ATHERSYS, INC / NEW
Form 10-Q/A
October 09, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q/A
(Amendment No. 1)

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2007

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________.

Commission file number: 000-52108

ATHERSYS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**20-4864095**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
3201 Carnegie Avenue, Cleveland, Ohio	**44115-2634**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code: **(216) 431-9900**
Former name, former address and former fiscal year, if changed since last report: **Not Applicable**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes þ No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o Accelerated filer o Non-accelerated filer þ
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes o No þ
The number of outstanding shares of the registrant s common stock, $0.001 par value, as of August 1, 2007, was 18,927,988.

ATHERSYS, INC.
TABLE OF CONTENTS

Table of Contents

EXPLANATORY NOTE

Athersys, Inc. (the Company) is filing this Amendment No. 1 on Form 10-Q/A (this Amendment) to amend and restate the consolidated statements of operations and the related financial information of the Company that were included in its original Quarterly Report on Form 10-Q for the three and six months ended June 30, 2007 (the Original Form 10-Q).

In June 2007, a wholly-owned subsidiary of the Company merged with and into Athersys, Inc. (Old Athersys), whereby Old Athersys became a wholly-owned subsidiary of the Company, which was named BTHC VI, Inc. at the time of such merger (the Merger). Prior to the consummation of the Merger, Old Athersys negotiated with holders of its convertible preferred stock a planned restructuring of its capital stock, which included the conversion of the preferred stock into shares of Old Athersys common stock, the termination of the warrants issued to the former holders of Class C convertible preferred stock and the termination of rights to preferred dividends, including the elimination of the accrued dividends payable to the former holders of Class C convertible preferred stock. As a result, immediately prior to the consummation of the Merger, all shares of Old Athersys convertible preferred stock (including termination of warrants and elimination of accrued dividends) were converted into 53,341,747 shares of Old Athersys common stock. Upon closing of the Merger, the 53,341,747 shares of Old Athersys common stock were exchanged for 1,912,356 shares of Company common stock using the Merger exchange rate. Old Athersys also retired the shares of its preferred and common stock held in treasury. Immediately following the Merger, the Company issued and sold 13,000,000 shares of common stock and warrants to purchase 3,250,000 shares of common stock to new investors for gross proceeds of $65.0 million (the Financing).

In July 2007, the Company filed a registration statement with the SEC to register the resale of the shares of common stock issued in the Financing, including the shares issuable upon the exercise of warrants. In late September 2007, in response to the Company s filing of an amended registration statement, the SEC issued a comment about the accounting for the change to the conversion ratios of the convertible preferred stock in connection with the Merger. In consultation with its independent registered public accounting firm and the Audit Committee of the Company s Board of Directors, the Company determined that the change to the conversion ratios of the convertible preferred stock effected as part of the restructuring of the Old Athersys capital stock should have been accounted for as an induced conversion, resulting in a $4.8 million deemed dividend that would increase the net loss attributable to common stockholders.

The Company s previously reported consolidated statements of operations for the three and six months ended June 30, 2007 included in the Original Form 10-Q did not include the $4.8 million amount in the net loss attributable to common stockholders, and the basic and diluted net loss per common share were understated as a result. The amended and restated consolidated statements of operations included in this Amendment now reflect this $4.8 million deemed dividend in the calculation of basic and diluted net loss per common share. Additionally, in light of the amendment and restatement of our consolidated statements of operations included in this Amendment, we have re-evaluated our disclosure controls and procedures as of June 30, 2007.

This Amendment amends and restates only Items 1, 2 and 4 of Part I of the Original Form 10-Q. Except as described in this Explanatory Note, this Amendment does not modify or update the disclosures in our Form 10-Q for the three and six months ended June 30, 2007. Therefore, this Amendment does not reflect any other events that occurred after the original August 17, 2007 filing date of the Original Form 10-Q. Forward-looking statements in this Amendment have also not been updated from the Original Form 10-Q.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

BTHC VI, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except share and per share data)

