

ATHERSYS, INC / NEW
Form 10-Q
November 10, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2008
- 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: 001-33876

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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No

The number of outstanding shares of the registrant's common stock, \$0.001 par value, as of November 1, 2008 was 18,927,988.

ATHERSYS INC.
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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.**

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

| | September 30, 2008 (Unaudited) | December 31, 2007 (Note) |
|--|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 14,748 | \$ 13,248 |
| Available-for-sale securities | 17,980 | 22,477 |
| Accounts receivable | 947 | 836 |
| Receivable from Angiotech | 243 | 63 |
| Investment interest receivable | 215 | 262 |
| Deposits | 740 | 163 |
| Prepaid expenses and other | 597 | 394 |
| Total current assets | 35,470 | 37,443 |
| Available-for-sale securities | 1,988 | 13,850 |
| Deposits | 144 | 100 |
| Note receivable, net | 43 | 86 |
| Equipment, net | 715 | 387 |
| Accounts receivable, net | | 42 |
| Equity investments | 317 | 317 |
| Total assets | \$ 38,677 | \$ 52,225 |
| Liabilities and stockholders equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,959 | \$ 1,011 |
| Accrued compensation and related benefits | 194 | 71 |
| Accrued clinical trial costs | 98 | 735 |
| Accrued expenses and other | 775 | 993 |
| Current portion of long-term debt, net | | 1,784 |
| Total current liabilities | 3,026 | 4,594 |
| Stockholders equity: | | |
| Preferred stock, at stated value; 10,000,000 shares authorized, and no shares issued and outstanding at September 30, 2008 and December 31, 2007 | | |
| Common stock, \$0.001 par value; 100,000,000 shares authorized, and 18,927,988 shares issued and outstanding at September 30, 2008 and December 31, 2007 | 19 | 19 |
| Additional paid-in capital | 209,443 | 208,039 |
| Accumulated other comprehensive (loss) income | (53) | 52 |

| | | |
|--|-----------|-----------|
| Accumulated deficit | (173,758) | (160,479) |
| Total stockholders' equity | 35,651 | 47,631 |
| Total liabilities and stockholders' equity | \$ 38,677 | \$ 52,225 |

Note: The balance sheet at December 31, 2007 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.

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

| | Three months ended | | Nine months ended | |
|--|---------------------------|-------------------|--------------------------|--------------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Revenues | | | | |
| License fees | \$ 885 | \$ 500 | \$ 1,728 | \$ 1,123 |
| Grant revenue | 393 | 360 | 1,118 | 1,339 |
| Total revenues | 1,278 | 860 | 2,846 | 2,462 |
| Costs and expenses | | | | |
| Research and development | 4,730 | 4,215 | 12,782 | 11,569 |
| General and administrative | 1,246 | 2,113 | 4,108 | 6,218 |
| Depreciation | 49 | 71 | 158 | 226 |
| Total costs and expenses | 6,025 | 6,399 | 17,048 | 18,013 |
| Loss from operations | (4,747) | (5,539) | (14,202) | (15,551) |
| Other income | 22 | 500 | 42 | 2,000 |
| Interest income | 232 | 724 | 974 | 946 |
| Interest expense | | (124) | (93) | (1,167) |
| Accretion of premium on convertible debt | | | | (456) |
| Net loss | \$ (4,493) | \$ (4,439) | \$ (13,279) | \$ (14,228) |
| Preferred stock dividends | \$ | \$ | \$ | \$ (659) |
| Deemed dividend resulting from induced conversion of convertible preferred stock | \$ | \$ | \$ | \$ (4,800) |
| Net loss attributable to common stockholders | \$ (4,493) | \$ (4,439) | \$ (13,279) | \$ (19,687) |
| Basic and diluted net loss per common share attributable to common stockholders | \$ (0.24) | \$ (0.23) | \$ (0.70) | \$ (2.44) |
| Weighted average shares outstanding, basic and diluted | 18,927,988 | 18,927,988 | 18,927,988 | 8,075,763 |
| See accompanying notes to unaudited condensed consolidated financial statements. | | | | |

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

| | Nine months ended | |
|---|--------------------------|-------------|
| | September 30, | |
| | 2008 | 2007 |
| Operating activities | | |
| Net loss | \$ (13,279) | \$ (14,228) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 158 | 226 |
| Gain on sale of fixed assets | (24) | |
| Accretion of premium on convertible debt | | 456 |
| Stock-based compensation | 1,404 | 4,718 |
| Provision on note receivable | 43 | 193 |
| Expense related to warrants issued to lenders | 16 | 459 |
| Amortization of premium (discount) on available-for-sale securities and other | (44) | 7 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (69) | 375 |
| Receivable from Angiotech | (180) | |
| Prepaid expenses and other assets | (777) | 157 |
| Accounts payable and accrued expenses | 216 | 553 |
| Net cash used in operating activities | (12,536) | (7,084) |
| Investing activities | | |
| Purchase of available-for-sale securities | (21,701) | (15,002) |
| Maturities of available-for-sale securities | 37,999 | |
| Proceeds from sale of fixed assets | 24 | |
| Purchase of equipment | (486) | (66) |
| Net cash provided by (used in) investing activities | 15,836 | (15,068) |
| Financing activities | | |
| Principal payments on debt | (1,800) | (2,576) |
| Proceeds from convertible promissory note | | 5,000 |
| Proceeds from issuance of common stock, net | | 58,494 |
| Net cash (used in) provided by financing activities | (1,800) | 60,918 |
| Increase in cash and cash equivalents | 1,500 | 38,766 |
| Cash and cash equivalents at beginning of the period | 13,248 | 1,528 |
| Cash and cash equivalents at end of the period | \$ 14,748 | \$ 40,294 |

See accompanying notes to unaudited condensed consolidated financial statements.

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Athersys, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

1. Background

We are a biopharmaceutical company engaged in the development and commercialization of therapeutic products in one business segment. Our operations consist primarily of research and product development activities.

