

Building Value & Making Life Better



2007 Annual Report

Aradigm

Specialty pharmaceutical company targeting severe respiratory diseases

Portfolio of proprietary therapies administered through inhalation to target diseases within the lungs and enable patients to lead healthier, happier, more productive lives

Innovative technologies that can improve the safety, efficacy and convenience of already-proven drugs

Product opportunities that allow for an abbreviated regulatory pathway to the marketplace and a small sales force serving physician specialists

Corporate partnerships and royalty agreements that extend Aradigm's internal capabilities beyond the field of respiratory disease therapy

In 2007, we took major steps forward in the development of our respiratory disease business, building value through innovative products, technologies and partnerships.

Dear Shareholders

What a difference a year can make. At the end of 2006, Aradigm's own product pipeline was undergoing preclinical research. By the end of 2007, we had two well-defined clinical development programs ready to advance into Phase 2 trials. What's more, we added an important new development and commercialization partnership with Lung Rx, Inc., a wholly owned subsidiary of United Therapeutics Corporation, for an inhaled treprostinil formulation that completed a successful Phase 3 study using a nebulizer for drug delivery. Under that agreement, we will conduct a bridging clinical trial using the AERx Essence® system for a more patient-friendly therapy. We also started an exciting, new product development collaboration with CyDex Pharmaceuticals, Inc. for multi-drug combination therapy targeting asthma and chronic obstructive pulmonary disease (COPD).

Furthermore, we ended the year in a stronger financial position. On December 31, 2007, we had \$40.5 million in cash, cash equivalents and short-term investments, compared to \$27.5 million on December 31, 2006. We kept a tight control over our burn rate and reduced expenses significantly in multiple areas of our business while advancing our research and development programs. In addition, we made full use of top quality suppliers by outsourcing production activities to conserve capital for product development. Contract manufacturers have the resources to fulfill our product supply needs for human trials and potential commercialization.

We believe that the fundamental changes implemented during this past year will build added value for our shareholders through a two-pronged business model:

- Developing respiratory disease therapies to satisfy underserved areas of need.
- Outlicensing and selling assets that aren't strategic to Aradigm's business.

During 2008, our efforts will be focused on human clinical trials. We will assess the value of Aradigm's inhaled liposomal ciprofloxacin formulation in both cystic fibrosis (CF) patients and non-CF bronchiectasis patients. In addition, we will conduct the bridging study using our AERx Essence system with treprostinil to treat pulmonary arterial hypertension. Our prospects are exciting.



Igor Gonda, Ph.D.
President, Chief Executive Officer and Director

A handwritten signature in black ink that reads "Igor Gonda".



Severe Respiratory Infections

Product candidate Inhaled liposomal ciprofloxacin

Treatment targets Lung infections associated with cystic fibrosis and bronchiectasis; bioterrorism lung infections such as inhalation anthrax

Cystic Fibrosis (ARD-3100)

2007 Progress Completed Phase 1 safety trial in healthy volunteers. Initiated Phase 2a trial.

2008 Projection Complete Phase 2a trial and report results.

Ciprofloxacin is approved by the FDA as an anti-infective agent and is widely prescribed by physicians to treat bacterial infections. However, this potent antibiotic is currently delivered to patients systemically via oral or intravenous administration. We believe that delivering it directly to the lung to treat respiratory infections may provide more rapid benefit as well as greater safety and efficacy. We also believe that our innovative, sustained-release liposomal formulation may enable drug concentrations to remain within the lungs for extended periods, thereby maximizing the therapeutic dosage at the infection site and minimizing wasteful exposure to the rest of the body, where it could cause side effects.

Our lead program is focused on cystic fibrosis (CF), a serious genetic disease that subjects patients to life-threatening lung infections. An estimated 30,000 people in the U.S. and about 70,000 worldwide have CF, and their annual medical cost is in excess of \$40,000 per patient. We believe our liposomal ciprofloxacin can make a significant difference. Clinical trial results to date suggest that inhalation of our sustained-release product could provide a safe, effective and convenient once-a-day therapy for CF-related lung infections. We intend to retain full ownership of this program and commercialize the product ourselves in the U.S.

