President

Address: 150 Industrial Road
San Carlos, CA 94070

THE INVESTOR:

AFAC EQUITY, L.P.

By: /s/ BRIAN M. FEUER

Name: Brian M. Feuer

Title: Attorney-in-Fact

Address: c/o McKinsey & Company
55 East 52nd Street, 27th Floor
New York, New York 10022

Exhibit 4.22

INHALE THERAPEUTIC SYSTEMS, INC.

AND

AFAC EQUITY, L.P.

COMMON STOCK PURCHASE AGREEMENT

July 9, 2002

INHALE THERAPEUTIC SYSTEMS, INC.
COMMON STOCK PURCHASE AGREEMENT

THIS COMMON STOCK PURCHASE AGREEMENT (this "Agreement") is made as of July 9, 2002, by and between **INHALE THERAPEUTIC SYSTEMS, INC.**, a Delaware corporation with its principal office at 150 Industrial Road, San Carlos, California 94070 (the "Company"), and **AFAC EQUITY L.P**. a Delaware limited partnership with its offices c/o McKinsey & Company, Inc. United States at 55 East 52nd Street, 27th Floor, New York, New York 10022 ("AFAC" or, the "Purchaser").

RECITALS

WHEREAS, the Company and McKinsey & Company, Inc. United States, an affiliate of AFAC ("McKinsey") have entered into that certain Confidentiality Agreement dated April 9, 2002 and that certain letter agreement dated May 23, 2002 with respect to the performance of certain consulting services by McKinsey (collectively, the "Related Agreements"); and

WHEREAS, in connection with the Related Agreements, the Company desires to issue to AFAC and AFAC desires to acquire from the Company shares of common stock of the Company, on the terms and subject to the conditions set forth in this Agreement.

NOW, THEREFORE, in consideration of the foregoing recitals and the mutual covenants and agreements contained herein, the parties hereto, intending to be legally bound, do hereby agree as follows:

1. PURCHASE OF COMMON STOCK.

1.1. Agreement to Sell and Purchase. At the Closing (as hereinafter defined), the Company will sell to AFAC and AFAC will purchase from the Company Thirty-Five Thousand Three Hundred Fifty-Two (35,352) shares of the common stock of the Company (the "Common Stock") in exchange for services rendered by McKinsey.

1.2. Closing; Closing Date. The completion of the sale and purchase of the Common Stock (the "Closing") shall be held at 9:00 a.m. (Pacific Time) on the date hereof (the "Closing Date"), at the offices of Cooley Godward LLP, 3175 Hanover Street, Palo Alto, California, or at such other time and place as the Company and the Purchasers may agree.

1.3. Delivery. At the Closing, subject to the terms and conditions hereof, the Company will deliver to AFAC a stock certificate dated as of the Closing Date.

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2. REPRESENTATIONS AND WARRANTIES OF THE COMPANY.

Except as otherwise specifically disclosed to the Purchasers in writing on the date hereof, the Company hereby represents and warrants to the Purchasers as follows:

2.1. Authorization. All corporate action on the part of the Company, its officers, directors and shareholders necessary for the authorization, execution and delivery of this Agreement and the Registration Rights Agreement by and between the Company and AFAC dated as of the date hereof in the form set forth as Exhibit A (the "Registration Rights Agreement") has been taken. The Company has the requisite corporate power to enter into this Agreement and the Registration Rights Agreement and carry out and perform its obligations under the terms of this Agreement and the Registration Rights Agreement. At the Closing, the Company will have the requisite corporate power to issue and sell the Common Stock. This Agreement and the Registration Rights Agreement

have been duly authorized, executed and delivered by the Company and, upon due execution and delivery by the Purchasers, this Agreement and the Registration Rights Agreement will be valid and binding agreements of the Company, except as enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally or by equitable principles.

2.2. Organization, Good Standing and Qualification. The Company is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware and has all requisite corporate power and authority to carry on its business as now conducted and as proposed to be conducted. The Company is duly qualified to transact business and is in good standing in each jurisdiction in which the failure so to qualify would have a material adverse effect on its business or properties.

2.3. Valid Issuance of Common Stock. The Common Stock, when issued, sold and delivered in accordance with the terms hereof will be duly and validly authorized and issued, fully paid and nonassessable.

2.4. Offering. Assuming the accuracy of the representations of the Purchasers in Section 3.3 of this Agreement on the date hereof and on the Closing Date, the offer, issue and sale of the Common Stock are and will be exempt from the registration and prospectus delivery requirement of the Securities Act and have been or will be registered or qualified (or are or will be exempt from registration and qualification) under the registration, permit or qualification requirements of all applicable state securities laws.

3. REPRESENTATIONS AND WARRANTIES OF THE PURCHASERS.

Purchaser hereby represents and warrants to the Company as follows:

3.1. Legal Power. Purchaser has the requisite corporate power and authority to enter into this Agreement and the Registration Rights Agreement, to carry out and perform its obligations under the terms of this Agreement and the Registration Rights Agreement. All action on Purchaser's part required for the lawful execution and delivery of this Agreement and the Registration Rights Agreement have been or will be effectively taken prior to the Closing.

3.2. Due Execution. This Agreement and the Registration Rights Agreement have been duly authorized, executed and delivered by the Purchaser, and, upon due execution and delivery by the Company, this Agreement and Registration Rights Agreement will be valid and

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binding agreements of Purchaser, except as enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally or by equitable principles.

3.3. Investment Representations. In connection with the sale and issuance of the Common Stock, Purchaser makes the following representations to the Company:

(a) Investment for Own Account. Purchaser is acquiring the Common Stock for its own account, not as nominee or agent, for investment and not with a view to, or for resale in connection with, any distribution or public offering thereof within the meaning of the Securities Act.