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. (Old 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 Old Athersys on June 8, 2007, with Old Athersys continuing as the surviving entity in the merger (the Merger). BTHC VI was a shell corporation with substantially no assets, liabilities or operations as of the date of the Merger, and had 299,622 shares of common stock outstanding. As a result of the Merger, Old Athersys became our wholly-owned subsidiary, and the business of Old Athersys became our sole operations. On August 31, 2007, Old Athersys changed its name to ABT Holding Company and BTHC VI changed its name to Athersys, Inc. Unless otherwise indicated, all references in this quarterly report to the Company or Athersys are (a) prior to the Merger, to ABT Holding Company (i.e., Old Athersys) and its subsidiaries and (b) following the Merger, to Athersys, Inc. and its subsidiaries, including ABT Holding Company.

BTHC VI's acquisition of Old Athersys on June 8, 2007 effected a change in control and was accounted for as a reverse acquisition whereby Old Athersys is the accounting acquirer for financial statement purposes. Accordingly, the financial statements of the Company presented reflect the historical results of Old 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 and preferred stock have been retroactively restated for all historical periods presented to reflect the Merger exchange rate of 0.0358493. Basic and diluted net loss per share attributable to common stockholders have been computed using the retroactively restated common stock.

Immediately after the Merger, we completed an offering of 13,000,000 shares of common stock for aggregate gross proceeds of \$65.0 million in June 2007, which 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. We 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.

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 Annual Report on Form 10-K for the year ended December 31, 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.

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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. Our 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. New Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Accounting Standards (SFAS) No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. The FASB delayed the effective date of SFAS No. 157 for non-financial assets and liabilities to fiscal years beginning after November 15, 2008. We adopted the provisions of SFAS No. 157 related to our financial assets and liabilities on January 1, 2008. See Note 6.

In May 2008, the FASB issued FASB Staff Position APB 14-1 (FSP 14-1), *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash on conversion to separately account for the liability and equity components in a manner that reflects the issuer's nonconvertible debt borrowing rate. The effective date of FSP 14-1 is January 1, 2009 for calendar year companies with retrospective application required for all periods presented for instruments that were outstanding during any period presented in the annual financial statements. We currently have no convertible debt instruments, but are evaluating the retrospective effect that FSP 14-1 will have on our financial statements.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*. This statement, which addresses the accounting for business acquisitions, is effective for fiscal years beginning on or after December 15, 2008, with early adoption prohibited, and generally applies to business acquisitions completed after December 31, 2008. Among other things, the new standard requires that all acquisition-related costs be expensed as incurred, and that all restructuring costs related to acquired operations be expensed as incurred. This new standard also addresses the current and subsequent accounting for assets and liabilities arising from contingencies acquired or assumed and, for acquisitions both prior and subsequent to December 31, 2008, requires the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. We do not expect its adoption to have a material impact on our financial statements.

In October 2008, the FASB issued FASB Staff Position (FSP), FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, which clarifies the application of SFAS No. 157, *Fair Value Measurements*, in a market that is not active and illustrates key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. This FSP did not have an impact on our financial statements.

4. Net Loss per Share

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 shares of common stock outstanding during the period.

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We have outstanding options and warrants, and prior to June 8, 2007, also had outstanding 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. The following instruments were excluded from the calculation of diluted net loss per share attributable to common stockholders because their effects would be anti-dilutive:

- 1) Outstanding stock options to purchase 3,733,240 shares of common stock at September 30, 2008 for both the three-month and nine-month periods ended September 30, 2008, and 3,701,634 shares of common stock at September 30, 2007 for both the three-month and nine-month periods ended September 30, 2007;
- 2) Warrants to purchase 5,125,496 shares of common stock at September 30, 2008 and 2007 for each of the three-month and nine-month periods ended September 30, 2008 and September 30, 2007, respectively;
- 3) Shares of common stock issuable upon the conversion of convertible preferred stock in the amount of 213,388 during the nine-month period ended September 30, 2007; and
- 4) Shares of common stock issuable upon the conversion of convertible promissory notes in the approximate amount of 149,465 during the nine-month period ended September 30, 2007.

5. Comprehensive Loss

In accordance with SFAS No. 130, *Reporting Comprehensive Income*, all components of comprehensive income (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 a reconciliation of net loss to comprehensive loss for all periods presented, in thousands.

| | Three months ended | | Nine months ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Net loss | \$ (4,493) | \$ (4,439) | \$ (13,279) | \$ (14,228) |
| Unrealized loss on available-for-sale securities | (45) | | (105) | |
| Comprehensive loss | \$ (4,538) | \$ (4,439) | \$ (13,384) | \$ (14,228) |

6. Fair Value of Financial Instruments

On January 1, 2008, we adopted SFAS No. 157 related to our financial assets and liabilities and the methods to measure fair value of assets and liabilities as set forth therein. Our available-for-sale securities typically include U.S. government obligations, corporate debt securities, floating rate notes and commercial paper. As of September 30, 2008, approximately 79% of our investments were in U.S. treasury bills.

SFAS No. 157 classifies the inputs used to measure fair value into the following hierarchy:

- Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 Unadjusted quoted prices in active markets for similar assets or liabilities, or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- Level 3 Unobservable inputs for the asset or liability.

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The following table provides a summary of the fair values of our assets and liabilities under SFAS No. 157 (in thousands):

| Description | Balance as of September 30, 2008 | Fair Value Measurements at September 30, 2008 Using | | |
|-------------|--|---|---|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |

| | | | | |
|-------------------------------|-----------|-----------|----|----|
| Available-for-sale securities | \$ 19,968 | \$ 19,968 | \$ | \$ |
|-------------------------------|-----------|-----------|----|----|

Fair value is based upon quoted market prices in active markets. We had no level 2 or level 3 assets at September 30, 2008. We review and reassess the fair value hierarchy classifications on a quarterly basis. Changes from one quarter to the next related to the observability of inputs to a fair value measurement may result in a reclassification between hierarchy levels.

7. Stock-Based Compensation

In 2007, we adopted two equity incentive plans that authorized an aggregate of 4,500,000 shares of common stock for awards to employees, directors and consultants. These 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.