	June 30, 2007	December 31, 2006

	(Unaudited)	(Note)
Assets		
Current assets:		
Cash and cash equivalents	$ 58,939	$ 1,528
Accounts receivable	384	872
Prepaid expenses and other	433	361
Total current assets	59,756	2,761
Notes receivable from related parties	562	562
Equipment, net	355	509
Accounts receivable, net	75	117
Equity investment and other assets	317	317
Total assets	$ 61,065	$ 4,266
Liabilities and stockholders equity (deficit)		
Current liabilities:		
Accounts payable	$ 1,008	$ 898
Accrued compensation and related benefits	65	423
Accrued expenses and other	1,047	1,214
Current portion of long-term debt, net	3,235	3,332
Total current liabilities	5,355	5,867
Long-term debt		1,800
Convertible promissory notes, net		7,510
Accrued interest		214
Accrued dividends		8,882
Stockholders equity:		
Convertible preferred stock, at stated value; no shares authorized, issued or outstanding at June 30, 2007; 13,432,350 shares authorized and 10,168,231 shares issued and outstanding at December 31, 2006		68,301

Preferred stock, 10,000,000 shares authorized and no shares issued and outstanding at June 30, 2007; no shares authorized, issued or outstanding at December 31, 2006		
Common stock, $0.001 par value;100,000,000 shares authorized and 18,927,988 shares issued and outstanding at June 30, 2007; 40,000,000 shares authorized and 293,770 shares issued and outstanding at December 31, 2006	19	
Additional paid-in capital	207,033	53,495
Treasury stock		(250)
Accumulated deficit	(151,342)	(141,553)
Total stockholders equity (deficit)	55,710	(20,007)
Total liabilities and stockholders equity (deficit)	$ 61,065	$ 4,266

Note: The balance sheet at December 31, 2006 has been derived from audited financial statements at that date. It does not include, however, all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements.

See accompanying notes to unaudited condensed consolidated financial statements.

1

Table of Contents

BTHC VI, Inc.
Condensed Consolidated Statements of Operations
(In thousands, except share and per share data)
(Unaudited)

	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Revenues				
License fees	$ 313	$ 261	$ 623	$ 481
Grant revenue	410	229	979	638
Total revenues	723	490	1,602	1,119
Costs and expenses				
Research and development (including stock compensation expense of $2,000 and $72 in the three months ended June 30, 2007 and 2006, respectively; and $2,031 and $159 in the six months ended June 30, 2007 and 2006, respectively)	4,989	2,361	7,354	4,945
General and administrative (including stock compensation expense of $2,089 and $46 in the three months ended June 30, 2007 and 2006, respectively; and $2,102 and $91 in the six months ended June 30, 2007 and 2006, respectively)	3,497	1,066	4,105	1,754
Depreciation	75	138	155	293
Total costs and expenses	8,561	3,565	11,614	6,992
Loss from operations	(7,838)	(3,075)	(10,012)	(5,873)
Other income (loss)	1,500	(3)	1,500	208
Interest income	175	38	222	67
Interest expense see Note 7	(710)	(255)	(1,043)	(490)
Accretion of premium on convertible debt	(196)		(456)	
	(7,069)	(3,295)	(9,789)	(6,088)

Loss before cumulative effect of change in accounting principle				
Cumulative effect of change in accounting principle				306
Net loss	$ (7,069)	$ (3,295)	$ (9,789)	$ (5,782)
Preferred stock dividends	$ (284)	$ (347)	$ (659)	$ (695)
Deemed dividend resulting from induced conversion of convertible preferred stock	(4,800)		(4,800)	
Net loss attributable to common stockholders 2007 restated	$ (12,153)	$ (3,642)	$ (15,248)	$ (6,477)
Dividends declared per common share	$	$	$	$
Basic and diluted net loss per common share 2007 restated:				
Net loss before cumulative effect of change in accounting principle	$ (2.53)	$ (12.40)	$ (5.99)	$ (23.19)
Cumulative effect of change in accounting principle				1.05
Net loss	$ (2.53)	$ (12.40)	$ (5.99)	$ (22.14)
Weighted average shares outstanding, basic and diluted	4,800,760	293,770	2,547,265	292,513

See accompanying notes to unaudited condensed consolidated financial statements.
2