Bronchiectasis (ARD-3150)

2007 Progress Obtained Phase 1 data (same trial as for cystic fibrosis).

2008 Projection Conduct Phase 2a clinical trial in non-CF bronchiectasis patients.

The same formulation of liposomal ciprofloxacin used to treat CF infections has the potential to provide a therapeutic benefit against infections in non-CF bronchiectasis as well. Bronchiectasis is a debilitating lung condition that results from injury or disease, including pneumonias and CF. It causes mucus buildup in respiratory passages and leads to a cycle of chronic lung infections that not only block airways but also cause further damage. Over 100,000 patients in the U.S. alone suffer from this serious condition.

We believe that Aradigm's inhalation therapy could make a significant difference in these patients. It delivers high drug concentrations directly to the infected lungs, rather than through the bloodstream. In addition, the formulation is purposefully designed to be retained at the treatment site for extended periods, potentially providing greater efficacy, as well as convenience for the patients.

From preclinical concepts to human clinical trials, we are building value in areas where we can make a substantial difference in both drug therapy and patients' quality of life

Inhalation Anthrax (ARD-1100)

2007 Progress Provided safety data for CF trials.

2008 Projection Build on data obtained from the CF and bronchiectasis product development programs.

Liposomal ciprofloxacin also offers potential for preventing and treating pulmonary anthrax infections and similar weapons of bioterrorism. For such applications, it is being developed through a partnership initially funded by DRDC, a division of the Canadian Department of National Defence, which previously demonstrated efficacy in an animal model of tularemia. Our AERx® system would enable patients to self-administer therapy quickly and easily.

The preclinical safety data from this program was used to support our entry into human clinical trials for cystic fibrosis (CF). In the future, we may, in turn, utilize some of the human data generated for CF and bronchiectasis to support the approval of liposomal ciprofloxacin for the prevention and treatment of lung infections caused by bioterrorism activities. While ciprofloxacin has been approved as an oral and injectable treatment of inhalation anthrax since 2000, we believe our product candidate may be able to deliver a longer-acting formulation directly to the lungs, with potentially greater efficacy and fewer treatment side effects.



Pulmonary Arterial Hypertension

Product candidate AERx Essence inhalation system for treprostinil
Treatment target Pulmonary arterial hypertension

ARD-1550

2007 Progress Established new partnership with Lung Rx, Inc., a wholly owned subsidiary of United Therapeutics Corporation.
2008 Projection Conduct bridging study comparing our AERx system to the nebulizer used in Lung Rx's successful TRIUMPH Phase 3 trial.

Pulmonary arterial hypertension (PAH) is a seriously debilitating disease of the blood vessels in the lungs. It affects an estimated 100,000 to 200,000 people worldwide. For these patients, prostacyclin analogs such as United Therapeutics' treprostinil are a well-established part of therapy.

Currently treprostinil, marketed under the brand name Remodulin®, is approved for administration via continuous intravenous or subcutaneous infusions. Our development and commercialization partner, Lung Rx (a wholly owned subsidiary of United Therapeutics), has been developing an inhaled formulation that could be less burdensome than the various approved injected and inhaled prostacyclin analog therapies. Lung Rx achieved positive results in its TRIUMPH study (TReprostinil Sodium Inhalation Used in the Management of Pulmonary Arterial Hypertension). In that Phase 3 trial, treprostinil was administered via an ultrasonic nebulizer. Still, nebulizers are quite cumbersome for patients, particularly if they must be used multiple times a day. We believe that our AERx Essence inhalation system for treprostinil offers a significantly more convenient means of delivering prostacyclin analogs. Palm-sized, easy to use and convenient to maintain, it has the potential to substantially lessen the burden of therapy for many PAH patients – not only by eliminating injections but also by reducing the duration and frequency of treatments.

Smoking Cessation

Product candidate AERx Essence system for nicotine
Treatment target Tobacco smoking addiction

ARD-1600

2007 Progress Completed Phase 1 in smokers.
2008 Projection Explore strategic development and commercialization plans, including funding, with both non-governmental and governmental organizations.

Despite widespread efforts to stop cigarette smoking, nicotine dependence remains a major healthcare issue. Related medical costs are estimated at \$75 billion in the U.S. and \$200 billion worldwide per year. And yet, 21% of Americans over age 18 and 650 million people worldwide currently smoke cigarettes. The fact is: although nicotine dependence and withdrawal symptoms are addressed by many therapies, the nicotine "high" and habit of inhaling nicotine are not. So the craving remains strong, and the person must use mind-over-matter to quit smoking, which is easier said than done.