As of September 30, 2008, a total of 771,000 shares are available for issuance under our equity compensation plans and 3,729,000 options to purchase shares of common stock were outstanding. Also, options to purchase 4,240 shares of common stock are outstanding related to our old option plans prior to the Merger in June 2007. For the three-month period ended September 30, 2008, stock compensation expense was approximately \$501,000. During the three-month period ended September 30, 2008, we issued options to purchase an aggregate of 18,000 shares of common stock to an employee and a director. At September 30, 2008, total unrecognized estimated compensation cost related to unvested stock options was approximately \$3.6 million, which is expected to be recognized by September 30, 2012 using the straight-line method.

8. Long-Term Debt

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

| | September 30, 2008 | December 31, 2007 |
|--------------------------------------|-----------------------|----------------------|
| Notes payable to lenders | \$ | \$ 1,800 |
| Discount related to warrant issuance | | (16) |
| Total, net | | 1,784 |
| Less current portion | | 1,784 |
| | \$ | \$ |

In November 2004, we issued \$7.5 million of notes payable to lenders, the proceeds of which were unrestricted and used for general corporate purposes. The notes were 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 notes

were repaid in full in June 2008.

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The lenders retain a right to receive a milestone payment of \$2.25 million upon the occurrence of certain events as follows: (1) the entire amount upon (a) the merger with or into another entity where our stockholders do not hold at least a majority of the voting power of the surviving entity, (b) the sale of all or substantially all of our assets, or (c) our liquidation or dissolution; or (2) a portion of the amount from proceeds of equity financings not tied to specific research and development activities that are part of a research or development collaboration, in which case, the senior lenders will receive an amount equal to 10% of proceeds above \$5.0 million in cumulative gross proceeds until the milestone amount is paid in full. The milestone payment is payable in cash, except that if the milestone event is (2) above, we may elect to pay 75% of the milestone in shares of common stock at the per-share offering price. No amounts have been recorded in relation to the milestone as of September 30, 2008.

Upon the closing of our equity offering in June 2007, 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 our 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, which was recognized as a debt discount over the remaining term of the loan.

9. Convertible Notes

Upon the closing of our equity offering in June 2007, convertible promissory notes issued to Angiotech Pharmaceuticals, Inc. pursuant to a collaboration, and to our bridge financing investors in 2006, were converted along with accrued interest into shares of common stock. The bridge notes, if not converted, were repayable with accrued interest at maturity, plus a repayment fee of 200% of the outstanding principal. We 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 unamortized premium was reversed and recorded in additional paid-in-capital when the notes were converted into common stock upon the closing of our equity offering in June 2007.

10. Warrants

As of September 30, 2008, we 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 | | |

11. Income Taxes

We have net operating loss and research and development tax credit carryforwards that may be used to reduce future taxable income and tax liabilities. However, as a result of the change in ownership related to our capital restructuring and equity offering in June 2007, we lost the use of a significant portion of our pre-Merger net operating loss carryforwards under Section 382 of the Internal Revenue Code. Our deferred tax assets have been fully offset by a valuation allowance due to our cumulative losses.

Table of Contents**12. Contingency**

We initially filed a shelf registration statement with the SEC in July 2007 covering the resale of 18,508,251 shares of common stock, which includes all shares of common stock issued in our equity offering in June 2007 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). The registration statement was declared effective by the SEC on October 18, 2007. Under the registration rights agreement entered into in connection with our June 2007 equity offering, subject to certain exceptions, if the registration statement ceases to remain effective, a 1% cash penalty will be assessed for each 30-day period until the registration statement becomes effective again, capped at 10%. Because the penalty is based on the number of unregistered shares of common stock held by the investors in our June 2007 equity offering, our maximum penalty exposure will decline over time as investors sell their shares of common stock that were included in the registration statement.

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 Annual Report on Form 10-K for the year ended December 31, 2007. Operating results are not necessarily indicative of results that may occur in future periods.

Overview and Recent Developments

We are 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 our proprietary technologies and core capabilities, we have developed a pipeline of therapeutic product development programs in multiple diseases and conditions. We have established drug development programs in the areas of obesity and central nervous system disorders. In addition, applying our proprietary cell therapy platform, MultiStem[®], we have established therapeutic product development programs in the areas of cardiovascular disease and hematopoietic stem cell transplant support, as well as other areas.

5HT_{2c} Agonist Program – ATHX-105

We have an active development program focused on small molecules that stimulate the 5HT_{2c} receptor, a key receptor in the brain that regulates appetite and food intake. We have identified multiple compounds with the potential for treating obesity, and our lead candidate, ATHX-105, has been in clinical development. In January 2008, we completed a Phase I clinical trial in the United Kingdom with ATHX-105, the primary objective of which was to assess the short-term safety of ATHX-105 and to establish an appropriate dose range for subsequent clinical studies conducted in order to assess safety and effectiveness. There were no severe or serious adverse events observed in the clinical trial, no negative effects on cardiovascular, hematology or other clinical parameters, and no discontinuations due to adverse events. In the third quarter of 2008, we completed two additional Phase I studies in the United Kingdom that provided further safety and tolerability data for ATHX-105. These studies indicated that the drug is well absorbed throughout the gastrointestinal tract, demonstrating the potential for the development of a controlled release formulation.

In the third quarter of 2008, we filed an additional investigational new drug application, or IND, in the United States to initiate a Phase II clinical trial to examine the safety and effectiveness of ATHX-105 in clinically obese patients. We received a letter from the FDA in September 2008 with comments on the IND filing along with a request for additional information, placing the program on partial clinical hold.

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In response to this letter, we assembled relevant information and conducted certain non-clinical studies as requested by the FDA. We recently submitted this information and preliminary data from these studies to the FDA for its review and comment prior to submission of a formal response to the FDA's letter. We have discussed this information with the FDA, and based on these discussions, we believe that continued successful development of ATHX-105 may be difficult or impractical, even if our responses to the FDA comments and the requested additional information are ultimately adequate to support removal of the partial clinical hold. Furthermore, if the FDA authorizes ATHX-105 development to move forward, we believe that the increased risks of development could make it substantially more difficult or impractical for us to establish an attractive, third-party collaboration for the further development and commercialization of ATHX-105. We are continuing to work with outside experts to further evaluate recently obtained data, information and guidance from the FDA, as well as conduct some additional analysis. We intend to submit our formal response to the FDA in the fourth quarter of 2008 and hope to get feedback from the FDA by year-end to determine if further development would be possible and warranted. We believe that the FDA may request additional information and/or studies as a condition to lifting the partial clinical hold and, if so, we will evaluate the costs and benefits of conducting such studies in light of these changes to the development profile for ATHX-105. Based on the FDA response, and our assessment of available information, we may decide to amend, delay, suspend, or terminate the further development of this program.