(b) Transfer Restrictions; Legends. Purchaser understands that (i) the Common Stock has not been registered under the Securities Act; (ii) the Common Stock is being offered and sold pursuant to an exemption from registration and that the Common Stock must be held by Purchaser indefinitely, and that Purchaser must, therefore, bear the economic risk of such investment indefinitely, unless a subsequent disposition thereof is registered under the Securities Act or is exempt from such registration; (iii) each certificate representing the Common Stock will be endorsed with the following legends:

> THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR UNDER THE SECURITIES LAWS OF CERTAIN STATES. THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE ACT AND THE APPLICABLE STATE SECURITIES LAWS, PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM. THE ISSUER OF THESE SECURITIES MAY REQUIRE AN OPINION OF COUNSEL IN FORM AND SUBSTANCE SATISFACTORY TO THE ISSUER TO THE EFFECT THAT ANY PROPOSED TRANSFER OR RESALE IS IN COMPLIANCE WITH THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS.

and (iv) the Company will instruct any transfer agent not to register the transfer of the Common Stock (or any portion thereof) unless the conditions specified in the foregoing legend are satisfied, until such time as a transfer is made, pursuant to the terms of this Agreement, and in compliance with Rule 144 under the Securities Act or pursuant to a registration statement or, if the opinion of counsel referred to above is to the further effect that such legend is not required in order to establish compliance with any provisions of the Securities Act or this Agreement, or other satisfactory assurances of such nature are given to the Company. Unless otherwise required by applicable securities laws, the Company shall be obligated, at the request of Purchaser, to cause the transfer agent to reissue unlegended certificates with respect to the Common Stock if (A) Purchaser shall have obtained an opinion of counsel reasonably acceptable to the Company to the effect that the Common Stock with respect to which unlegended certificates are to be issued may lawfully be disposed of without registration, qualification or

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legend; or (B) the Common Stock can be sold without restriction as to the number of securities sold under Rule 144(k). Further, the Company will instruct the transfer agent to remove the legend on Common Stock (A) upon the sale of such Common Stock pursuant to an effective registration statement, provided the transfer agent and Company have received evidence or assurances of such sale in a form satisfactory to the transfer agent and the Company or (ii) upon the sale of such Common Stock pursuant to Rule 144 under the Securities Act, provided the transfer agent and the Company have received evidence or assurances from Purchaser of compliance with Rule 144 in a form satisfactory to the transfer agent and the Company.

(c) Financial Sophistication. Purchaser has such knowledge and experience in financial or business matters that it is capable of evaluating the merits and risks of the investment in connection with the transactions contemplated in this Agreement.

(d) Accredited Investor Status. Purchaser is an "accredited investor" as such term is defined in Rule 501(a) of the rules and regulations promulgated under the Securities Act.

3.4. No Brokers. No broker, finder or investment banker is entitled to any brokerage, finder's or other fee or commission in connection with the transactions contemplated by this Agreement based on arrangements made by Purchaser.

4. Conditions to Closing.

4.1. Conditions to Obligations of Purchasers at Closing. AFAC's obligation to purchase the Common Stock at the Closing is subject to the fulfillment to the Purchaser's satisfaction, on or prior to the Closing, of all of the following conditions, any of which may be waived by Purchaser:

(a) Representations and Warranties True; Performance of Obligations. The representations and warranties made by the Company in Section 2 hereof shall be true and correct in all material respects on the Closing Date with the same force and effect as if they had been made on and as of said date and the Company shall have performed and complied with all obligations and conditions herein required to be performed or complied with by it on or prior to the Closing.

(b) Registration Rights Agreement. The Company shall have executed and delivered the Registration Rights Agreement in the form attached hereto as Exhibit A.

(c) Qualifications, Legal Investment. All authorizations, approvals, or permits, if any, of any governmental authority or regulatory body of the United States or of any state that are required in connection with the lawful sale and issuance of the Common Stock shall have been duly obtained and shall be effective on and as of the Closing. No stop order or other order enjoining the sale of the Common Stock shall have been issued and no proceedings for such purpose shall be pending or, to the knowledge of the Company, threatened by the SEC, or any commissioner of corporations or similar officer of any state having jurisdiction over this

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transaction. At the time of the Closing, the sale and issuance of the Common Stock shall be legally permitted by all laws and regulations to which Purchaser and the Company are subject.

4.2. Conditions to Obligations of the Company. The Company's obligation to issue and sell the Common Stock at the Closing is subject to the fulfillment to the Company's satisfaction, on or prior to the Closing of the following conditions, any of which may be waived by the Company:

(a) Representations and Warranties True. The representations and warranties made by Purchaser in Section 3 hereof shall be true and correct in all material respects on the Closing Date with the same force and effect as if they had been made on and as of said date.

(b) Performance of Obligations. Purchaser shall have performed and complied with all agreements and conditions herein required to be performed or complied with by them on or before the Closing.

(c) Registration Rights Agreement. Purchaser shall have executed and delivered the Registration Rights Agreement in the form attached hereto as Exhibit A.

(d) Qualifications, Legal Investment. All authorizations, approvals, or permits, if any, of any governmental authority or regulatory body of the United States or of any state that are required in connection with the lawful sale and issuance of the Common Stock shall have been duly obtained and shall be effective on and as of the Closing. No stop order or other order enjoining the sale of the Common Stock shall have been issued and no proceedings for such purpose shall be pending or, to the knowledge of the Company, threatened by the SEC, or any commissioner of corporations or similar officer of any state having jurisdiction over this transaction. At the time of the Closing, the sale and issuance of the Common Stock shall be legally permitted by all laws and regulations to which the Purchaser and the Company are subject.

5. MISCELLANEOUS.

5.1. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California, without regard to the choice of law provisions thereof, and the federal laws of the United States.

5.2. Successors and Assigns. Except as otherwise expressly provided herein, the provisions hereof shall inure to the benefit of, and be binding upon, the successors, assigns, heirs, executors, and administrators of the parties hereto.

5.3. Entire Agreement. This Agreement, the Registration Rights Agreement, the Related Agreements and the exhibits hereto and thereto, and the other documents delivered pursuant hereto, constitutes the full and entire understanding and agreement among the parties with regard to the subjects hereof and no party shall be liable or bound to any other party in any manner by any representations, warranties, covenants, or agreements except as specifically set

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forth herein or therein. Nothing in this Agreement, express or implied, is intended to confer upon any party, other than the parties hereto and their respective successors and assigns, any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided herein.

5.4. Severability. In the event any provision of this Agreement shall be invalid, illegal, or unenforceable, it shall to the extent practicable, be modified so as to make it valid, legal and enforceable and to retain as nearly as practicable the intent of the parties, and the validity, legality, and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

5.5. Amendment and Waiver. Except as otherwise provided herein, any term of this Agreement may be amended and the observance of any term of this Agreement may be waived (either generally or in a particular instance, either retroactively or prospectively, and either for a specified period of time or indefinitely), with the written consent of the Company and Purchaser. Any amendment or waiver effected in accordance with this Section shall be binding upon any holder of any securities purchased under this Agreement, each future holder of all such securities, and the Company.