Our goal is to develop an inhaled therapy that addresses both the nicotine dependence and the inhalation habit. Using the AERx Essence system, our product is designed to deliver a mist of "clean nicotine" deep into the lungs and, unlike the nicotine patch, provide the nicotine plasma levels associated with cigarettes. Over time, the dose would decrease, gradually lowering the nicotine levels thought to be associated with addiction. Our Phase 1 results showed a significant reduction in cravings for cigarettes.

Multi-Drug Therapy

Product candidate AERx Essence system for multi-drugs
Treatment targets Severe asthma and COPD

ARD-1700

2007 Progress Established new partnership with CyDex.
2008 Projection Collaborate with CyDex to finalize product choices for optimal drug combinations in respiratory disease therapy.

In August 2007, Aradigm began a unique collaboration with CyDex Pharmaceuticals, Inc., a company that has many years of success in solving formulation problems for poorly soluble drugs. Together we are collaborating on the development and commercialization of products that utilize our AERx pulmonary drug delivery technology and CyDex' solubilization and stabilization technologies to deliver combinations of inhaled corticosteroids, anticholinergics and beta-2 agonists for the treatment of asthma and chronic obstructive pulmonary disease (COPD). This program addresses serious healthcare problems and major market needs.

The treatment of severe asthma costs over \$5 billion in the U.S. for prescription drugs alone. Non-asthma COPD is a leading cause of death in America. Both conditions require multiple drug therapies. Our product development program focuses on providing significant improvements in FDA-approved treatments. These include drugs that are typically used together but administered separately, as well as approved multi-drug combinations that, when delivered with the AERx Essence system, could provide a more attractive therapy choice for certain types of patients.



Specialty Pharmaceutical Company

Therapeutic products that target underserved needs in the treatment of severe respiratory diseases

Proven drugs in proprietary formulations and/or delivery systems designed to improve safety, efficacy and convenience

Planned product distribution through a small, dedicated Aradigm sales force serving U.S. respiratory physicians

Abbreviated regulatory pathways through clinical trials and into potential commercialization

Potential Royalties & Milestone Payments

Lung Rx (United Therapeutics subsidiary)

Zogenix (Intraject technology applications)

Additional outlicensing of technology and intellectual property assets, both within the field of respiratory disease therapy and in other healthcare arenas

While focused on making life better for seriously ill patients, Aradigm is building value for shareholders by applying a two-pronged business model.

Board of Directors

Virgil D. Thompson
Chairman of the Board, Aradigm Corporation

Frank H. Barker
Former Group Chairman, Johnson & Johnson

Igor Gonda, Ph.D.
President and Chief Executive Officer, Aradigm Corporation

Stephen O. Jaeger
Chairman of the Board, Savient Pharmaceuticals, Inc.

Timothy P. Lynch
President and Chief Executive Officer,
NeuroStat Pharmaceuticals

John M. Siebert, Ph.D.
Chairman and Chief Executive Officer,
CyDex Pharmaceuticals, Inc.

Officers

Igor Gonda, Ph.D.
President and Chief Executive Officer

Babatunde A. Otulana, M.D.
Senior Vice President, Development, and
Chief Medical Officer

Norman Halleen
Interim Chief Financial Officer

D. Jeffery Grimes
General Counsel and Secretary

Common Stock

Aradigm's common stock is quoted on the OTC Bulletin Board under the Symbol ARDM.

Except for the historical information contained herein, this report contains forward-looking statements that involve risk and uncertainties, including statements relating to the timing of clinical trials, clinical results, the successful development of new therapies, the receipt of royalty, milestone or other payments and the management of growth, as well as the other risks detailed from time to time in Aradigm's Securities and Exchange Commission filings, including Aradigm's Annual Report on Form 10-K and Quarterly Reports on Form 10-Q.

Aradigm, AERx, and AERx Essence are registered trademarks, and the Aradigm Logo is a trademark of Aradigm Corporation. Other names and brands may be claimed as the property of others.

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002CS-14422