MultiStem

We are developing MultiStem for multiple disease indications, and believe it could have therapeutic relevance across a range of areas. In the fourth quarter of 2007, we received FDA authorization to advance two MultiStem product development programs into clinical trials, in the areas of transplant support in leukemia and lymphoma patients and for treatment of damage from myocardial infarction. The application of MultiStem for certain cardiovascular applications, including myocardial infarction, is being developed with our partner, Angiotech Pharmaceuticals, Inc. ("Angiotech"). We initiated both of these trials in 2008 and have begun enrolling patients in each study. In addition to these programs, we are also developing MultiStem for certain other conditions and intend to seek FDA authorization to conduct clinical trials for some of these indications, including ischemic stroke.

In September 2008, Angiotech announced certain reorganization initiatives to reduce its costs, citing the potential need for an amendment and reduction in cash outlays related to our collaboration, on a list of possible actions. At this time, no such amendment or reduction has been requested or made to our collaboration, and Angiotech continues to fund its share of Phase I costs on a timely basis. In the event that Angiotech fails to fund its obligations under the terms of our contract, our net costs for the Phase I clinical study would increase or the study may be curtailed.

Other Programs

We are also developing pharmaceutical products for the treatment of certain conditions affecting the central nervous system, such as ADHD, narcolepsy and other cognitive or attention disorders. We plan to complete certain preclinical studies in the fourth quarter of 2008, and if appropriate, select a clinical candidate for this program within the next several months upon the successful conclusion of current studies.

Financial

In June 2007, we completed a merger with BTHC VI, Inc. and its wholly-owned subsidiary that was formed for the purpose of completing the merger. BTHC VI was a public shell corporation with substantially no assets, liabilities or operations. We continued as the surviving entity in the merger and our business became the sole operations of BTHC VI after the merger. BTHC VI's acquisition of us effected a change in control and was accounted for as a reverse acquisition whereby we were the accounting acquirer for financial statement purposes. Accordingly, our financial statements present our historical results and do not include the historical financial results of BTHC VI prior to the merger.

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Immediately after the merger, we completed an offering of 13,000,000 shares of common stock for aggregate gross proceeds of \$65.0 million in June 2007, which included the issuance of warrants to purchase 3,250,000 shares of common stock to the investors. We 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.

We have incurred losses since inception of operations in December 1995 and had an accumulated deficit of \$174 million at September 30, 2008. Our losses have resulted principally from costs incurred in research and development, clinical and preclinical product development, acquisition and licensing costs, and general and administrative costs associated with our operations. We have used the financing proceeds from private equity and debt offerings and other sources of capital to develop our technologies, to discover and develop therapeutic product candidates and to acquire certain technologies and assets. We have also built drug development capabilities that have enabled us to advance product candidates into clinical trials. We have established strategic collaborations that have provided revenues and capabilities to help further advance our product candidates, and we have also built a substantial portfolio of intellectual property.

Results of Operations

Since our inception, our revenues have consisted of license fees from our collaborators and grant proceeds primarily from federal and state grants. We have derived no revenue on the sale of FDA-approved products to date. Research and development expenses consist primarily of costs associated with external clinical and preclinical study fees, manufacturing costs, salaries and related personnel costs, legal expenses resulting from intellectual property application processes, and laboratory supply and reagent costs. We expense research and development costs as they are incurred. We expect to continue to make significant investments in research and development to enhance our technologies, advance clinical trials of our product candidates, expand our regulatory affairs and product development capabilities, conduct preclinical studies of our products and manufacture our products. General and administrative expenses consist primarily of salaries and related personnel costs, professional fees and other corporate expenses. To date, we have financed our operations through private equity and debt financing and investments by strategic collaborators. We expect to continue to incur substantial losses through at least the next several years.

The following tables set forth our revenues and expenses for the periods indicated. The following tables are stated in thousands.

Revenues

| | Three months ended | | Nine months ended | |
|---------------|---------------------------|---------------|--------------------------|-----------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| License fees | \$ 885 | \$ 500 | \$ 1,728 | \$ 1,123 |
| Grant revenue | 393 | 360 | 1,118 | 1,339 |
| | \$ 1,278 | \$ 860 | \$ 2,846 | \$ 2,462 |

Table of Contents**Research and development expenses**

| <i>Type of expense</i> | Three months ended | | Nine months ended | |
|--|---------------------------|-----------------|--------------------------|------------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Personnel costs | \$ 675 | \$ 621 | \$ 2,241 | \$ 2,067 |
| Research supplies | 267 | 126 | 649 | 485 |
| Facilities | 196 | 193 | 608 | 568 |
| Clinical and preclinical development costs | 2,639 | 2,067 | 6,471 | 3,500 |
| Sponsored research | 89 | 105 | 300 | 286 |
| Patent legal fees | 452 | 145 | 1,077 | 806 |
| Other | 216 | 699 | 880 | 1,567 |
| Stock-based compensation | 196 | 259 | 556 | 2,290 |
| | \$ 4,730 | \$ 4,215 | \$ 12,782 | \$ 11,569 |

General and administrative expenses

| <i>Type of expense</i> | Three months ended | | Nine months ended | |
|-----------------------------|---------------------------|-----------------|--------------------------|-----------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Personnel costs | \$ 370 | \$ 405 | \$ 1,335 | \$ 1,404 |
| Facilities | 86 | 96 | 259 | 247 |
| Legal and professional fees | 227 | 604 | 733 | 883 |
| Other | 258 | 682 | 933 | 1,256 |
| Stock-based compensation | 305 | 326 | 848 | 2,428 |
| | \$ 1,246 | \$ 2,113 | \$ 4,108 | \$ 6,218 |

Three Months Ended September 30, 2008 and 2007

Revenues. Revenues increased to \$1.3 million for the three months ended September 30, 2008 from \$860,000 in the comparable period in 2007. License fee revenue increased \$385,000 for the three months ended September 30, 2008 compared to the three months ended September 30, 2007. The increase in license fee revenue was a result of the nature and timing of target acceptances under our collaboration agreement with BMS, and the achievement of a clinical development milestone in September 2008. Grant revenue increased \$33,000 for the three months ended September 30, 2008 compared to the three months ended September 30, 2007. The increase in grant revenue was due to the timing of expenditures that are reimbursed with grant proceeds. Our revenues may decline in 2009 as we complete the final phase of the BMS collaboration, and our revenues may fluctuate based on the achievement and timing of BMS milestones, if any, and based on our obtaining additional grant funding.

