We are a young drug company. We develop new drugs in the areas of pain management and hematology/oncology.

We have two late-stage drug candidates in Phase III clinical tests. Remoxy™ is a proprietary, abuse-resistant opioid. It is the first drug of its kind to enter late-stage testing. Another abuse-resistant opioid, PTI-202, is scheduled for development in 2007. Oxytrex™ is a novel painkiller that potentially offers less physical dependence than currently marketed opioid painkillers.

Our early-stage drugs include a new treatment for metastatic melanoma, a deadly form of skin cancer. We are also working on a new treatment for patients with hemophilia, a rare blood disorder.

We're based outside of San Francisco, California.

We love what we do.
Dear Shareholder,

Pain Therapeutics was founded eight years ago with the singular goal of creating a new generation of painkillers. Back then our plan necessarily spoke in terms of concepts and intentions. There were no late-stage clinical trials, our main assets being big ideas, some patents, our people and a modest bank account. The task we set out for ourselves was to develop new drugs for patients with severe chronic pain. I’m pleased to report this initial program is now firmly in place. In doing so, we also found a way to stay in good financial shape and to lay the groundwork for the next chapter of this company’s life. Thus, it is now possible to talk about the results of a plan put into action eight years ago.

Here are some specifics. In 2006, Pain Therapeutics ran its operations out of 10,000 square feet of space located about two miles North of San Francisco International Airport. Our team of 40 employees had a gross budget of about $40 million (our net budget was under $3 million) and a clear mission to make things happen in the safest, most expedient manner.
Foggy barriers remain to proper pain relief. Chief among them is a prevailing negative attitude toward opioid painkillers. When properly prescribed and properly used, opioids can be effective for chronic pain. But misuse or abuse can be fatal.
It Was a Year of Heavy Lifting

The results of our effort can be gleaned from a synopsis of nine press releases issued throughout 2006:

- $150,000,000 Cash Received By Pain Therapeutics From Our Commercial Partner for Remoxy – January 3, 2006
- Pain Therapeutics Commences Pivotal Phase III Clinical Trial for Remoxy and Receives Special Protocol Assessment From FDA – February 16, 2006
- Pain Therapeutics Announces Data Presentation at American Pain Society Meeting – March 15, 2006
- Pain Therapeutics Testifies Before U.S. Congress on Innovative Approaches to Prevent Prescription Drug Abuse – July 26, 2006
- Pain Therapeutics Initiates Clinical Program of a Second Abuse-resistant Painkiller; Triggers $5,000,000 Milestone Payment From Commercial Partner – August 2, 2006
- Oxytrex Mechanism of Action Further Elucidated – New Data Published in Peer-reviewed Journal and Neuroscience Meeting – October 16, 2006
- Pain Therapeutics Announces Major New Initiative in Oncology – Initial Clinical Opportunity Targets Metastatic Melanoma – November 8, 2006
- Pain Therapeutics Announces Positive Phase I Study Results with PTI-202, The Company’s Second Abuse-resistant Painkiller – November 29, 2006
- Pain Therapeutics Initiates Phase III Study with Oxytrex – December 13, 2006

These announcements are sunbursts for any size company. But for an emerging company, such as we are, these 2006 achievements express our commitment to excel not just in science, but across economic, strategic, clinical and commercial goals as well.
“It often happens that a player carries out a deep and complicated calculation, but fails to spot something elementary right at the first move.”

Alexander Kotov, Chess Grandmaster
Our business model is simple to articulate and difficult to practice.
We in-license technology from major universities and shape it into new drugs. The difficulty is to practice this art while maintaining standards of discipline. This includes constantly reminding ourselves that we mustn’t overpay for unproven technology or fall for gee-whiz technology that may never see the clinical light of day. In each case we also start with a clear hypothesis of how to make money. We are willing to test the rigor of our hypothesis by conducting pilot clinical studies on newly-licensed technology. We believe this model allows us to spot hidden value in new technology while limiting our capital exposure.

Risk management, in practice. In our industry, progress involves a long process of hypothesis and testing, bold thoughts and critical counterarguments, all driven by a diversity of animal and clinical data that are rarely as comprehensive or clear as we’d wish. In this context, the art of drug development isn’t necessarily to avoid mistakes. Rather, progress is made by making mistakes as fast as possible, while avoiding making the same mistake twice.