Table of Contents

BTHC VI, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months ended June 30,	
	2007	**2006**
Operating activities		
Net loss	$ (9,789)	$ (5,782)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	155	293
Equity in earnings of unconsolidated affiliate		(117)
Accretion of premium on convertible debt	456	
Forgiveness of note receivable from related party		122
Compensation common stock options	4,133	250
Expense related to warrants issued to lenders	438	
Income from cumulative effect of change in accounting principle		(306)
Amortization of premium on available for sale securities and other	7	24
Changes in operating assets and liabilities:		
Accounts receivable	530	239
Prepaid expenses and other assets	(72)	143
Accounts payable and accrued expenses	(95)	819
Net cash used in operating activities	(4,237)	(4,315)
Investing activities		
Purchase of available for sale securities		(3,024)
Maturities of available for sale securities		3,804
Purchases of equipment	(3)	(67)
Net cash (used in) provided by investing activities	(3)	713
Financing activities		
Principal payments on debt	(1,843)	(1,222)
Proceeds from convertible promissory note	5,000	5,000
Proceeds from issuance of common stock, net	58,494	6
Net cash provided by financing activities	61,651	3,784
Increase in cash and cash equivalents	57,411	182
Cash and cash equivalents at beginning of the period	1,528	1,080
Cash and cash equivalents at end of the period	$ 58,939	$ 1,262

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

BTHC VI, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

1. Background; Recent Merger and Offering   Restated

On May 24, 2007, BTHC VI, Inc. (BTHC VI) and its wholly owned subsidiary, B-VI Acquisition Corp., entered into an Agreement and Plan of Merger with Athersys, Inc. (Athersys). Pursuant to the terms of the Agreement and Plan of Merger, B-VI Acquisition Corp., which BTHC VI recently had incorporated for the purpose of completing the merger transaction described herein, merged with and into Athersys on June 8, 2007, with Athersys continuing as the surviving entity in the merger (the Merger). As a result of the Merger, Athersys became our wholly-owned subsidiary, and the business of Athersys became our sole operations. Unless otherwise indicated, all references to the Company are to BTHC VI, together with its wholly-owned subsidiary, Athersys.

Prior to the consummation of the Merger, the Company negotiated with holders of its convertible preferred stock a planned restructuring of its capital stock, which included the conversion of the preferred stock into shares of the Company s common stock, the termination of the warrants issued to the former holders of Class C Convertible Preferred Stock and the termination of rights to preferred dividends, including the elimination of the accrued dividends payable to the former holders of Class C Convertible Preferred Stock. As a result, immediately prior to the consummation of the Merger, all convertible preferred stock (including termination of warrants and elimination of accrued dividends) was converted into 53,341,747 shares of common stock. The change to the conversion ratios of the convertible preferred stock was deemed to be an induced conversion, which resulted in a $4.8 million deemed dividend and an increase to the net loss attributable to common stockholders in June 2007. Upon closing of the Merger, the 53,341,747 shares of common stock were exchanged for 1,912,356 shares of BTHC VI common stock using the Merger exchange rate. The Company also retired the shares of preferred and common stock held in treasury.

At the time the Merger was deemed effective, each share of common stock of Athersys was converted into 0.0358493 shares of BTHC VI common stock, par value $0.001 per share. Prior to the Merger, BTHC VI effected a 1-for-1.67 reverse stock split of its shares of common stock and increased the number of authorized shares of common stock to 100,000,000.

BTHC VI s acquisition of Athersys on June 8, 2007 effected a change in control and was accounted for as a reverse acquisition whereby Athersys is the accounting acquirer for financial statement purposes. Accordingly, the financial statements of the Company presented reflect the historical results of Athersys and do not include the historical financial results of BTHC VI prior to the consummation of the Merger. The Company s authorized and issued shares of common stock have been retroactively restated for all periods present to reflect the shares of BTHC VI common stock after giving effect to the Merger. Basic and diluted net loss per share attributable to common stockholders has been computed using the retroactively restated common stock.

Immediately after the Merger, BTHC VI completed an offering of 13,000,000 shares of common stock for aggregate gross proceeds of $65.0 million (the Offering). Offering costs in the amount of approximately $6.5 million were netted against the proceeds of the Offering, resulting in net proceeds from the Offering of approximately $58.5 million. The Offering included the issuance of warrants to purchase 3,250,000 shares of common stock to the investors with an exercise price of $6.00 and a five-year term. BTHC VI also issued warrants to purchase 500,000 shares of common stock to the lead investor and warrants to purchase 1,093,525 shares of common stock to the placement agents, each with an exercise price of $6.00 and a five-year term. The placement agents also received cash fees in an amount equal to 8.5% of the gross proceeds, excluding proceeds from existing investors in the Company. In consideration for certain advisory services, the Company paid an affiliate and largest stockholder of BTHC VI a one-time fee of $350,000 in cash upon consummation of the Merger.