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Research and Development Expenses. Research and development expenses increased to \$4.7 million for the three months ended September 30, 2008 from \$4.2 million in the comparable period in 2007. The increase of approximately \$0.5 million relates primarily to the following: a \$572,000 increase in clinical and preclinical development costs related to preparations for the Phase II clinical trial of ATHX-105 and two Phase I clinical trials related to MultiStem, a \$307,000 increase in patent legal costs and a \$198,000 increase in research supplies and personnel and facilities costs in the three months ended September 30, 2008 compared to the comparable period in 2007. These increases were offset by a decrease in other expenses of \$483,000, a decrease in stock compensation expense of \$63,000 and a decrease in sponsored research costs of \$16,000 in the three months ended September 30, 2008 compared to the comparable period in 2007. Our clinical costs for the three months ended September 30, 2008 are reflected net of Angiotech's cost-sharing amount related to our MultiStem acute myocardial infarction collaboration in the amount of \$243,000. The decrease in other expenses for the three months ended September 30, 2008 was primarily a result of the milestone payment in the comparable period in 2007 in the amount of \$500,000 associated with a stem cell collaboration. Our clinical and preclinical development costs may increase as we advance the clinical development of our product candidates. Other than external expenses for our clinical and preclinical programs, we do not track our research expenses by project; rather, we track such expenses by the type of cost incurred.

General and Administrative Expenses. General and administrative expenses decreased to \$1.2 million for the three months ended September 30, 2008 from \$2.1 million in the comparable period in 2007. The decrease of \$0.9 million relates primarily to a \$424,000 decrease in other expenses, a \$377,000 decrease in legal and professional fees and a \$21,000 decrease in stock compensation expense. Included in other expenses for the three months ended September 30, 2007 was an allowance against a loan receivable in the amount of \$193,000 and \$489,000 of costs associated with being a reporting company under the Securities Exchange Act of 1934, such as printing, investor and public relations costs, directors and officers insurance costs and costs related to compliance with Section 404 of the Sarbanes-Oxley Act of 2002. Such costs have been reduced for the three months ended September 30, 2008. Similarly, legal and professional fees for the three months ended September 30, 2008 were lower than the comparable period in 2007 primarily as a result of legal and accounting fees incurred in connection with 2007 SEC filings, which have been reduced for the three months ended September 30, 2008.

Depreciation. Depreciation expense decreased to \$49,000 for the three months ended September 30, 2008 from \$71,000 for the comparable period in 2007. The decrease was due to more equipment becoming fully depreciated.

Other Income. In May 2007, we sold certain non-core assets related to our asthma drug discovery program to a pharmaceutical company for \$2.0 million, of which \$1.5 million was received at closing and recorded in other income. The remaining \$500,000 was received and recognized as other income in August 2007 upon our delivery of certain ancillary assets related to the program.

Interest Income. Interest income represents interest income earned on our cash and available-for-sale securities. Interest income decreased to \$232,000 for the three months ended September 30, 2008 from \$724,000 for the comparable period in 2007 due to declining interest rates and lower cash balances. Due to declining interest rates and lower cash balances as a result of our ongoing and planned clinical and preclinical development, we expect our 2008 interest income to decline over the remainder of 2008.

Nine Months Ended September 30, 2008 and 2007

Revenues. Revenues increased to \$2.8 million for the nine months ended September 30, 2008 from \$2.5 million in the comparable period in 2007. License fee revenue increased \$605,000 for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. The increase in license fee revenue over this period was a result of the nature and timing of target acceptances under our collaboration agreement with BMS, and the achievement of a clinical development milestone in September 2008. Grant revenue decreased \$221,000 for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. The decrease in grant revenue was due to the timing of expenditures that are reimbursed with grant proceeds. Our revenues may decline in 2009 as we complete the final phase of the BMS collaboration, and our revenues may fluctuate based on the achievement and timing of BMS milestones, if any, and based on our obtaining additional grant funding.

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Research and Development Expenses. Research and development expenses increased to \$12.8 million for the nine months ended September 30, 2008 from \$11.6 million in the comparable period in 2007. The increase of approximately \$1.2 million relates primarily to the following: an increase in clinical and preclinical development costs of \$3.0 million, an increase in personnel, research supplies and facilities costs of \$378,000, and an increase in patent legal costs of \$271,000 for the nine months ended September 30, 2008 compared to the comparable period in 2007. These increases were partially offset by a decrease in stock compensation expense of \$1.7 million and a decrease in other expenses of \$687,000 for the nine months ended September 30, 2008 compared to the comparable period in 2007. The \$3.0 million increase in preclinical and clinical costs was a result of the continuation of the ATHX-105 Phase I clinical trial that was completed in January 2008, clinical and nonclinical studies in preparation for a Phase II clinical trial of ATHX-105, and preparation for Phase I clinical trials for MultiStem that commenced in 2008. Our clinical costs for the nine months ended September 30, 2008 are reflected net of Angiotech's cost-sharing amount related to our MultiStem acute myocardial infarction collaboration in the amount of \$709,000. The decrease in other expenses for the nine months ended September 30, 2008 was primarily a result of milestone payments in 2007 in the amount of \$1.0 million associated with a stem cell collaboration. Our clinical and preclinical development costs may increase as we advance the clinical development of our product candidates. Other than external expenses for our clinical and preclinical programs, we do not track our research expenses by project; rather, we track such expenses by the type of cost incurred.