5.6. Notices. Unless otherwise provided, any notice required or permitted under this Agreement shall be given in writing and shall be deemed effectively given upon personal delivery to the party to be notified or upon delivery by confirmed facsimile transmission, nationally recognized overnight courier service, or upon deposit with the United States Post Office, by registered or certified mail, postage prepaid and addressed to the party to be notified at the address first indicated for such party above, or at such other address as such party may designate by ten (10) days' advance written notice to the other parties.

5.7. Fees and Expenses. The Company and Purchaser shall bear their own expenses and legal fees incurred on their behalf with respect to this Agreement and the transactions contemplated hereby. Each party hereby agrees to indemnify and to hold harmless of and from any liability the other party for any commission or compensation in the nature of a finder's fee to any broker or other person or firm (and the costs and expenses of defending against such liability or asserted liability) for which such indemnifying party or any of its employees or representatives are responsible.

5.8. Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed an original, but all of which together shall constitute one instrument.

IN WITNESS WHEREOF, the foregoing Common Stock Purchase Agreement is hereby executed as of the date first above written.

THE COMPANY:

INHALE THERAPEUTIC SYSTEMS, INC.

By: /s/ AJIT S. GILL
Name: Ajit S. Gill
Title: Chief Executive Officer and President

Address: 150 Industrial Road San Carlos, CA 94070

THE PURCHASER:

AFAC EQUITY, L.P.

By: /s/ BRIAN M. FEUER

Name: Brian M. Feuer

Title: Attorney-in-Fact

Address: c/o McKinsey & Company 55 East 52nd Street, 27th Floor New York, NY 10022

EXHIBIT A

REGISTRATION RIGHTS AGREEMENT

EXHIBIT A

REGISTRATION RIGHTS AGREEMENT

THIS REGISTRATION RIGHTS AGREEMENT is made as of the 9TH day of July, 2002, by and between Inhale Therapeutic Systems, Inc., a Delaware corporation (the "**Company**") and AFAC Equity, L.P., a Delaware limited partnership (the "**Investor**").

RECITALS

WHEREAS, the Company and McKinsey & Company, Inc. United States, an affiliate of the Investor ("**McKinsey**") are parties to a certain confidentiality agreement effective as of April 9, 2002 and a letter agreement dated May 23, 2002 (collectively, the "**Consulting Agreement**"); and

WHEREAS, the Company and Investor are parties to that certain Common Stock Purchase Agreement dated as of the date hereof the "**Purchase Agreement**") pursuant to which the Company shall issue Thirty-Five Thousand Three Hundred Fifty-Two (35,352) shares of Company common stock (the "Shares") to the Investor in partial consideration of services provided by McKinsey to the Company; and

WHEREAS, the Purchase Agreement provides that the Company and the Investor will enter into a registration rights agreement in form and substance reasonably satisfactory to both parties;

NOW, THEREFORE, in consideration of the mutual promises and covenants set forth herein, the parties hereto agree as follows:

1. Registration Rights.

1.1 Definitions. For purposes of this Section 1:

(a) The term "**Act**" means the Securities Act of 1933, as amended.

(b) The term "**Holder**" means any person owning Registrable Securities or any assignee thereof in accordance with Section 1.9 hereof.

(c) The term "**1934 Act**" means the Securities Exchange Act of 1934, as amended.

(d) The terms "**register**," "**registered**," and "**registration**" refer to a registration effected by preparing and filing a registration statement or similar document in compliance with the Act, and the declaration or ordering of effectiveness of such registration statement or document.

(e) The term "**Registrable Securities**" means (i) the Shares and (ii) any Common Stock of the Company issued as (or issuable upon the conversion or exercise of any warrant, right or other security that is issued as) a dividend or other distribution with respect to, or in exchange for, or in replacement of, the Shares. Notwithstanding the foregoing, Registrable Securities shall not include (i) any securities sold by a person to the public either pursuant to a registration statement or Rule 144 or sold in a private transaction in which the transferor's rights under Section 1 of this Agreement are not assigned; (ii) any securities for which the rights of a Holder have terminated pursuant to Section 1.10 herein.

(f) The number of shares of "Registrable Securities" outstanding shall be determined by the number of shares of Common Stock outstanding that are, and the number of shares of Common Stock issuable pursuant to then exercisable or convertible securities that are, Registrable Securities.

(g) The term "**SEC**" shall mean the Securities and Exchange Commission.

1.2 Company Registration.

(a) If (but without any obligation to do so) the Company proposes (i) to register for its own account any of its common stock under the Act in connection with an underwritten public offering of such securities (other than a registration relating solely to the sale of securities to participants in a Company stock plan or a registration relating to a corporate reorganization, merger or other transaction under Rule 145 of the Act) (a "**Company Offering**"); or (ii) to register the offering of its common stock by stockholders of the Company other than the Holders ("**Other Selling Stockholders**") other than in connection with a Company Offering or a registration relating solely to the sale of securities to participants in a Company stock plan or a registration relating to a corporate reorganization, merger or other transaction under Rule 145 of the Act (a "**Secondary Offering**"), the Company shall, at such time, promptly give each Holder written notice of such Company Offering or Secondary Offering, as applicable. Upon the written request of each Holder given within fifteen (15) days after mailing of such notice by the Company in accordance with Section 2.5, the Company shall, subject to the provisions of Section 1.2(b) and other restrictions set forth herein, cause to be registered under the Act all of the Registrable Securities that each such Holder has requested to be registered. Notwithstanding the foregoing, the Company shall have no obligation to notify the Holders, cause to be registered any Registrable Securities, or undertake any other obligation in connection with this Agreement in connection with (i) any proposed Company Offering in which the proposed maximum offering price to the public exceeds **[80% of Purchase Price]** (as adjusted for stock splits, combinations, dividends and the like occurring after the date hereof); or (ii) any Secondary Offering made pursuant to that certain Preferred Stock Purchase Agreement dated January 7, 2002 by and between the Company and Enzon, Inc.