Athersys is a biopharmaceutical company engaged in the development and commercialization of therapeutic products in one business segment. Operations consist primarily of research and product development activities.

Table of Contents

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in our registration statement on Form S-1 as filed with the SEC on July 10, 2007. The accompanying financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and Article 10 of Regulation S-X. Accordingly, since they are interim statements, the accompanying financial statements do not include all of the information and notes required by GAAP for complete financial statements. The accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of financial position and results of operations for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The Company s critical accounting policies, estimates and assumptions are described in Management s Discussion and Analysis of Financial Condition and Results of Operations, which is included below in this quarterly report on Form 10-Q.

3. Net Loss per Share Restated

The Company has revised its accounting for the change in conversion ratios of its convertible preferred stock in response to comments from the staff of the Securities and Exchange Commission in the course of its review of the Company s registration statement. The change to the conversion ratios of the convertible preferred stock represents an induced conversion which resulted in a deemed dividend in the amount of $4.8 million which was previously not included in determining the net loss attributable to common stockholders. In reporting the deemed dividend, the Company has increased the net loss attributable to common stockholders for the three and six months ended June 30, 2007 to $12,153,000 and $15,248,000, respectively, as compared to $7,353,000 and $10,448,000, as originally reported and increased the basic and diluted net loss per common share for the three and six months ended June 30, 2007 to $2.53 and $5.99, respectively, as compared to $1.53 and $4.10, as originally reported.

Basic and diluted net loss per share attributable to common stockholders are presented in conformity with SFAS No. 128, *Earnings per Share*, for all periods presented. In accordance with SFAS No. 128, basic and diluted net loss per share has been computed using the weighted-average number of common stock outstanding during the period.

The Company has outstanding certain options and warrants, and prior to June 8, 2007, had outstanding certain convertible debt and convertible preferred stock, which have not been used in the calculation of diluted net loss per share because to do so would be anti-dilutive. As such, the numerator and the denominator used in computing both basic and diluted net loss per share attributable to common stock holders are equal.

Outstanding stock options to purchase 3,629,814 and 127,686 shares of common stock for each of the three and six-month periods ended June 30, 2007 and June 30, 2006, respectively, were not included in the calculation of diluted net loss per share attributable to common stockholders because their effects were antidilutive.

Warrants to purchase 5,125,496 and 25,639 shares of common stock for each of the three and six-month periods ended June 30, 2007 and June 30, 2006, respectively, were not included in the calculation of diluted net loss per share attributable to common stockholders because their effects were antidilutive.

Shares of common stock issuable upon the conversion of convertible preferred stock in the amount of 276,071 and 319,839 on a historical basis (1,450,028 and 1,679,915 taking into consideration the restructuring of Athersys stock that occurred in 2007 at the time of the Merger) for the three and six-month periods ended June 30, 2007, respectively, and 364,093 on a historical basis (1,912,356 taking into consideration the restructuring of Athersys stock that occurred in 2007 at the time of the Merger) for each of the three and six-month periods ended June 30, 2006 were not included in the calculation of diluted net loss per share attributable to common stockholders because their effects were antidilutive.

Shares of common stock issuable upon the conversion of convertible promissory notes in the amount of 202,631 and 224,197 on a historical basis (1,833,179 and 2,028,281 taking into consideration the closing of the Offering in 2007) for the three and six-month periods ended June 30, 2007, respectively, and 62,312 and 31,156 on a historical basis (563,732 and 281,866 taking into consideration the closing of the Offering in 2007) for the three and six-month periods ended June 30, 2006, respectively, were not included in the calculation of diluted net loss per share attributable to common stockholders because their effects were antidilutive.

Table of Contents

4. Comprehensive Loss

In accordance with SFAS No. 130, *Reporting Comprehensive Loss*, all components of comprehensive loss, including net loss, are reported in the financial statements in the period in which they are recognized. Comprehensive loss is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Below is the reconciliation, in thousands, of net loss to comprehensive loss for all periods presented.