General and Administrative Expenses. General and administrative expenses decreased to \$4.1 million for the nine months ended September 30, 2008 from \$6.2 million in the comparable period in 2007. The decrease of \$2.1 million relates primarily to a \$1.6 million decrease in stock compensation expense, a \$323,000 decrease in other expenses and a \$150,000 decrease in legal, professional, and consulting fees for the nine months ended September 30, 2008. Included in other expenses for the nine months ended September 30, 2007 was a one-time advisory fee of \$350,000 related to the merger and an allowance against a loan receivable in the amount of \$193,000, which were the primary reasons for the decrease in other expenses. Legal and professional fees for the nine months ended September 30, 2008 were lower than the comparable period in 2007 primarily as a result of legal and accounting fees incurred in connection with 2007 SEC filings, which have been reduced for the nine months ended September 30, 2008.

Depreciation. Depreciation expense decreased to \$158,000 for the nine months ended September 30, 2008 from \$226,000 for the comparable period in 2007. The decrease was due to more equipment becoming fully depreciated.

Other Income. In May 2007, we sold certain non-core assets related to our asthma drug discovery program to a pharmaceutical company for \$2.0 million, of which \$1.5 million was received at closing and recorded in other income. The remaining \$500,000 was received and recognized as other income in August 2007 upon our delivery of certain ancillary assets related to the program.

Interest Income. Interest income represents interest income earned on our cash and available-for-sale securities. Interest income increased to \$974,000 for the nine months ended September 30, 2008 from \$946,000 for the comparable period in 2007 due to the increase in our average cash balances as a result of our equity offering in June 2007. Due to declining interest rates and lower cash balances as a result of our ongoing and planned clinical and preclinical development, we expect our 2008 interest income to decline over the remainder of 2008.

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Interest Expense. Interest expense decreased to \$93,000 for the nine months ended September 30, 2008 from \$1.2 million for the comparable period in 2007. Interest expense in the nine months ended September 30, 2008 consists primarily of interest on our senior loan. Our senior loan was repaid in June 2008. Included in interest expense for the nine-month period ended September 30, 2007 was interest on our senior loan and subordinated convertible promissory notes issued to our bridge investors in October 2006 and to Angiotech, which were converted into common stock upon the closing of our equity offering in June 2007. Unless we enter into a new debt arrangement, we do not expect any significant interest expense for the remainder of 2008.

Accretion of Premium on Convertible Debt. The accretion of premium on convertible debt for the nine months ended September 30, 2007 relates to the subordinated convertible promissory notes issued to bridge investors in October 2006. The notes, if not converted, were repayable with accrued interest at maturity, plus a repayment fee of 200% of the outstanding principal. We 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 unamortized premium was reversed and recorded in additional paid-in-capital when the notes were converted into common stock upon the closing of our equity offering in June 2007.

Deemed Dividend. In connection with the merger in 2007, all shares of Athersys convertible preferred stock were converted into common stock, which resulted in a deemed dividend in the amount of \$4.8 million from the induced conversion associated with the change in the conversion ratios. This amount is reflected as an increase to the net loss attributable to common stockholders for the nine months ended September 30, 2007.

LIQUIDITY AND CAPITAL RESOURCES

Our sources of liquidity include our cash balances and available-for-sale securities. At September 30, 2008, we had \$14.7 million in cash and cash equivalents and \$20.0 million in available-for-sale securities. We expect to have available cash to fund our operations into 2010 based on our current business and operational plans and assuming no new financings. We have primarily financed our operations through private equity and debt financings that have resulted in aggregate cumulative proceeds of approximately \$200 million.

In September 2008, BMS successfully advanced into Phase II clinical development a drug candidate discovered using a target provided by us, thereby triggering a clinical development milestone payment to us. Our collaboration agreement with BMS, which was initially established in 2001, is now in its final phase. We intend to continue to prepare and deliver validated drug targets for use by BMS in its drug discovery efforts until the collaboration objectives have been fulfilled. We will remain entitled to receive license fees for targets delivered to BMS, as well as milestone payments and royalties on compounds developed by BMS using our technology.

Our available-for-sale securities typically include U.S. government obligations, corporate debt securities, floating rate notes and commercial paper. As of September 30, 2008, approximately 79% of our investments were in U.S. treasury bills. We have been investing conservatively due to the current economic conditions, including the current credit crisis, and have prioritized liquidity and the preservation of principal in lieu of potentially higher returns. As a result, we have experienced no losses on the principal of our investments. Also, although these unfavorable market and economic conditions have resulted in a decrease to our market capitalization, there has been no impairment to the value of our assets. Our fixed assets are used for internal research and development and, therefore, are not impacted by these external factors.

We will require substantial additional funding in order to continue our research and product development programs, including preclinical testing and clinical trials of our product candidates. We anticipate higher cash expenditures in 2008 as compared to 2007, which reflects the impact of preparations for the ATHX-105 Phase II clinical trial, including clinical and nonclinical studies, and the initiation of two MultiStem clinical trials in 2008. Based on current plans, we expect the costs associated with preclinical testing and clinical trials of our product candidates to increase in 2009. Our funding requirements may change at any time due to technological advances, changes to clinical study design, competition from other companies or for other reasons. Our future capital requirements will also depend on numerous other factors, including scientific progress in our research and development programs, additional personnel costs, progress in preclinical testing and clinical trials, the time and cost related to proposed regulatory approvals, if any, and the costs in filing and prosecuting patent applications and enforcing patent claims. We cannot assure you that adequate funding will be available to us or, if available, that it will be available on acceptable terms, particularly in

light of the current credit crisis. Any shortfall in funding could result in our having to curtail our research and development efforts.

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We expect to continue to incur substantial losses through at least the next several years and may incur losses in subsequent periods. The amount and timing of our future losses are highly uncertain. Our ability to achieve and thereafter sustain profitability will be dependent upon, among other things, successfully developing, commercializing and obtaining regulatory approval or clearances for our technologies and products resulting from these technologies. Net cash used in operating activities was \$12.5 million for the nine months ended September 30, 2008 and \$7.1 million for the nine months ended September 30, 2007 and represented the use of cash for funding preclinical and clinical product development activities, including funding certain deposit and advance accounts related to the clinical trials, and for administrative costs. We expect that net cash used in operating activities will increase as we advance the clinical development of our product candidates.