Why do we think our model works? Because throughout the process of developing new drugs, we view ourselves as managers and shareholders who realize that investors matter as much as clinical solutions.
People in Pain

For millions of people around the world, daily physical pain is a fact of life. Conventional painkillers are problematic for many people with severe, chronic pain. This is why we are developing novel painkillers. Oxycodone is a strong opioid painkiller with an abuse liability similar to morphine; Remoxy is our abuse-resistant form of oxycodone. Oxytrex is an opioid painkiller that potentially offers minimal physical dependence.
I am a man in a hurry. But I know that maintaining steady enthusiasm for our work over nearly a decade is a defining – and necessary – trait of Pain Therapeutics’ corporate culture. This is something short-term investors can never comprehend, and we sympathize. Ten years is an eternity in an age of instant messaging. But through it all we learn to think with vision, and with generosity, about developing new drugs. The strength of such conviction gives us the clarity to look beyond present norms and towards future possibilities without the noise of tradition barking in our ears. We feel we owe this to our long-term investors, to clinical patients and to our own employees.

In reporting on our 2006 activities, I also want to recognize the many individuals who are responsible for our progress, including employees, board members and scientific/medical consultants. They are too numerous to name here but I find them all to have the indispensable skills necessary to their areas of responsibility. Their collective knowledge, coupled to a bias for action, makes them absolutely vital to Pain Therapeutics.

I feel good about our progress in 2006, but my urgency for the future comes down to this: for Pain Therapeutics to contribute to clinical medicine on the scale that I envision, we cannot rest complacent. I aspire to make Pain Therapeutics what Florence was to the 15th century – not the richest or most powerful, but the city that through its contributions to humanity shined a bright light into posterity. If we do this, I believe the rest will follow, including prosperity for shareholders, legacy for our employees and new drugs for patients. This is what drives me to take Pain Therapeutics to the top in 2007 and beyond.

Respectfully,

Remi Barbier

Remi Barbier
Shareholder Since 1998
Chairman, President & CEO
Chronic pain is a complex experience. Its meaning is difficult to articulate, as it varies according to person, place, time and type of pain. In the ancient days, many believed that pain was punishment from the gods. Today, many still endure chronic pain in silence. Untreated pain involves feelings of vulnerability, inadequacy, dependence and limitations; these worries can dominate the lives of those who suffer from severe chronic pain.
**Metastatic Melanoma**

*Melanoma is a type of skin cancer.* Early-stage melanoma is curable. But for patients with late-stage melanoma, the prognosis is poor. We are developing a new treatment for these patients: a radio-labeled monoclonal antibody. In animal models, this treatment shrinks tumors and extends survival. If these results are replicated in patients, we believe this new treatment has a bright future in clinical medicine.
Operating under the highest ethical standards always has been a priority for the people associated with Pain Therapeutics. We take seriously our responsibility to develop new drugs that may improve or save people’s lives. Since drug development is a long-term affair that can take 10 years or more to regulatory approval, our reputation among consumers, physicians and pharmacists precedes us by a decade. This is why we don’t preach integrity, we practice it with regularity.
Very Important
We don’t have regulatory approval for our products, we generate no product revenue and can’t predict when or if we will ever turn a profit.

Disclaimer: This Annual Report contains forward-looking statements that include risks and uncertainties. We disclaim any intent or obligation to update these forward-looking statements. Examples of statements include, but are not limited to, any statements relating to our future results, the clinical status, the potential benefits or the size of the potential market for our drug candidates. These statements involve risks and uncertainties associated with our business. You are cautioned not to rely on such statements as our actual performance may differ. For a full description of our business and further information on its risks and uncertainties please refer to our Form 10-K for the year ended December 31, 2006.

Stock Information
Our common stock trades on The NASDAQ Stock Market® under the symbol PTIE. No dividends have been paid on the common stock to date and we do not anticipate paying dividends in the foreseeable future. On February 1, 2007 there were 85 holders of record of our common stock.

Annual Meeting
Our Annual Meeting of Stockholders will be at 10:00 a.m. Pacific Time on May 24, 2007 at the offices of Wilson Sonsini Goodrich & Rosati, 650 Page Mill Road, Palo Alto, California.

Price Range of Common Stock
The following table lists the high and low reported sales prices for our common stock as reported on The NASDAQ Stock Market®.

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<th>Quarter</th>
<th>2006 High</th>
<th>2006 Low</th>
<th>2005 High</th>
<th>2005 Low</th>
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<td>First Quarter</td>
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Credit
Creative Team: Barbier and Waarich
Design: Edmonds Design • www.edmonds-design.com
Photographs: Elizabeth Solaka • www.elizabethsolaka.com
“I aspire to make Pain Therapeutics what Florence was to the 15th century – not the richest or most powerful, but the city that through its contributions to humanity shined a bright light into posterity...This is what drives me to take Pain Therapeutics to the top in 2007 and beyond.”
“If you want to build a ship, don’t drum up people to collect wood and don’t assign them tasks and work, but rather teach them to long for the endless immensity of the sea”.

Antoine de Saint-Exupéry