	Three months ended June 30,		Six months ended June 30,	
	2007	**2006**	**2007**	**2006**
Net loss	$(7,069)	$(3,295)	$(9,789)	$(5,782)
Unrealized gain on available-for-sale securities		2		13
Comprehensive loss	$(7,069)	$(3,293)	$(9,789)	$(5,769)

5. Equity Restructuring

Immediately prior to the Merger (see Note 1), all shares of Athersys preferred stock were converted into shares of Athersys common stock. The preferred stock on the balance sheet was eliminated and accounted for as common stock issued and additional paid-in capital. Also, $250,000 of treasury stock held by Athersys was retired in connection with the Merger and reversed to additional paid-in capital. Accrued dividends on Athersys convertible preferred stock were eliminated and reversed to additional paid-in capital. Additionally, warrants that were issued to the former holders of convertible preferred stock were terminated.

6. Share-based Compensation

Equity Compensation Plans

BTHC VI adopted an incentive plan prior to closing the Merger that made available 3,035,000 shares of common stock for awards to employees, directors and consultants. Upon closing the Merger, another similar incentive plan was adopted that made available 1,465,000 shares of common stock for awards to employees, directors and consultants. These equity incentive plans authorize the issuance of equity-based compensation in the form of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares and units, and other stock-based awards to qualified employees, directors and consultants. Total awards under these plans are limited to 4,500,000 shares of common stock in the aggregate.

In May 2007, the majority of Athersys outstanding options were terminated. New option awards to purchase 3,625,000 shares of common stock with an exercise price of $5.00 were granted to employees, directors and certain consultants in June 2007 upon the closing of the Merger. The options that were granted to employees vest approximately 40% on the date of grant, and ratably over three years thereafter. The option awards granted to non-employees and board members generally vest at varying percentages over three years. Upon the closing of the Merger, BTHC VI assumed 5,052 options granted to former employees and consultants of Athersys, which will be governed by the former Athersys equity plans until the awards expire.

Table of Contents

Impact of Adoption of SFAS No. 123R

In December 2004, SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R), was issued as a revision to SFAS No. 123, *Accounting for Stock Options* (SFAS No. 123). The new statement was adopted by the Company on January 1, 2006. Prior to January 1, 2006, the Company elected to account for its stock-based compensation in accordance with the intrinsic value method as described in the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, as permitted by SFAS No. 123. As such, compensation was determined prior to 2006 on the date of issuance or grant as the excess of the current estimated market value of the underlying stock over the purchase or exercise price of the stock option. Compensation expense was recognized over the respective vesting periods of the equity instruments, if any, using the graded vesting method as prescribed by Financial Accounting Standards Board Interpretation No. 28.

On January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R using the modified-prospective-transition method. Under that transition method, compensation cost recognized subsequent to adoption includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R. For some of the awards granted prior to the adoption of SFAS No. 123R, the Company recognized compensation expense on the accelerated method. For awards granted subsequent to adoption of SFAS No. 123R, the Company recognizes expense on the straight-line method. Upon adoption of SFAS 123R, Athersys estimated forfeitures in calculating the expense relating to share-based compensation, while previously Athersys was permitted to recognize forfeitures as an expense reduction upon occurrence. The adjustment to apply estimated forfeitures to previously recognized share-based compensation was accounted for as a cumulative effect of a change in accounting principle at January 1, 2006 and reduced net loss by $306,000 for the six months ended June 30, 2006.

Valuation of Share-based Compensation under SFAS No. 123R

The Company uses a Black-Scholes option pricing model to estimate the grant-date fair value of share-based awards under SFAS No. 123R. The expected term of options granted represents the period of time that option grants are expected to be outstanding. The Company used the simplified method under SAB No. 107 to calculate the expected life of option grants in 2007 given its limited history. We determine volatility by using the historical stock volatility of other companies with similar characteristics. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. If actual forfeitures vary from the estimate, the Company will recognize the difference in compensation expense in the period the actual forfeitures occur or when options vest.

In May 2007, Athersys terminated the majority of stock option awards to its officers, employees, directors and consultants. Only a nominal number of option awards (5,052 option shares) held by former employees and consultants were assumed by BTHC VI. Upon closing the Merger, options for 3,625,000 shares of stock were issued under the BTHC VI equity incentive plans to employees, directors and consultants at an exercise price of $5.00 per share.

The Company accounted for the termination of the Athersys options to employees, directors, and consultants as a settlement and any previously unrecognized compensation expense ($385,000) was recognized on the termination date in May 2007. The options for 5,052 shares that were assumed by BTHC VI were fully vested when they were assumed, and no additional compensation was recognized.