Net cash provided by investing activities was \$15.8 million for the nine months ended September 30, 2008 compared to a use of \$15.1 million for the nine months ended September 30, 2007. The fluctuation from period to period was due to the timing of purchases and maturity dates of investments and purchases of equipment. Purchases of equipment were \$486,000 in the nine months ended September 30, 2008 and \$66,000 in the nine-month period ended September 30, 2007.

Financing activities used cash of \$1.8 million for the nine months ended September 30, 2008 and provided cash of \$60.9 million for the nine months ended September 30, 2007. The fluctuation relates primarily to proceeds from the equity offering in June 2007, the issuance of convertible promissory notes in the first quarter of 2007 and the repayment of our senior loan in June 2008.

Investors in our equity offering in June 2007 received five-year warrants to purchase an aggregate of 3,250,000 shares of common stock with an exercise price of \$6.00 per share. The lead investor in the June offering, Radius Venture Partners, invested \$10.0 million in the June offering and received additional five-year warrants to purchase an aggregate of 500,000 shares of common stock with a cash or cashless exercise price of \$6.00 per share. The placement agents for the June offering received five-year warrants to purchase an aggregate of 1,093,525 shares of common stock with a cash or cashless exercise price of \$6.00 per share. The exercise of such warrants could provide us with cash proceeds. No warrants were exercised at September 30, 2008.

Our senior loan was repaid in full in June 2008. The senior lenders retain a right to receive a milestone payment of \$2.25 million upon the occurrence of certain events as follows: (1) the entire amount upon (a) the merger with or into another entity where our stockholders do not hold at least a majority of the voting power of the surviving entity, (b) the sale of all or substantially all of our assets, or (c) our liquidation or dissolution; or (2) a portion of the amount from proceeds of equity financings not tied to specific research and development activities that are part of a research or development collaboration, in which case, the senior lenders will receive an amount equal to 10% of proceeds above \$5.0 million in cumulative gross proceeds until the milestone amount is paid in full. The milestone payment is payable in cash, except that if the milestone event is (2) above, we may elect to pay 75% of the milestone in shares of common stock at the per-share offering price. No milestone events occurred in the nine-month period ended September 30, 2008. The senior lenders also received warrants to purchase 149,026 shares of common stock with an exercise price of \$5.00 upon the closing of our equity offering in June 2007. The exercise of such warrants could provide us with cash proceeds. No warrants were exercised at September 30, 2008. We are considering entering into a new debt facility in 2008 or 2009, although we cannot assure you that such funding will be available to us or, if available, that it will be available on acceptable terms, particularly in light of the current credit crisis.

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In connection with our 2006 MultiStem collaboration with Angiotech, Angiotech purchased subordinated convertible promissory notes in the aggregate principal amount of \$10.0 million, which were converted along with accrued interest into common stock upon the closing of our equity offering in June 2007. Upon the successful achievement of specified clinical development and commercialization milestones, we may also receive up to \$3.75 million of additional equity investments and \$63.75 million of aggregate cash payments, though there can be no assurance that we will achieve any milestones.

Under the terms of the collaboration, the parties plan to jointly fund clinical development activity, whereby preclinical costs will be borne solely by us, costs for Phase I and Phase II studies will be borne 50% by us and 50% by Angiotech, costs for the first phase III study will be borne 33% by us and 67% by Angiotech, and costs for any Phase III studies subsequent to the first Phase III study will be borne 25% by us and 75% by Angiotech. We have lead responsibility for preclinical and early clinical development and manufacturing of the MultiStem product, and Angiotech will take the lead on pivotal and later clinical trials and commercialization. Late in 2007, the parties began to share costs for Phase I clinical development, which is reconciled quarterly. As of September 30, 2008, \$243,000 was due from Angiotech representing its share of costs for the third quarter of 2008. We will receive nearly half of the net profits from the sale of any jointly developed, approved products. In addition, we will retain the commercial rights to MultiStem for all other therapeutic applications, including treatment of stroke, bone marrow transplantation and oncology support, blood and immune system disorders, autoimmune disease, and other indications that we may elect to pursue. In December 2007, we achieved a clinical development milestone upon the authorization of our IND by the FDA. This milestone event required Angiotech to either purchase \$5.0 million of our common stock, or forego the purchase and allow us to select from two pre-defined milestone replacements. Angiotech opted to forego the purchase, and we elected to increase our share of the net profits from the sale of approved products as the milestone replacement. In September 2008, Angiotech announced certain reorganization initiatives to reduce its costs, citing the need for a potential amendment and reduction in cash outlays related to our collaboration, among a list of several selected actions. At this time, no such amendment or reduction has been made to our collaboration, and Angiotech continues to fund its share of Phase I costs on a timely basis. In the event that Angiotech fails to fund its obligations under the terms of our contract, our costs for the Phase I clinical study would increase or the study may be curtailed. We have an operating lease for our office and laboratory space with options to renew through March 2013 at the existing rental rate, which is approximately \$267,000 per year. We exercised options to renew the lease through March 2010. In February 2008, we entered into a three-year lease agreement for office and laboratory space for our Belgian subsidiary, with an annual rent of approximately \$45,000, subject to annual adjustments based on an inflationary index. The lease includes an option to renew for four additional years, through December 31, 2014. We have no off-balance sheet arrangements.

CRITICAL ACCOUNTING POLICIES AND MANAGEMENT ESTIMATES

The SEC defines critical accounting policies as those that are, in management's view, important to the portrayal of our financial condition and results of operations and demanding of management's judgment. Our discussion and analysis of financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). The preparation of these financial statements requires us to make estimates on experience and on various assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates. A description of these accounting policies and estimates is included in Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2007. There have been no material changes in our accounting policies and estimates as described in our Annual Report. For additional information regarding our accounting policies, see Note B to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2007.