(b) Underwriting Requirements. In connection with any offering in which the Holder would otherwise be permitted to include Registrable Securities pursuant to this Section 1.2 involving an underwriting of shares of the Company's capital stock, the Company shall not be required under this Section 1.2 to include any of the Holders' securities in such underwriting unless they accept the terms of the underwriting as agreed upon between the Company and the underwriters selected by it (or by other persons entitled to select the underwriters) and enter into an underwriting agreement in customary form with an underwriter or underwriters selected by the Company, and then only in such quantity as the underwriters determine in their sole discretion will not jeopardize the success of the offering by the Company. If the total amount of securities, including Registrable Securities, requested by

stockholders to be included in such offering exceeds the amount of securities sold other than by the Company that the underwriters determine in their sole discretion is compatible with the success of the offering, then the Company shall be required to include in the offering only that number of such securities, including Registrable Securities, that the underwriters determine in their sole discretion will not jeopardize the success of the offering (the securities so included to be apportioned pro rata among the selling Holders according to the total amount of securities entitled to be included therein owned by each selling Holder or in such other proportions as shall mutually be agreed to by such selling Holders), but in no event shall the amount of securities of the selling Holders included in the offering be reduced below fifteen percent (15%) of the total amount of securities included in such offering. For purposes of the preceding parenthetical concerning apportionment, for any selling stockholder that is a Holder of Registrable Securities and that is a partnership or corporation, the partners, retired partners and stockholders of such Holder, or the estates and family members of any such partners and retired partners and any trusts for the benefit of any of the foregoing persons shall be deemed to be a single "selling Holder," and any pro rata reduction with respect to such "selling Holder" shall be based upon the aggregate amount of Registrable Securities owned by all such related entities and individuals.

1.3 Obligations of the Company. Whenever required under this Section 1 to effect the registration of any Registrable Securities, the Company shall, as expeditiously as reasonably possible:

(a) prepare and file with the SEC a registration statement with respect to such Registrable Securities and use its best efforts to cause such registration statement to become effective, and, upon the request of the Holders of a majority of the Registrable Securities registered thereunder, keep such registration statement effective until, with respect to a Company Offering, the distribution of securities by the Company contemplated in the registration statement is completed, or, with respect to a Secondary Offering, the earlier of (i) the completion of the distribution contemplated in the registration statement by the Other Selling Stockholders; (ii) the termination of all Other Selling Stockholders' rights to require registration pursuant to such registration statement or (iii) the date 120 days following the initial effective date of such registrations statement. Notwithstanding any other provision of this Agreement, the Holders understand and acknowledge that there may be periods during which the Company may determine, in good faith, based on the advice of counsel, that it is in the best interest of the Company and its stockholders to defer disclosure of non-public information until such information has reached a more advanced stage and that during such periods sales of Registrable Securities and the effectiveness of any registration statement covering Registrable Securities, may be suspended or delayed. The Holders agree that upon receipt of any notice from the Company of the development of any material non-public information, each Holder will forthwith discontinue its disposition of Registrable Securities pursuant to any such registration statement until such Holder's receipt of copies of an appropriately supplemented or amended prospectus and, if so directed by the Company, each Holder will use reasonable commercial efforts to deliver to the Company all copies, of the prospectus relating to such Registerable Shares current at the time of receipt of such notice;

(b) prepare and file with the SEC such amendments and supplements to such registration statement and the prospectus used in connection with such registration statement as may be necessary to comply with the provisions of the Act with respect to the disposition of all securities covered by such registration statement;

(c) furnish to the Holders such numbers of copies of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Act, and such other documents as they may reasonably request in order to facilitate the disposition of Registrable Securities owned by them;

(d) use reasonable commercial efforts to register and qualify the securities covered by such registration statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Holders, provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions;

(e) notify each Holder of Registrable Securities covered by such registration statement at any time when a prospectus relating thereto is required to be delivered under the Act or the happening of any event as a result of which the prospectus included in such registration statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances then existing;

(f) cause all such Registrable Securities registered pursuant to this Section 1 to be listed on each securities exchange on which similar securities issued by the Company are then listed;

(g) provide a transfer agent and registrar for all Registrable Securities registered pursuant to this Section 1 and a CUSIP number for all such Registrable Securities, in each case not later than the effective date of such registration; and

(h) use reasonable commercial efforts to furnish, at the request of any Holder requesting registration of Registrable Securities pursuant to this Section 1, on the date that such Registrable Securities are delivered to the underwriters for sale in connection with a registration pursuant to this Section 1, if such securities are being sold through underwriters, (i) an opinion, dated such date, of the counsel representing the Company for the purposes of such registration, in form and substance as is customarily given to underwriters in an underwritten public offering, addressed to the underwriters, and (ii) a letter dated such date, from the independent certified public accountants of the Company, in form and substance as is customarily given by independent certified public accountants to underwriters in an underwritten public offering, addressed to the underwriters.

1.4 Information from Holder. It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Section 1 with respect to the Registrable Securities of any selling Holder that such Holder shall furnish to the Company such information regarding itself, the Registrable Securities held by it, and the intended method of disposition of such securities as shall be required to effect the registration of such Holder's Registrable Securities.

1.5 Expenses of Registration. All expenses other than underwriting discounts, commissions and fees and disbursements of counsel for the Selling Holders incurred in connection with registrations, filings or qualifications pursuant to Section 1.2, including (without limitation) all registration, filing and qualification fees, printers' and accounting fees, fees and disbursements of counsel for the Company shall be borne by the Company.

1.6 Delay of Registration. No Holder shall have any right to obtain or seek an injunction restraining or otherwise delaying any such registration as the result of any controversy that might arise with respect to the interpretation or implementation of this Section 1.

1.7 Indemnification. In the event any Registrable Securities are included in a registration statement under this Section 1:

(a) To the extent permitted by law, the Company will indemnify and hold harmless each Holder, the partners or officers, directors and stockholders of each Holder, any underwriter (as defined in the Act) for such Holder and each person, if any, who controls such Holder or underwriter within the meaning of the Act or the 1934 Act, against any losses, claims, damages or liabilities (joint or several) to which they may become subject under the Act, the 1934 Act or any state securities laws, insofar as such losses, claims, damages, or liabilities (or actions in respect thereof) arise out of or are based upon any of the following statements, omissions or violations (collectively, a "**Violation**"): (i) any untrue statement or alleged untrue statement of a material fact contained in such registration statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto, (ii) the omission or alleged omission to state therein a material fact required to be stated therein, or necessary to make the statements therein not misleading, or (iii) any violation or alleged violation by the Company of the Act, the 1934 Act, any state securities laws or any rule or regulation promulgated under the Act, the 1934 Act or any state securities laws; and the Company will reimburse each such Holder, underwriter or controlling person for any legal or other expenses reasonably incurred by them in connection with investigating or defending any such loss, claim, damage, liability or action; *provided, however*, that the indemnity agreement contained in this subsection l.7(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Company (which consent shall not be unreasonably withheld), nor shall the Company be liable in any such case for any such loss, claim, damage, liability or action to the extent that it arises out of or is based upon a Violation that occurs in reliance upon and in conformity with written information furnished expressly for use in connection with such registration by any such Holder, underwriter or controlling person.

(b) To the extent permitted by law, each selling Holder will indemnify and hold harmless the Company, each of its directors, each of its officers who has signed the registration statement, each person, if any, who controls the Company within the meaning of the Act, any underwriter, any other Holder selling securities in such registration statement and any controlling person of any such underwriter or other Holder, against any losses, claims, damages or liabilities (joint or several) to which any of the foregoing persons may become subject, under the Act, the 1934 Act or any state securities laws, insofar as such losses, claims, damages or liabilities (or actions in respect thereto) arise out of or are based upon any Violation, in each case to the extent (and only to the extent) that such Violation occurs in reliance upon and in conformity with written information furnished by such Holder expressly for use in connection with such registration; and each such Holder will reimburse any person intended to be indemnified pursuant to this subsection l.7(b), for any legal or other expenses reasonably incurred by such person in connection with investigating or defending any such loss, claim, damage, liability or action; *provided, however*, that the indemnity agreement contained in this subsection l.7(b) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Holder (which consent shall not be unreasonably withheld), provided that in no event shall any indemnity under this subsection l.7(b) exceed the gross proceeds from the offering received by such Holder.

(c) Promptly after receipt by an indemnified party under this Section 1.7 of notice of the commencement of any action (including any governmental action), such indemnified party will, if a claim in respect thereof is to be made against any indemnifying party under this Section 1.7, deliver to the indemnifying party a written notice of the commencement thereof and the indemnifying party shall have the right to participate in, and, to the extent the indemnifying party so desires, jointly with any other indemnifying party similarly noticed, to assume the defense thereof with counsel mutually satisfactory to the parties; *provided, however*, that an indemnified party (together with all other indemnified parties that may be represented without conflict by one counsel) shall have the right to retain one separate counsel, with the fees and expenses to be paid by the indemnifying party, if representation of such indemnified party by the counsel retained by the indemnifying party would be inappropriate due to actual or potential differing interests between such indemnified party and any other party represented by such counsel in such proceeding. The failure to deliver written notice to the indemnifying party within a reasonable time of the commencement of any such action, if prejudicial to its ability to defend such action, shall relieve such indemnifying party of any liability to the indemnified party under this Section 1.7, but the omission so to deliver written notice to the indemnifying party will not relieve it of any liability that it may have to any indemnified party otherwise than under this Section 1.7.

(d) If the indemnification provided for in this Section 1.7 is held by a court of competent jurisdiction to be unavailable to an indemnified party with respect to any loss, liability, claim, damage or expense referred to herein, then the indemnifying party, in lieu of indemnifying such indemnified party hereunder, shall contribute to the amount paid or payable by such indemnified party as a result of such loss, liability, claim, damage or expense in such proportion as is appropriate to reflect the relative fault of the indemnifying party on the one hand and of the indemnified party on the other in connection with the statements or omissions that resulted in such loss, liability, claim, damage or expense, as well as any other relevant equitable considerations. The relative fault of the indemnifying party and of the indemnified party shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission to state a material fact relates to information supplied by the indemnifying party or by the indemnified party and the parties' relative intent, knowledge, access to information, and opportunity to correct or prevent such statement or omission.

(e) The obligations of the Company and Holders under this Section 1.7 shall survive the completion of any offering of Registrable Securities in a registration statement under this Section 1, and otherwise.

1.8 Rule 144 Reporting. With a view to making available to the Holders the benefits of Rule 144 promulgated under the Act and any other rule or regulation of the SEC that may at any time permit a Holder to sell securities of the Company to the public without registration, the Company agrees to:

(a) file with the SEC in a timely manner all reports and other documents required of the Company under the Act and the 1934 Act; and

(b) furnish to any Holder, so long as the Holder owns any Registrable Securities, forthwith upon request (i) a written statement by the Company that it has complied with the reporting requirements of SEC Rule 144 (at any time after ninety (90) days after the effective date of the first registration statement filed by the Company for an offering of its securities to the general public), the Act and the 1934 Act (at any time after it has become subject to such reporting requirements), (ii) a copy of the most recent annual or quarterly report of the Company and such other reports and documents so filed by the Company, and (iii) such other information as may be reasonably requested in availing any Holder of any rule or regulation of the SEC that permits the selling of any such securities without registration or pursuant to such form.

1.9 Assignment of Registration Rights. The rights to cause the Company to register Registrable Securities pursuant to this Section 1 may be assigned (but only with all related obligations) by a Holder only to an affiliate of the Investor or McKinsey (an "**Affiliate**"), provided: (a) the Company is, within a reasonable time after such transfer, furnished with written notice of the name and address of such Affiliate and the securities with respect to which such registration rights are being assigned; (b) such Affiliate agrees in writing to be bound by and subject to the terms and conditions of this Agreement, including without limitation the provisions of Section 1.10 below; and (c) such assignment shall be effective only if immediately following such transfer the further disposition of such securities by the transferee or assignee is restricted under the Act.

1.10 Termination of Registration Rights. The Company's obligations under this Section 1 to effect the registration of any Registrable Securities shall terminate as to any Holder at such time as all the Registrable Securities held by such Holder are eligible for sale under Rule 144.

2. Miscellaneous.

2.1 Successors and Assigns. Except as otherwise provided herein, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective successors and assigns of the parties (including transferees of any shares of Registrable Securities). Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

2.2 Governing Law. This Agreement shall be governed by, and construed and enforced in accordance with the internal laws of the State of California, without reference to conflicts of law provisions thereof.

2.3 Counterparts. This Agreement may be executed by facsimile and in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

2.4 Titles and Subtitles. The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

2.5 Notices. Unless otherwise provided, any notice required or permitted under this Agreement shall be given in writing and shall be deemed effectively given upon personal delivery to the party to be notified or upon delivery by confirmed facsimile transmission, nationally recognized overnight courier service, or upon deposit with the United States Post Office, by registered or certified mail, postage prepaid and addressed to the party to be notified at the address indicated for such party on the signature page hereof, or at such other address as such party may designate by ten (10) days' advance written notice to the other parties.

2.6 Expenses. If any action at law or in equity is necessary to enforce or interpret the terms of this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees, costs and necessary disbursements in addition to any other relief to which such party may be entitled.

2.7 Entire Agreement: Amendments and Waivers. This Agreement, the Purchase Agreement, the Consulting Agreement and the agreements referenced therein constitute the full and entire understanding and agreement among the parties with regard to the subjects hereof and thereof. Any term of this Agreement may be amended and the observance of any terms of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively), only with the written consent of the Company and the holders of at least two–thirds of the Registrable Securities. Any amendment or waiver effected in accordance with this paragraph shall be binding upon each holder of any Registrable Securities each future holder of all such Registrable Securities, and the Company.

2.8 Severability. If one or more provisions of this Agreement are held to be unenforceable under applicable law, such provision shall be excluded from this Agreement and the balance of the Agreement shall be interpreted as if such provision were so excluded and shall be enforceable in accordance with its terms.

2.9 Aggregation of Stock. All shares of Registrable Securities held or acquired by affiliated entities or persons shall be aggregated together for the purpose of determining the availability of any rights under this Agreement.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

THE COMPANY:

INHALE THERAPEUTIC SYSTEMS, INC.

By: /s/ AJIT S. GILL
Name: Ajit S. Gill
Title: Chief Executive Officer and President

Address: 150 Industrial Road
San Carlos, CA 94070

THE INVESTOR:

AFAC EQUITY, L.P.

By: /s/ BRIAN M. FEUER

Name: Brian M. Feuer

Title: Attorney-in-Fact

Address: c/o McKinsey & Company
55 East 52nd Street, 27th Floor
New York, New York 10022

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

July 31, 2002

Douglas H. Altschuler
2001 California Ave #403
San Francisco, California 94109

Dear Douglas:

This letter sets forth the substance of the separation agreement (the "Agreement") which Inhale Therapeutic Systems, Inc. ("Inhale" or the "Company") is offering to you to aid in your employment transition.

1. Resignation. Your employment with the Company will terminate upon the earlier ("Termination Date") of: (a) your commencement of full-time employment with another employer; or (b) June 6, 2003. You agree to notify Inhale promptly upon your acceptance of full-time employment before May 31, 2003.

2. Further Services. [*] You agree to provide, upon Company request at any time before the Termination Date, reasonable telephone consultation services to the Company, in order to assist with the transition of responsibility. Prior to the Termination Date, you further agree to provide up to three days of personal services, as requested by the Company, per calendar month at no additional charge other than the usual and customary reimbursement of out-of-pocket expenses. The Company further agrees to pay you $1000.00 per day of additional compensation for any personal services beyond three days per calendar month it may request.

3. Compensation and Benefits. Until the Termination Date, you will continue to accrue vacation and to receive your current base salary (the "Salary Continuance") and benefits, except as follows. To the extent provided by the federal COBRA law, and by the Company's current group health insurance policies, as of the Termination Date you will be eligible to continue your group health insurance benefits at your own expense. Later, you may be able to convert to an individual policy through the provider of the Company's health insurance, if you wish. You will not be eligible for, and will not receive, any other form of compensation such as bonuses, commissions or incentive compensation.

4. Stock Options. You were granted one or more options to purchase shares (post-split) of the Company's common stock, pursuant to the Company's 2000 Equity Incentive Plan (the "Plan"). Under the terms of the Plan and your stock option grant, vesting will continue until the Termination Date, at which time vesting will cease. Your rights to exercise any vested shares will be as set forth in the Plan and your option grant.

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5. Voicemail and Email Access. You will continue to have access to the Company's voicemail and email facilities, including the use of the Company laptop computer, until the Termination Date.

6. Accrued Salary And Vacation Pay. On the Termination Date, the Company will pay you all accrued salary, and all accrued and unused vacation earned through the Termination Date, subject to standard payroll deductions and withholdings.

7. Severance Payment. Although the Company has no policy or procedure for providing severance benefits, in the event that you commence full-time employment with another employer prior to June 6, 2003, the Company will pay you, as severance, an amount equivalent to your base salary from the Termination Date until June 6, 2003, subject to standard payroll deductions and withholdings ("Severance Payment"). The Severance Payment, if due, will be paid in a lump sum within ten (10) days after the Termination Date.

8. Other Compensation or Benefits. You acknowledge that, except as expressly provided in this Agreement, you will not receive any additional compensation, severance or benefits after the Termination Date.

9. Expense Reimbursements. You agree that, within thirty (30) days of the Separation Date, you will submit your final documented expense reimbursement statement reflecting all business expenses you incurred through the Separation Date, if any, for which you seek reimbursement. The Company will reimburse you for these expenses pursuant to its regular business practice.

10. Return of Company Property. By the Separation Date, you agree to return to the Company all Company documents (and all copies thereof) and other Company property that you have had in your possession at any time, including, but not limited to, Company files, notes, drawings, records, business plans and forecasts, financial information, specifications, computer-recorded information, tangible property (including, but not limited to, computers), credit cards, entry cards, identification badges and keys; and, any materials of any kind that contain or embody any proprietary or confidential information of the Company (and all reproductions thereof).

11. Proprietary Information Obligations. You acknowledge your continuing obligations under your Proprietary Information and Inventions Agreement, including but not limited to your obligation not to use or disclose any confidential or proprietary information of the Company. A copy of your

Proprietary Information and Inventions Agreement is attached hereto as Exhibit A.

12. Confidentiality. The provisions of this Agreement will be held in strictest confidence by you and the Company and will not be publicized or disclosed in any manner whatsoever; *provided, however*, that: (a) you may disclose this Agreement to your immediate

family; (b) the parties may disclose this Agreement in confidence to their respective attorneys, accountants, auditors, tax preparers, and financial advisors; (c) the Company may disclose this Agreement as necessary to fulfill standard or legally required corporate reporting or disclosure requirements; and (d) the parties may disclose this Agreement insofar as such disclosure may be necessary to enforce its terms or as otherwise required by law. In particular, and without limitation, you agree not to disclose the terms of this Agreement to any current or former Company employee.

13. Nondisparagement. (a) Both you and the Company agree not to disparage the other party, and you further agree not to disparage the Company's officers, directors, employees, shareholders and agents, in any manner likely to be harmful to them or their business, business reputation or personal reputation; and the Company further agrees not to disparage you in any manner likely to be harmful to you or your business, business reputation or personal reputation provided, further, that both you and the Company will respond accurately and fully to any question, inquiry or request for information when required by legal process. [*]

(b) [*].

14. Mandatory Arbitration. Both you and the Company agree that any and all disputes arising from your or the Company's breach or alleged breach of paragraphs 12 or 13 of this Agreement shall be resolved, to the fullest extent permissible by law, by final and binding confidential arbitration held in San Francisco, California through the American Arbitration Association under its then-existing rules and procedures. **Both you and the Company acknowledge that by agreeing to this arbitration procedure, both you and the Company waive the right to resolve any such dispute through a trial by judge or jury or administrative proceeding.** The arbitrator shall be authorized to award any or all remedies that you or the Company would be entitled to seek in a court of law. The prevailing party in any such arbitration shall be entitled to seek recovery of his or its attorney's fees and costs. Nothing in this paragraph is intended to prevent either you or the Company from obtaining injunctive relief in court to prevent irreparable harm pending the conclusion of any such arbitration.

15. Release of Claims. In exchange for the Salary Continuance, COBRA Premiums, benefits continuance, eligibility for the Severance Payment, and other consideration under this Agreement to which you would not otherwise be entitled, and except as otherwise set forth in this Agreement, you hereby release, acquit and forever discharge the Company, its subsidiaries, and its and their respective officers, directors, agents, servants, employees, attorneys, shareholders, successors, assigns and affiliates, of and from any and all claims, liabilities, demands, causes of action, costs, expenses, attorneys' fees, damages, indemnities and obligations of every kind and nature, in law, equity, or otherwise, known and unknown, suspected and unsuspected, disclosed and undisclosed, arising out of or in any way related to agreements, events, acts or conduct at any time prior to and including the date you sign this Agreement, including but not limited to: any and all such claims and demands directly or indirectly arising

out of or in any way connected with your employment with the Company or the termination of that employment; claims or demands related to salary, bonuses, commissions, stock, stock options, or any other ownership interests in the Company, vacation pay, fringe benefits, expense reimbursements, sabbatical benefits, severance benefits, or any other form of compensation; claims pursuant to any federal, state, local law, statute or cause of action including, but not limited to, the federal Civil Rights Act of 1964, as amended; the federal Age Discrimination in Employment Act of 1967, as amended ("ADEA"); the federal Americans with Disabilities Act of 1990; the California Fair Employment and Housing Act, as amended; tort law; contract law; wrongful discharge; discrimination; fraud; defamation; harassment; emotional distress; and breach of the implied covenant of good faith and fair dealing.

16. ADEA Waiver. You acknowledge that you are knowingly and voluntarily waiving and releasing any rights you may have under the ADEA, as amended. You also acknowledge that the consideration given for the waiver and release in the preceding paragraph hereof is in addition to anything of value to which you were already entitled. You further acknowledge that you have been advised by this writing, as required by the ADEA, that: (a) your waiver and release do not apply to any rights or claims that may arise after the date you sign this Agreement; (b) you have been advised hereby that you have the right to consult with an attorney prior to executing this Agreement; (c) you have twenty-one (21) days to consider this Agreement (although you may choose to voluntarily execute this Agreement earlier); (d) you have seven (7) days following your execution of this Agreement to revoke the Agreement (in writing); and (e) this Agreement will not be effective until after the date upon which the revocation period has expired, which will be the eighth day after this Agreement is executed by you, provided that the Company has also executed this Agreement by that date.

17. Section 1542 Waiver. In giving the release described in Paragraphs 15 and 16, above, which includes claims that may be unknown to you at present, you acknowledge that you have read and understand Section 1542 of the California Civil Code which reads as follows: **"A general release does not**

extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor." You hereby expressly waive and relinquish all rights and benefits under that section and any law or legal principle of similar effect in any jurisdiction with respect to the release of unknown and unsuspected claims granted in this Agreement.

18. Post-Death Payment. In the event of your death, any balance then remaining under this Agreement which has not yet been paid shall be due and payable to your parents, Dr. Gerald and/or Phyllis Altschuler.

19. Miscellaneous. This Agreement, including its exhibit, constitutes the complete, final and exclusive embodiment of the entire agreement between you and the Company with regard to this subject matter. It is entered into without reliance on any promise or representation,

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written or oral, other than those expressly contained herein, and it supersedes any other such promises, warranties or representations. This Agreement may not be modified or amended except in a writing signed by both you and a duly authorized officer of the Company. This Agreement will bind the heirs, personal representatives, successors and assigns of both you and the Company, and inure to the benefit of both you and the Company, their heirs, successors and assigns. If any provision of this Agreement is determined to be invalid or unenforceable, in whole or in part, this determination will not affect any other provision of this Agreement and the provision in question will be modified by the court so as to be rendered enforceable. This Agreement will be deemed to have been entered into and will be construed and enforced in accordance with the laws of the State of California as applied to contracts made and to be performed entirely within California.

If this Agreement is acceptable to you, please sign below and return the original to me.

I wish you good luck in your future endeavors.

Sincerely,

INHALE THERAPEUTIC SYSTEMS, INC.

By: /s/ Elizabeth Frisby
Elizabeth Frisby
Vice President, Human Resources

AGREED:

/s/ Douglas H. Altschuler
Douglas H. Altschuler

July 31, 2002
Date

EXHIBIT A

PROPRIETARY INFORMATION AND INVENTIONS AGREEMENT

Inhale Therapeutic Systems

EMPLOYEE AGREEMENT

In consideration of my employment or continued employment by Inhale Therapeutic Systems, Inc. (the "Company"), I agree as of the date I was first employed by Company as follows:

1. This Agreement supersedes any and all previous oral or written communications, discussions and agreements between Company and me with respect to the subject of this Agreement.

2. I shall devote my full time and best efforts during my employment with Company to the business of Company and shall not, without the prior approval of (a) an executive officer of the Company if I am not an executive officer of the Company, or (b) the Board of Directors of the Company

if I am an executive officer of the Company, (i) engage in any other professional employment or consulting, or (ii) except as appropriate in connection with my employment by the Company, directly or indirectly participate in or assist any business which is a current or potential supplier or customer of Company.

3. During my employment by Company and for a period of one year thereafter I shall notify Company of any and all ideas, (including but not limited to computer programs, software and documentation), formulae, devices, improvements, methods, processes or discoveries related to Company's business and/or its actual or demonstrably anticipated research and development ("Inventions") which I develop, and those Inventions developed during my employment by Company shall be the sole property of Company and I hereby assign my entire right, title and interest in any and all such Inventions to Company, if:

   a. I used equipment, supplies facilities and/or confidential and/or proprietary and/or trade secret information of Company in developing or creating said Inventions; and/or

   b. The Inventions result, in whole or in part, from any work performed by me for Company; and/or

   c. The Inventions relate at the time of conception or reduction to practice of the Inventions to Company's business, and/or its actual demonstrably anticipated research and development.

   I shall make and maintain adequate and current written records of all Inventions, which records shall be and remain the property of Company.

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4. I shall not, at any time during or following my employment by Company, disclose, other than to Company's authorized personnel, or otherwise use for non-Company purposes, any confidential or proprietary information, whether business or technical, or know-how of any nature whatsoever (whether or not a trade secret) relating to any activity of Company, or any invention, which is owned or licensed by Company of which has been otherwise disclosed to Company.

5. I shall keep on Company's premises (except when required elsewhere in connection with the conduct of Company's business) and shall deliver to Company upon termination of my employment all writings related to the business of Company, and all documents, equipment, materials and other personal property belonging to Company. I further agree not to make or retain any copy, duplication, facsimile, reproduction or replication of any of the foregoing except as necessary to perform my duties as an employee of the Company.

6. I agree to abide by, and comply with, all of the rules, regulations and policies of Company. I will not, in connection with my employment by Company, use or disclose to Company any confidential, trade secret or other proprietary information of any previous employer or other person to which I am not lawfully entitled.

7. Except for those obligations specifically set forth in another writing signed by me and an officer of Company (a copy of which is presented to Company with this Agreement), I shall be under no obligation to others which restricts my right to perform the undertakings set forth in this Agreement or which creates a conflict with my other duties and responsibilities as an employee of Company. The purpose of this Paragraph 7 is solely for me to advise Company of any alleged obligations to others that may exist and in no manner should be construed as Company's acceptance of such obligations (even if an officer of Company should sign this Agreement).

8. I agree that unless specifically provided in another writing signed by me and (a) an executive officer of Company if I am not an executive officer of the Company, or (b) another executive officer of the Company if I am an executive officer of the company, my employment by Company is not for a definite period of time. Rather, my employment relationship with Company is one of employment at will and my continued employment is not obligatory by either myself or Company.

9. This Agreement shall be construed and governed by the laws of the State of California applicable to contracts entered into and wholly to be performed by California residents.

10. The waiver of any breach of this Agreement shall not constitute a waiver of subsequent similar of dissimilar breaches of this Agreement, or a waiver of any of the obligations contained herein.

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11. This Agreement shall be binding upon the pass to the benefit of the successors and assigns of Company.

12. I recognize the right of Company to notify any third party of the existence of this Agreement and/or its provisions and/or my agreeing to it.

13. Should a provision or part of a provision of this Agreement be found as a matter or law to be invalid, such finding shall not have the effect of invalidating the remainder of this Agreement and the provision or part thereof as to which such finding of invalidity is made shall be interpreted so as to be ineffective only to the extent of such invalidity without invalidating the remainder of such provision or part thereof or any of the other provisions of this Agreement.

EMPLOYEE:		INHALE THERAPEUTIC SYSTEMS, INC.:	
Signed:	/s/ Douglas H. Altschuler	By:	/s/ Donald Campodonico
Name:	Douglas H. Altschuler	Title:	Vice President Human Resources
Dated:	September 14, 2001	Dated:	September 14, 2001

ACKNOWLEDGMENT OF NOTIFICATION
REGARDING LIMITS ON ASSIGNMENT OF INVENTIONS

I acknowledge that by signing the Employee Agreement to which this Acknowledgment of Notification is attached and specifically, that under the terms of Paragraph 3 of the Agreement, I have agreed that inventions, discoveries and improvements developed by me during my employment with Company shall be the sole property of Company and are thereby assigned to Company.

I further acknowledge that Company has notified me that under California Labor Code Section 2870 the above-referenced Paragraph 3 of the Employee Agreement does not apply to inventions, discoveries or improvements developed by me during my employment with Company:

a. For which no equipment, supplies, facilities, and/or trade secret, and/or confidential and/or proprietary information of Company was used by me; AND

b. Which do not result from any work performed by me for Company, AND

c. Which do not relate directly to the business of Company, at the time of conception or reduction to practice of the invention, discovery or improvement and/or its actual or demonstrably anticipated research and development.

Acknowledgment:

I hereby certify that I have read and understood the above Acknowledgment of Notification regarding those inventions, discoveries and improvements which I may develop during my employment with Company which do/will not become the property of Company and for which I have made no assignment to Company under Acknowledgment of Notification is attached.

EMPLOYEE: /s/ Douglas H. Altschuler

Douglas H. Altschuler
(Printed or Typewritten)

DATED: September 14, 2001

EXHIBIT B

[*]

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

CONFIDENTIAL

QuickLinks -- Click here to rapidly navigate through this document

Exhibit 99.1

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
AND CHIEF FINANCIAL OFFICER PURSUANT
TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C § 1350, as adopted), Ajit S. Gill, Chief Executive Officer and President of Inhale Therapeutic Systems, Inc. (the "Company"), and Brigid A. Makes, Vice President, Finance and Administration and Chief Financial Officer of the Company, each hereby certifies that, to the best of his or her knowledge:

1. The Company's Quarterly Report on Form 10-Q for the period ended September 30, 2002, to which this Certification is attached as Exhibit 99.1 (the "Periodic Report"), fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Periodic Report and results of operations of the Company for the period covered by the Periodic Report.

Dated: November 14, 2002

/s/ AJIT S. GILL	/s/ BRIGID A. MAKES
Ajit S. Gill *Chief Executive Officer, President and Director*	Brigid A. Makes *Vice President, Finance and Administration, Chief Financial Officer and Assistant Secretary*

QuickLinks

Exhibit 99.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002