The fair value of unvested stock options granted to consultants is measured on a quarterly basis using the Black-Scholes method and the related expense is recognized over the period that services are provided. The key assumptions used in the computation of expense at June 30, 2007 included the fair value of the Company s stock of $7.75 at June 30, 2007, volatility of 75.3%, risk-free interest rate of 5.5%, and an expected life represented by the contractual term of 5 years.

The weighted-average estimated fair value of stock options granted

7

Table of Contents

under the equity compensation plans during the six months ended June 30, 2007 was $2.91 per share for employees and directors using the following assumptions:

Expected volatility	75.9%
Risk-free interest rate	5.5%
Weighted average expected life (years)	5.75 years
Dividend yield	0.0%

Share-based Award Activity

The following table summarizes the Company s stock option activity during the six months ended June 30, 2007:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)
Outstanding at January 1, 2007	116,083	$ 80.61	2.86
Granted	3,625,000	5.00	9.68
Exercised			
Forfeited/cancelled/expired	(111,269)	78.66	2.88
Outstanding at June 30, 2007	3,629,814	$ 5.21	9.67
Vested and exercisable at June 30, 2007	1,225,814	$ 5.61	9.67

As of June 30, 2007, a total of 875,000 shares are available for issuance under the Company s equity compensation plans. For the six-month period ended June 30, 2007, stock compensation expense was approximately $4.1 million. At June 30, 2007, total unrecognized estimated compensation cost related to unvested stock options was approximately $6.6 million, which is expected to be recognized by June 30, 2010 using the straight-line method.

8

Table of Contents

7. Long-Term Debt

A summary of the Company s long-term debt outstanding is as follows (in thousands):

	June 30, 2007	December 31, 2006
Notes payable to lenders	$3,235	$ 5,132
Less current portion	3,235	3,332
	$	$ 1,800

In November 2004, the Company issued $7.5 million of notes payable to lenders, the proceeds of which are unrestricted and used for general corporate purposes. The notes are payable in 30 monthly payments after the initial interest-only period that expired December 1, 2005, with a fixed interest rate of 13% and a maturity date of June 1, 2008.

The lenders have the right to receive a milestone payment of $2.25 million upon the first to occur of the following milestone events: (1) a firmly underwritten initial public offering of common stock; (2) a merger with or into another entity where the Company s stockholders do not hold at least a majority of the voting power of the surviving entity; (3) the sale of all or substantially all of the Company s assets; and (4) the liquidation or dissolution of the Company. The milestone payment is payable in cash, except that if the milestone event is an initial public offering, the Company may elect to pay 75% of the milestone in shares of common stock at the per share offering price to the public. No amounts have been recorded in relation to the milestone as of June 30, 2007.

Upon the closing of the Offering, warrants to purchase 149,026 shares of common stock with an exercise price of $5.00 per share and a seven-year term were issued to the Company s lenders in accordance with the loan agreement. The value of the warrants was $492,000 based on the Black-Scholes valuation of the underlying security, of which $438,000 was recognized in June 2007 as additional interest expense and the remaining $54,000 will be recognized over the remaining term of the loan.

8. Convertible Notes

Collaboration Convertible Notes

In 2006, the Company entered into a collaboration with a pharmaceutical company. The Company issued a $5.0 million convertible promissory note to the collaborator at the inception of the program, which was followed by the issuance of an additional convertible promissory note in the aggregate principal amount of $5.0 million in January 2007 upon the achievement of certain milestones. Upon the closing of the Offering, the convertible notes aggregating $10.0 million were converted along with accrued interest into 1,885,890 shares of common stock at a conversion price of $5.50 per share, which was 110% of the price per share in the Offering in accordance with the terms of the notes.

Bridge Notes and Warrants

Also in 2006, the Company completed a bridge financing of $2.5 million in the form of convertible promissory notes. The notes were issued primarily to existing stockholders of the Company. The notes

9

Table of Contents

bore interest at 10%, had a three-year term, and were secured by a lien on substantially all of the assets of the Company. The notes, if not converted, were repayable with accrued interest at maturity, plus a repayment fee of 200% of the outstanding principal. The Company computed a premium on the debt in the amount of $5.25 million due upon redemption, which was being accreted over the term of the notes using the effective interest method.

The bridge noteholders also received warrants to purchase common stock, which were exercisable only upon a restructuring of the Company s capital stock in connection with a financing. The exercise price was $0.01 per share and the number of shares issuable was based on a formula tied to the pre-money value of the Company. The Company recognized a $250,000 discount on the notes, which was allocated to the fair value of the warrants in 2006.

Upon the closing of the Offering, the bridge notes were converted along with accrued interest into 531,781 shares of common stock at a conversion price of $5.00 per share, which was the price per share in the Offering. The notes were reversed and the related premium and discount were eliminated and recorded as additional paid-in capital. The bridge noteholders also exercised their warrants upon the closing of the Offering for 999,977 shares of common stock at an aggregate exercise price of $10,000. Upon the conversion of the bridge notes, the bridge noteholders also received warrants to purchase 132,945 shares of common stock at $6.00 per share with a five-year term, which was consistent with the warrants issued to new investors in the Offering.

9. Warrants

As of June 30, 2007, the Company had the following outstanding warrants to purchase shares of common stock:

Number of underlying shares	Exercise Price	Expiration
4,976,470	$ 6.00	June 8, 2012
149,026	$ 5.00	June 8, 2014
5,125,496		

10. Other Recent Events

In May 2007, Athersys sold certain non-core assets related to its asthma discovery program to a pharmaceutical company for $2.0 million, of which $1.5 million was received at closing. The remaining $0.5 million was received in August 2007 upon Athersys delivery of certain ancillary assets related to the program. Athersys recognized a gain on the sale (other income) of these assets in the amount of $2.0 million, of which $1.5 million was recognized in May 2007 and $0.5 million will be recognized in August 2007.

Upon the closing of the Offering, the Company achieved a milestone related to its stem cell technology and issued 1,379 shares of common stock and paid $500,000 cash to the former holders of the technology. The issued shares were recorded at fair value on the date the milestone was achieved. The consideration paid under this arrangement has been recorded as research and development expense. The Company may be required to pay cash of $0.5 million to the former holders of the technology upon the

Table of Contents

achievement of an additional milestone in connection with the Company s filing of an investigational new drug application with the FDA.

The Company filed a resale registration statement with the SEC in July 2007 covering 18,508,251 shares of common stock, which includes all shares of common stock issued in the Offering and shares of common stock issuable upon exercise of warrants issued in the Offering (as well as the 531,781 shares of common stock issued to the bridge noteholders and the 132,945 shares underlying their warrants). Subject to certain exceptions, if the resale registration statement is not declared effective (within 90 days of the filing date) by the SEC or ceases to remain effective, a cash penalty will be assessed representing 1% of the amount invested in the Offering for each 30-day period (capped at 10%) until the registration statement is either declared effective or becomes effective again, as applicable.

11. Taxes

Athersys has net operating loss and research and development credit carryforwards that result in deferred tax assets that have been fully offset by a valuation allowance. Athersys use of its current net operating loss and research and development credit carryforwards will be significantly limited under Section 382 of the Internal Revenue Code as a result of the change in ownership related to the Merger and the Offering.

In July 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, which is applicable for fiscal years beginning after December 15, 2006. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position reported or expected to be reported on a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Athersys adopted the provisions of FIN 48 on January 1, 2007. Upon adoption of FIN 48 and through June 30, 2007, Athersys determined that it had no liability for uncertain income taxes as prescribed by FIN 48. Athersys policy is to recognize potential accrued interest and penalties related to the liability for uncertain tax benefits, if applicable, in income tax expense. Net operating loss and credit carryforwards since inception remain open to examination until the statute expires for the period in which the carryforwards are utilized, and will for a period post utilization. Athersys does not anticipate any events during 2007 that would require it to record a liability related to any uncertain income taxes.

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

This discussion and analysis should be read in conjunction with our financial statements and notes thereto included in this quarterly report on Form 10-Q and the audited financial statement and notes thereto included in our registration statement on Form S-1 as filed with the SEC on July 10, 2007. Operating results are not necessarily indicative of results that may occur in future periods.

Overview and Recent Developments

Athersys is a biopharmaceutical company engaged in the discovery and development of therapeutic product candidates designed to extend and enhance the quality of human life. Through the application of its proprietary technologies, Athersys has established a pipeline of therapeutic product development programs in multiple disease areas that it intends to advance into clinical trials in 2007 and 2008. Athersys lead product candidate is ATHX-105, which is a treatment for obesity that is currently in a phase I clinical trial. Athersys is also developing novel pharmaceutical products for the treatment of

Table of Contents