Table of Contents**New Accounting Standards**

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. The FASB delayed the effective date of SFAS No. 157 for non-financial assets and liabilities to fiscal years beginning after November 15, 2008. We adopted the provisions of SFAS No. 157 related to our financial assets and liabilities on January 1, 2008, which did not have a material impact on our financial position or results of operations. See Note 6 to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

In May 2008, the FASB issued FASB Staff Position APB 14-1 (FSP 14-1), *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash on conversion to separately account for the liability and equity components in a manner that reflected the issuer's nonconvertible debt borrowing rate. The effective date of FSP 14-1 is January 1, 2009 for calendar year companies with retrospective application required for all periods presented for instruments that were outstanding during any period presented in the annual financial statements. We currently have no convertible debt instruments, but are evaluating the retrospective effect that FSP 14-1 will have on our financial statements.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*. This statement, which addresses the accounting for business acquisitions, is effective for fiscal years beginning on or after December 15, 2008, with early adoption prohibited, and generally applies to business acquisitions completed after December 31, 2008. Among other things, the new standard requires that all acquisition-related costs be expensed as incurred, and that all restructuring costs related to acquired operations be expensed as incurred. This new standard also addresses the current and subsequent accounting for assets and liabilities arising from contingencies acquired or assumed and, for acquisitions both prior and subsequent to December 31, 2008, requires the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. We do not expect its adoption to have a material impact on our financial statements.

In October 2008, the FASB issued FASB Staff Position (FSP), FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, which clarifies the application of SFAS No. 157, *Fair Value Measurements*, in a market that is not active and illustrates key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. This FSP did not have an impact on our financial statements.

CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. These forward-looking statements relate to, among other things, the expected timetable for development of our product candidates, our growth strategy, and our future financial performance, including our operations, economic performance, financial condition, prospects, and other future events. We have attempted to identify forward-looking statements by using such words as anticipates, believes, can, continue, could, estimates, expects, intends, may, plans, potential, should, will, or other similar terms. These forward-looking statements are only predictions and are largely based on our current expectations. These forward-looking statements appear in a number of places in this quarterly report on Form 10-Q.

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In addition, a number of known and unknown risks, uncertainties, and other factors could affect the accuracy of these statements. Some of the more significant known risks that we face are the risks and uncertainties inherent in the process of discovering, developing, and commercializing products that are safe and effective for use as human therapeutics, including the uncertainty regarding market acceptance of our product candidates and our ability to generate revenues. These risks may cause our actual results, levels of activity, performance, or achievements to differ materially from any future results, levels of activity, performance, or achievements expressed or implied by these forward-looking statements.

Other important factors to consider in evaluating our forward-looking statements include:

- our ability to successfully initiate or complete clinical trials for our product candidates;
- the possibility of delays in, adverse results of and excessive costs of the development process;
- changes in external market factors;
- changes in our industry's overall performance;
- changes in our business strategy;
- our ability to protect our intellectual property portfolio;
- our possible inability to enter into licensing or co-development arrangements for certain product candidates;
- our possible inability to execute our strategy due to changes in our industry or the economy generally, including the current economic crisis;
- our ability to obtain capital in difficult market conditions;
- changes in financial stability of collaborators;
- changes in productivity and reliability of suppliers; and
- the success of our competitors and the emergence of new competitors.

Although we currently believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee our future results, levels of activity or performance. We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. You are advised, however, to consult any further disclosures we make on related subjects in our reports on Forms 10-Q, 8-K and 10-K furnished to the SEC. You should understand that it is not possible to predict or identify all risk factors. Consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk

Our exposure to interest rate risk is related to our investment portfolio. Fixed rate investments may have their fair market value adversely impacted from changes in interest rates. Due in part to these factors, our future investment income may fall short of expectations. Further, we may suffer losses in investment principal if we are forced to sell securities that have declined in market value due to changes in interest rates. We invest our excess cash primarily in debt instruments of the U.S. government and its agencies, corporate debt securities, floating-rate notes and A1+/P1 commercial paper. As of September 30, 2008, approximately 79% of our investments were in U.S. treasury bills. We have been investing conservatively due to the current economic conditions and have emphasized liquidity and security in lieu of potentially higher returns. As a result, we have experienced no losses on the principal of our investments.

We enter into loan arrangements with financial institutions when needed and when available to us. At September 30, 2008, we had no outstanding debt.

Table of Contents**Item 4. Controls and Procedures.****Disclosure controls and procedures**

Our management, under the supervision of and with the participation of our Chief Executive Officer and our Vice President of Finance, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as of the end of the period covered by this quarterly report on Form 10-Q. Based upon this evaluation, our Chief Executive Officer and Vice President of Finance have concluded that, as of the end of the period covered by this quarterly report on Form 10-Q, our disclosure controls and procedures were effective.

Changes in internal control over financial reporting

During the third quarter of 2008, there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION**Item 6. Exhibits.**

| Exhibit No. | Description |
|-------------|--|
| 31.1 | Certification of Gil Van Bokkelen, Chairman and Chief Executive Officer, pursuant to SEC Rules 13a-14(a) and 15d-14(a) adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Laura K. Campbell, Vice President of Finance, pursuant to SEC Rules 13a-14(a) and 15d-14(a) adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Gil Van Bokkelen, Chairman and Chief Executive Officer, and Laura Campbell, Vice President of Finance, pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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SIGNATURES

Pursuant to the requirements of 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.

ATHERSYS, INC.

Date: November 10, 2008

/s/ Gil Van Bokkelen
Gil Van Bokkelen
Chairman and Chief Executive Officer
(principal executive officer authorized to
sign on behalf of the registrant)

/s/ Laura K. Campbell
Laura K. Campbell
Vice President, Finance
(principal financial and accounting officer
authorized to sign on behalf of the
registrant)

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EXHIBIT INDEX

| Exhibit No. | Description |
|-------------|--|
| 31.1 | Certification of Gil Van Bokkelen, Chairman and Chief Executive Officer, pursuant to SEC Rules 13a-14(a) and 15d-14(a) adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Laura K. Campbell, Vice President of Finance, pursuant to SEC Rules 13a-14(a) and 15d-14(a) adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Gil Van Bokkelen, Chairman and Chief Executive Officer, and Laura Campbell, Vice President of Finance, pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |