SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 June 30, 2005

OR

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 0-32501

CYTORI THERAPEUTICS, INC.

(Exact name of Registrant as Specified in Its Charter)

DELAWARE	**33-0827593**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
3020 CALLAN ROAD, SAN DIEGO, CALIFORNIA	**92121**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(858) 458-0900**

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 o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes o No ☒

As of July 31, 2005, there were 15,175,684 shares of the registrant's common stock outstanding.

CYTORI THERAPEUTICS, INC.

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Cytori Therapeutics, Inc.:

We have reviewed the consolidated condensed balance sheet of Cytori Therapeutics, Inc. (formerly MacroPore Biosurgery, Inc.) and subsidiaries as of June 30, 2005, and the related consolidated condensed statements of operations and comprehensive loss for the three-month and six-month periods ended June 30, 2005 and 2004, and the related consolidated condensed statements of cash flows for the six-month periods ended June 30, 2005 and 2004. These consolidated condensed financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated condensed financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Cytori Therapeutics, Inc. and subsidiaries as of December 31, 2004, and the related consolidated statements of operations and comprehensive loss, shareholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 11, 2005, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated condensed balance sheet as of December 31, 2004 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Note 1 of Macropore Biosurgery, Inc.'s audited financial statements as of December 31, 2004 and for the year then ended, discloses that the Company derives a substantial portion of its revenues from a related party. Our auditor's report on those financial statements dated March 11, 2005, includes an explanatory paragraph referring to the matter in note 1 of those financial statements.

/s/ KPMG LLP

San Diego, California
August 12, 2005

CYTORI THERAPEUTICS, INC.
(formerly known as MacroPore Biosurgery, Inc.)
CONSOLIDATED CONDENSED BALANCE SHEETS

	As of June 30, 2005 (Unaudited)	As of December 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 3,076,000	$ 2,840,000
Short-term investments, available-for-sale	11,746,000	10,579,000
Accounts receivable, net of allowance for doubtful accounts of $5,000 and $8,000 in 2005 and 2004, respectively	491,000	863,000
Inventories	532,000	379,000
Other current assets	901,000	984,000
Total current assets	16,746,000	15,645,000
Property and equipment, net	2,900,000	3,080,000
Other assets	393,000	236,000
Intangibles, net	1,987,000	2,122,000

Goodwill	4,387,000	4,387,000
Total assets	$ 26,413,000	$ 25,470,000
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 2,489,000	$ 2,329,000
Current portion of long-term obligations	773,000	938,000
Total current liabilities	3,262,000	3,267,000
Deferred gain on sale of assets	5,650,000	5,650,000
Deferred license fee revenue	1,500,000	1,500,000
Deferred development revenue	1,083,000	1,092,000
Option liability	246,000	—
Deferred other	7,811,000	—
Long-term obligations, less current portion	819,000	1,128,000
Total liabilities	20,371,000	12,637,000
Stockholders' equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; -0- shares issued and outstanding in 2005 and 2004	—	—
Common stock, $0.001 par value; 95,000,000 shares authorized; 18,040,018 and 16,820,018 shares issued and 15,167,184 and 13,947,184 shares outstanding in 2005 and 2004, respectively	18,000	17,000
Additional paid-in capital	77,817,000	74,737,000
Accumulated deficit	(61,361,000)	(51,475,000)
Treasury stock, at cost	(10,414,000)	(10,414,000)
Accumulated other comprehensive loss	(18,000)	(32,000)
Total stockholders' equity	6,042,000	12,833,000
Total liabilities and stockholders' equity	$ 26,413,000	$ 25,470,000

SEE NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

CYTORI THERAPEUTICS, INC.
(formerly known as MacroPore Biosurgery, Inc.)
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(UNAUDITED)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2005	2004	2005	2004
Revenues:				
Sales to related party	$ 1,477,000	$ 894,000	$ 3,232,000	$ 2,815,000
Sales to third parties	2,000	636,000	4,000	977,000
Research grant	62,000	10,000	85,000	100,000
Development	—	—	9,000	—
	1,541,000	1,540,000	3,330,000	3,892,000
Cost of revenues:				
Cost of revenues, including stock based compensation expense of $0 and $1,000 for the three months ended June 30, 2005 and 2004, respectively; $0 and $3,000 for the six months ended June 30, 2005 and 2004, respectively	738,000	314,000	1,483,000	1,191,000
Inventory provision	—	—	—	242,000
Gross profit	803,000	1,226,000	1,847,000	2,459,000
Operating expenses:				
Research and development, excluding stock based compensation expense of $63,000 and $32,000 for the three months ended June 30, 2005 and 2004, respectively; $63,000 and $32,000 for the six months ended June 30, 2005 and 2004, respectively	3,596,000	2,668,000	6,869,000	5,175,000
Sales and marketing, excluding stock based compensation expense of $0 and $11,000 for the three months ended June 30, 2005 and 2004, respectively; $0 and $22,000 for the six months ended June 30, 2005 and 2004, respectively	337,000	654,000	728,000	1,612,000
General and administrative, excluding stock based compensation expense of $0 and $36,000 for the three months ended June 30,	2,098,000	1,575,000	4,007,000	2,801,000

2005 and 2004, respectively; $0 and $71,000 for the six months ended June 30, 2005 and 2004, respectively				
Stock based compensation (excluding cost of revenues stock based compensation)	63,000	79,000	63,000	125,000
Change in fair value of option liability	60,000	—	60,000	—
Restructuring charge	—	70,000	—	70,000
Total operating expenses	6,154,000	5,046,000	11,727,000	9,783,000
Operating loss	(5,351,000)	(3,820,000)	(9,880,000)	(7,324,000)
Other income (expense):				
Gain on sale of assets, related party	—	—	—	5,000,000
Interest income	54,000	57,000	109,000	112,000
Interest expense	(36,000)	(48,000)	(76,000)	(87,000)
Other income (expense), net	(26,000)	1,000	(39,000)	(21,000)
Total other income (expense)	(8,000)	10,000	(6,000)	5,004,000
Net loss	(5,359,000)	(3,810,000)	(9,886,000)	(2,320,000)
Other comprehensive income (loss)-unrealized holding income (loss)	14,000	(41,000)	14,000	(50,000)
Comprehensive loss	$ (5,345,000)	$ (3,851,000)	$ (9,872,000)	$ (2,370,000)
Basic and diluted net loss per common share	$ (0.37)	$ (0.27)	$ (0.70)	$ (0.17)
Basic and diluted weighted average common shares	14,379,849	13,920,186	14,168,234	13,933,111

SEE NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

CYTORI THERAPEUTICS, INC.
(formerly known as MacroPore Biosurgery, Inc.)
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the six months ended June 30, 2005	2004
Cash flows from operating activities:		
Net loss	$ (9,886,000)	(2,320,000)
Adjustments to reconcile loss to net cash used in operating activities:		
Depreciation and amortization	861,000	866,000
Inventory provision	—	242,000
Reduction in allowance for doubtful accounts	(3,000)	(19,000)
Change in fair value of option liability	60,000	—
Restructuring charge	—	70,000
Amortization of gain on sale of assets, related party	—	(156,000)
Amortization of gain on sale of assets	—	(189,000)
Gain on sale of assets, related party	—	(5,000,000)
Stock based compensation	63,000	119,000
Increases (decreases) in cash caused by changes in operating assets and liabilities:		
Accounts receivable	375,000	(147,000)
Inventories	(153,000)	(51,000)
Other current assets	83,000	(79,000)
Other assets	(157,000)	35,000
Accounts payable and accrued expenses	160,000	(413,000)
Deferred development revenue	(9,000)	58,000
Net cash used in operating activities	(8,606,000)	(6,984,000)
Cash flows from investing activities:		
Proceeds from sale and maturity of short-term investments	22,089,000	30,006,000
Purchases of short-term investments	(23,242,000)	(34,548,000)
Proceeds from sale of assets, related party	—	5,000,000
Proceeds from sale of assets, net	—	6,960,000
Purchases of property and equipment	(546,000)	(463,000)
Acquisition costs	—	(21,000)
Net cash (used in) provided by investing activities	(1,699,000)	6,934,000
Cash flows from financing activities:		

Principal payments on long-term obligations	(474,000)	(382,000)
Proceeds from long-term obligations	—	722,000
Proceeds from exercise of employee stock options	15,000	26,000
Proceeds from sale of common stock	3,003,000	—
Proceeds from issuance of options	186,000	—
Proceeds received in excess of fair market value of common stock	7,811,000	—
Purchase of treasury stock	—	(1,043,000)
Net cash provided by (used in) financing activities	10,541,000	(677,000)
Net increase (decrease) in cash and cash equivalents	236,000	(727,000)
Cash and cash equivalents at beginning of period	2,840,000	2,820,000
Cash and cash equivalents at end of period	$ 3,076,000	$ 2,093,000
Supplemental disclosure of cash flows information:		
Cash paid during period for:		
Interest	$ 80,000	$ 86,000
Taxes	7,000	11,000

SEE NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

CYTORI THERAPEUTICS, INC.
(formerly known as MacroPore Biosurgery, Inc.)
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
JUNE 30, 2005
(UNAUDITED)

1. Basis of Presentation

The accompanying unaudited consolidated condensed financial statements as of June 30, 2005 and for the three and six months ended June 30, 2005 and 2004 have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for annual financial statements. The consolidated condensed balance sheet at December 31, 2004 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the financial position and results of operations of Cytori Therapeutics, Inc. ("Cytori" or the "Company"), formerly known as MacroPore Biosurgery, Inc., have been included. Operating results for the three and six months ended June 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. For further information, refer to the consolidated financial statements for the year ended December 31, 2004 and footnotes thereto which were included in the Company's Annual Report on Form 10-K, dated March 31, 2005.

2. Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates. Estimates and assumptions are reviewed periodically, and the effects of revisions are reflected in the consolidated financial statements in the periods they are determined to be necessary.

The Company's most significant estimates and critical accounting policies involve revenue recognition, determining the warranty provision, evaluating for goodwill impairment, and the accounting for product line dispositions.

3. Segment Information

On July 11, 2005, the Company announced the reorganization of its business based on two distinct operating segments – (a) Regenerative cell technology and (b) MacroPore Biosurgery, which manufactures bioresorbable implants. In the past, the Company's resources were managed on a consolidated basis. However, in an effort to better reflect the Company's focus and significant progress in the development of regenerative therapeutics, the Company is now reporting its financial results in two segments. As a result, the Company's name has been changed from MacroPore Biosurgery, Inc. to Cytori Therapeutics, Inc.

The Company's regenerative cell technology segment is focused on the discovery and development of cell-based therapies for cardiovascular disease, spine and orthopedic conditions, gastrointestinal disorders and new approaches for aesthetic and reconstructive surgery using regenerative cells from adipose tissue, also known as fat tissue. The MacroPore Biosurgery division manufactures and distributes the HYDROSORB™ family of FDA-cleared bioresorbable spine and orthopedic implants; the division also develops the Thin Film bioresorbable implants for Senko Medical Trading Co. ("Senko"), which has exclusive distribution rights to these products in Japan.

The Company measures the success of each operating segment based on operating results, and additionally, in the case of the regenerative cell technology segment, the achievement of key research objectives. In arriving at operating loss for each segment, the Company uses the same accounting policies as those used for the consolidated company and as described in Note 1 to the Company's consolidated financial statements for the year ended December 31, 2004. However, segment operating results exclude allocations of company-wide general and administrative costs, changes in fair value of option liability, and the restructuring charge.

Prior year results presented below have been developed on the same basis as the current year figures. For all periods presented, the Company did not have any intersegment transactions.

The following tables provide information regarding the performance and assets of the Company's operating segments:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Revenues:				
Regenerative cell technology	$ 64,000	$ 12,000	$ 89,000	$ 106,000
MacroPore Biosurgery	1,477,000	1,528,000	3,241,000	3,786,000
Total Revenues	$ 1,541,000	$ 1,540,000	$ 3,330,000	$ 3,892,000
Segment losses:				
Regenerative cell technology	$ (2,821,000)	$ (1,854,000)	$ (5,359,000)	$ (3,346,000)
MacroPore Biosurgery	(372,000)	(285,000)	(454,000)	(1,036,000)
General and administrative expenses	(2,098,000)	(1,611,000)	(4,007,000)	(2,872,000)
Changes in fair value of option liability	(60,000)	—	(60,000)	—
Restructuring charge	—	(70,000)	—	(70,000)
Total operating loss	$ (5,351,000)	$ (3,820,000)	$ (9,880,000)	$ (7,324,000)

	As of June 30, 2005	As of December 31, 2004
Assets:		
Regenerative cell technology	$ 7,519,000	$ 7,795,000
MacroPore Biosurgery	3,149,000	3,457,000
Corporate assets	15,745,000	14,218,000
Total assets	$ 26,413,000	$ 25,470,000

4. Stock Based Compensation

The Company applies the intrinsic value-based method of accounting as prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations including Financial Accounting Standards Board ("FASB") Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation-An Interpretation of APB Opinion No. 25" to account for its employee stock option plans. Under the intrinsic value method, compensation expense is recognized only if the current market price of the underlying stock exceeds the exercise price as of the measurement date (typically the date of grant). Any resulting expense is recorded on a straight-line basis over the applicable vesting period. Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As permitted by SFAS No. 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above, and has adopted the disclosure requirements of SFAS No. 123, as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure."

The pro forma effects of stock-based compensation on net income (loss) and net income (loss) per common share have been estimated using a grant date fair value model (Black-Scholes option-pricing model).

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no restrictions and are fully transferable and negotiable in a free trading market. Black-Scholes does not consider the employment, transfer or vesting restrictions that are inherent in the Company's employee options. Use of an option valuation model, as required by SFAS No. 123, includes subjective assumptions based on long-term predictions, including the expected stock price volatility and average life of each option grant. Because the Company's employee stock options have characteristics different from those of freely traded options, and because the assumptions underlying the Black-Scholes model involve substantial judgment, the Company's estimate of the fair value of its awarded stock options may differ from the ultimate value realized by the recipient employee.

The Company estimated that the weighted average estimated fair values of stock options granted for the three and six months ended June 30, 2005 were $2.18 and $2.27 per share, respectively, on the date of grant. The weighted average estimated fair values of stock options granted during the three and six months ended June 30, 2004 were $3.27 and $3.27 per share, respectively, on the date of grant. Fair value under SFAS No. 123 is determined using the Black-Scholes option-pricing model with the following assumptions:

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
Expected term	6 years	7 years	6 years	7 years
Interest rate	3.99%	3.89-4.35%	3.97%	3.31-4.35%
Volatility	82.7%	87.0%	81.5%	87.0-89.3%
Dividends	—	—	—	—

Had compensation expense been recognized for stock-based compensation plans in accordance with SFAS No. 123, the Company would have recorded the following net loss and net loss per share amounts:

	For the three months ended June 30,	For the six months endedJune 30,

	2005	2004	2005	2004
Net loss:				
As reported	$ (5,359,000)	$ (3,810,000)	$ (9,886,000)	$ (2,320,000)
Add: Employee stock based compensation expense included in reported net loss, net of related tax effects	—	48,000	—	96,000
Deduct: Total employee stock based compensation expense determined under Black-Scholes method for all awards, net of related tax effects	(689,000)	(629,000)	(1,417,000)	(1,227,000)
Pro forma	$ (6,048,000)	$ (4,391,000)	$ (11,303,000)	$ (3,451,000)
Basic loss per common share:				
As reported	$ (0.37)	$ (0.27)	$ (0.70)	$ (0.17)
Pro forma	$ (0.42)	$ (0.32)	$ (0.80)	$ (0.25)

The pro forma compensation expense may not be representative of such expense in future years.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), “Share-based Payment” (“FAS 123R”). As amended by Securities and Exchange Commission Release No. 33-8568, “Amendment to Rule 4-01(a) of Regulation S-X Regarding the Compliance Date for Statement of Financial Accounting Standards No. 123 (Revised 2004), Share-Based Payment”, FAS 123R is effective for annual periods beginning after June 15, 2005 (January 1, 2006 for the Company).

FAS 123R will require all share-based payment transactions, including those with employees, to be measured at fair value. Moreover, the fair value of share-based payment awards (including employee stock option grants) will be recognized as expense in the statements of operations over the requisite service period of each award. FAS 123R also changes the manner in which deferred taxes are recognized on share-based payment awards, as well as the accounting for award modifications.

The adoption of FAS 123R will have a material effect on the Company’s results of operations. Based on pro forma amounts for historical periods presented earlier in this note, the Company’s reported net loss will increase (or its net income would be reduced) each quarterly period once FAS 123R has been adopted.

5. Short-term Investments

The Company invests excess cash in highly liquid debt instruments of financial institutions and corporations with strong credit ratings and in United States government obligations. The Company has established guidelines relative to diversification and maturities that maintain safety and liquidity. These guidelines are periodically reviewed and modified to take advantage of trends in yields and interest rates.

The Company has evaluated its investments in accordance with the provisions of SFAS No. 115, “Accounting for Certain Investments in Debt and Equity Securities.” Based on such evaluation, the Company’s management has determined that all of its investment securities are properly classified as available-for-sale. Based on the Company’s intent, its investment policies and its ability to liquidate debt securities, the Company classifies such short-term investment securities within current assets. Available-for-sale securities are carried at fair value, with unrealized gains and losses reported as a separate component of Stockholders’ Equity as accumulated other comprehensive income (loss). The amortized cost basis of debt securities is periodically adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included as a component of interest income or interest expense. The amortized cost basis of securities sold is based on the specific identification method and all realized gains and losses are recorded as a component within other income (expense).

The Company reviews the carrying values of its investments and writes down such investments to estimated fair value by a charge to the statements of operations when the severity and duration of a decline in the value of an investment is considered to be other than temporary. The cost of securities sold or purchased is recorded on the settlement date.

At June 30, 2005, the excess of historical cost over the fair value of the Company’s short-term investments is immaterial.

6. Inventories

Inventories include the cost of material, labor and overhead, and are stated at the lower of average cost, determined on the first-in,

first-out (FIFO) method, or market. The Company periodically evaluates its on-hand stock and makes appropriate provisions for any stock deemed as excess or obsolete.

During the first quarter of 2004, the Company recorded a provision of approximately $242,000 for excess inventory. Such excess inventory was produced in consideration of the Company’s responsibility to be a back-up supplier for the craniomaxillofacial (“CMF”) product line. The Company sold the assets related to this product line to an affiliate of Medtronic on September 30, 2002. In April of 2004, Medtronic indicated that it would no longer purchase CMF inventory from the Company under the back-up supply arrangement, leading to the determination that the remaining CMF inventory on hand would not be recoverable.

7. Long-Lived Assets

In accordance with SFAS No. 144, “Accounting for Impairment or Disposal of Long-Lived Assets,” the Company assesses certain of its long-lived assets, such as property and equipment and intangible assets other than goodwill, for potential impairment when there is a change in circumstances that indicates carrying values of assets may not be recoverable. Such long-lived assets are deemed to be impaired when the undiscounted future cash flows expected to be generated by the asset (or asset group) are less than the asset’s carrying amount. Any required impairment loss would be measured as the amount by which the asset’s carrying value exceeds its fair value, and would be recorded as a reduction in the carrying value of the related asset and a

charge to operating expense. During the six months ended June 30, 2005 and 2004, the Company had no impairment losses associated with its long-lived assets.

8. Revenue Recognition

Product Sales

The Company sells its MacroPore Biosurgery products to distributors and, prior to the sale of its Thin Film product line in May 2004 (see note 16), also sold products directly to hospitals. The Company has agreements with its distributors wherein title and risk of loss pass upon shipment of the products to the distributor. Revenue is recognized upon shipment of products to distributors following receipt and acceptance of a distributor's purchase order. Before the sale of the Thin Film product line in May 2004, revenue from sales to hospitals was recognized upon delivery of the product.

On occasion, the Company offers extended payment terms to customers. The Company does not recognize revenues under these arrangements until the payment becomes due or is received, if that occurs earlier. Moreover, the Company warrants that its products are free from manufacturing defects at the time of shipment to its customers. The Company has recorded a reserve for the estimated costs it may incur under its warranty program (see note 9).

The majority of the Company's revenues are from Medtronic, under a Distribution Agreement dated January 5, 2000 and amended December 22, 2000 and October 8, 2002, as well as a Development and Supply Agreement dated January 5, 2000 and amended December 22, 2000 and September 30, 2002. These revenues are classified as sales to related party in the statements of operations.

Any upfront payments received from license/distribution agreements are recognized as revenues ratably over the period in which the customer benefits from the license/distribution agreement. Any recognized amounts are reported as sales to related party or sales to third parties depending upon the counterparty to the transaction.

In September 2002, the Company entered into various agreements with Medtronic and a subsidiary of Medtronic for the sale of the Company's CMF product line. The net proceeds received were recorded as deferred gain on sale of assets, related party. As part of the sale agreement, the Company agreed to act as a back-up supplier to Medtronic until Medtronic could integrate the acquired CMF assets into its manufacturing operations. The back-up supply agreement required that the Company sell CMF products ordered by Medtronic at the Company's manufacturing cost. The Company recognized as revenue in the first quarter of 2004, a portion of the deferred gain upon the sale of CMF products to Medtronic under the Company's back-up supply arrangement. The amount of the deferred gain recognized is equal to the excess of the fair value of products sold, based on historical selling prices of similar products, over the Company's manufacturing cost. The residual portion of the deferred gain on sale of assets was fully recognized in the third quarter of 2004.

Research

The Company earns revenue for performing tasks under research agreements with both commercial enterprises and governmental agencies like the National Institutes of Health ("NIH"). Milestone payments are considered to be payments received for the accomplishment of a discrete, substantive earnings event. The non-refundable payment arising from the achievement of a defined milestone is recognized as revenue when the following performance criteria for that milestone have been met:

- Substantive effort was required to achieve the milestone,
- The amount of the milestone payments appears reasonably commensurate with the effort expended, and
- Collection (or retention) of the payment is reasonably assured.

When the Company is reimbursed for costs incurred under grant arrangements with the NIH, the Company recognizes revenues for the lesser of:

- Qualifying costs incurred (and not previously recognized), plus any allowable grant fees for which the Company is entitled to funding from the NIH; or,
- The outputs generated to date versus the total outputs expected to be achieved under the research arrangement.

Revenue earned under development agreements is classified as research grant or development revenues in the Company's statements of operations, depending on the nature of the arrangement. The costs associated with development agreements are recorded as research and development expense.

In the three months and six months ended June 30, 2005, the Company recognized NIH grant revenue of $62,000 and $85,000, respectively, and incurred qualifying costs of $61,000 and $83,000. In the three months and six months ended June 30, 2004, the Company recognized NIH grant revenue of $10,000 and $100,000 and incurred costs of $54,000 and $153,000. In the first quarter of 2005, the Company recognized development revenue of $9,000 and incurred costs of $10,000. There were no comparable development revenues or costs in 2004.

9. Warranty

The Company provides a limited warranty under its agreements with its customers for products that fail to comply with product specifications. The Company has recorded a reserve for estimated costs it may incur under its warranty program.

The following summarizes the Company's warranty reserve at June 30, 2005 and 2004:

	As of January 1,	Additions-charges to expenses	Claims	As of June 30,
2005:				
Warranty reserve	$ 102,000	$ 23,000	$ —	$ 125,000
2004:				
Warranty reserve	$ 267,000	$ 36,000	$ (251,000)	$ 52,000

In August 2003, as part of its ongoing product monitoring process, the Company determined that some of the products sold to Medtronic did not meet certain expectations, based on criteria previously communicated by the Company to Medtronic. The Company agreed to a "no charge" replacement of the affected inventory in the possession of Medtronic. In the six months ended June 30, 2004, the Company incurred claims of $251,000 related to the replacement of this product. In the six months ended June 30, 2005, the Company incurred no claims related to the replacement of this product.

10. Income Taxes

In all periods presented in these condensed consolidated financial statements, there was no provision or benefit for income taxes recorded due to the Company's accumulated net loss position and the recognition of a full valuation allowance against deferred tax assets. There were also no components of current or deferred federal or state income tax provisions recorded for the periods presented.

11. Earnings (Loss) Per Share

The Company computes income (loss) per share based on the provision of SFAS No. 128, "Earnings Per Share." Basic per share data is computed by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted per share data is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period increased to include, if dilutive, the number of additional common share equivalents that would have been outstanding if potential common shares had been issued using the treasury stock method. Potential common shares were related entirely to outstanding but unexercised option awards and warrants for all periods presented.

The Company has excluded all potentially dilutive securities from the calculation of diluted loss per share attributable to common stockholders for the three and six months ended June 30, 2005 and 2004 as their inclusion would be antidilutive. Potentially dilutive common shares excluded from the calculations of diluted loss per share were 1,534,393 and 1,533,893 for the three and six months ended June 30, 2005, respectively, and 2,420,623 and 2,356,623 for the three and six months ended June 30, 2004, respectively.

Additionally, potential common shares excluded from per share calculations due to exercise prices that exceeded average market values were 6,161,928 and 6,162,428 for the three and six months ended June 30, 2005, respectively, and 2,779,306 and 2,843,306 for the three and six months ended June 30, 2004, respectively. Potential common shares in 2005 include 2,200,000 shares related to the Olympus equity agreement (see note 19).

12. Commitments

The Company has contractual obligations on leases of office and manufacturing space as follows:

Years Ending December 31,	Operating Leases
For the remainder of 2005	$ 687,000
2006	1,918,000
2007	1,924,000
2008	1,556,000
2009	1,383,000
2010	707,000
Total	$ 8,175,000

Rent expense for the six months ended June 30, 2005 and 2004 was $504,000 and $412,000, respectively.

On May 24, 2005, the Company entered into a new lease for 91,000 square feet located at 3020 and 3030 Callan Road, San Diego, California. The Company intends to move the majority of its operations to this new facility over the next year. The agreement bears rent at a rate of $1.15 per square foot, with annual increases of 3%. The lease term is 57 months, commencing on October 1, 2005 and expiring on June 30, 2010. In addition, the Company is committed to providing a minimum of $837,000 in improvements to the facility. These improvements are reflected in the table of contractual obligations shown above.

13. Long-term Debt

As of June 30, 2005 the future contractual principal payments, for the remainder of 2005 and subsequent years, on all of the Company's promissory notes are as follows:

2005	$ 463,000
2006	614,000
2007	427,000
2008	88,000
Total	$ 1,592,000

14. Composition of Certain Financial Statement Captions

Inventories

	June 30, 2005 (Unaudited)	December 31, 2004

Raw materials	$ 200,000	$ 189,000
Finished goods	332,000	190,000
	$ 532,000	$ 379,000

Other Current Assets

	June 30, 2005 (Unaudited)	December 31, 2004
Prepaid expenses	$ 670,000	$ 809,000
Accrued interest receivable	105,000	121,000
Other receivables	126,000	54,000
	$ 901,000	$ 984,000

Property and Equipment, net

	June 30, 2005 (Unaudited)	December 31, 2004
Manufacturing and development equipment	$ 4,323,000	$ 3,928,000
Office and computer equipment	2,327,000	2,186,000
Leasehold improvements	1,973,000	1,963,000
	8,623,000	8,077,000
Less accumulated depreciation and amortization	(5,723,000)	(4,997,000)
	$ 2,900,000	$ 3,080,000

Intangibles, net

	June 30, 2005 (Unaudited)	December 31, 2004
Intangibles	$ 2,695,000	$ 2,695,000
Less accumulated amortization	(708,000)	(573,000)
	$ 1,987,000	$ 2,122,000

The amortization expense of intangibles for the three and six months ended June 30, 2005 was $67,000 and $135,000, respectively.

Estimated amortization of intangibles for the balance of 2005 and the years ended:

2005	$ 135,000
2006	270,000
2007	270,000
2008	270,000
2009	270,000
Thereafter	772,000
	$ 1,987,000

Accounts Payable and Accrued Expenses

	June 30, 2005 (Unaudited)	December 31, 2004
Accounts payable	$ 304,000	$ 481,000
Accrued bonus	401,000	472,000
Accrued vacation	632,000	579,000
Accrued expenses	687,000	560,000
Accrued professional fees	340,000	135,000
Warranty reserve (note 9)	125,000	102,000
	$ 2,489,000	$ 2,329,000

15. Gain on Sale of Assets, Related Party

In January 2004, the Company received a $5,000,000 milestone payment from Medtronic relating to the 2002 disposition of the Company's CMF product line. As part of the disposition arrangement, the Company had agreed to complete clinical research regarding Faster Resorbable Polymers, an area that directly relates to the CMF product line transferred to Medtronic. The Company became entitled to the $5,000,000 payment after fulfilling the research requirements set out in the CMF sale agreement. The $5,000,000 payment was recognized during the first half of 2004 as gain on sale of assets, related party in the accompanying statement of operations.

16. Sale of Thin Film Product Line

In May 2004, the Company sold most, but not all, of its intellectual property rights and tangible assets related to its Thin Film product line to MAST Biosurgery AG, a Swiss corporation ("MAST") and a subsidiary of MAST. Specifically, the Company retained the rights to develop and market Thin Film products in Japan (see Note 17).

In addition to transferring certain assets to MAST, the Company agreed to perform the following under the sale agreement:

- For a period of up to one year after the closing date, provide up to 300 hours of training to MAST representatives in all aspects of the manufacturing process related to the transferred Thin Film product line,
- For a period of up to one year after the closing date, act as a back-up supplier to MAST, and provide, in almost all cases, such product at the Company's manufacturing cost, and
- For a period of up to one year after the closing date, supply or cause its suppliers to provide MAST with specified raw material at the Company's cost.

Because of these additional performance requirements, the Company did not initially recognize any gain on sale of the Thin Film assets in the accompanying statement of operations. Instead, the Company initially recorded – and continues to report – the net proceeds as deferred gain on sale of assets in the accompanying balance sheets.

The deferred gain on sale of assets will be recognized as gain on sale of assets when the Company completes all remaining performance obligations under the Thin Film sale agreement. As discussed in Note 18, in August 2005, the Company and MAST settled arbitration proceedings related to the sale agreement. Accordingly, the Company will recognize the gain on sale of assets of $5,650,000, less $124,000 of related deferred costs, in the statement of operations in the third quarter of 2005.

The sale agreement granted MAST a "Purchase Right" to acquire our Thin Film-related interests and rights for Japan at the following terms:

- From May 31, 2005 to May 31, 2007, the exercise price of the Purchase Right will be equal to the fair market value of the Japanese business, but in no event will be less than $3,000,000.
- Moreover, between June 1, 2005 and May 31, 2007, MAST will have a right of first refusal to match the terms of any outside offer to buy our Japanese Thin Film business.

If MAST exercises the Purchase Right, MAST may become obligated to reimburse the Company for certain costs the Company has incurred or will incur related to product development and protection of intellectual property rights in Japan.

17. Thin Film Japan Distribution Agreement

In the third quarter of 2004, the Company entered into a Distribution Agreement with Senko Medical Trading Co. ("Senko"). Under this agreement, the Company granted to Senko an exclusive license to sell and distribute certain Thin Film products in Japan.

At the inception of this arrangement, the Company received a $1,500,000 license fee that was recorded as deferred license fee revenue in the accompanying balance sheet. No portion of this license fee has been recognized in the statements of operations during any periods covered by these financial statements. The Company will recognize the deferred license fee as revenue systematically over the term of the Distribution Agreement once "commercialization" has been achieved. In simplest terms, commercialization occurs when one or more Thin Film product registrations are completed with the Japanese Ministry of Health, Labour and Welfare ("MHLW"). The Distribution Agreement contains certain provisions that could require the Company to return a portion of the upfront license fee. For instance, if it is determined in good faith by the Company and Senko that commercialization of the Thin Film product is unobtainable, then 50% of the $1,500,000 license fee will be returned to Senko. Also, if the Company terminates the Distribution Agreement at any time within the initial three years post-commercialization, for any reason except for material breach by Senko, then a pro-rata share of the license fee will be returned to Senko. In no event will the Company recognize deferred license fee in the income statement if this would cause the remaining deferred income balance to fall below the amount that the Company potentially would have to refund to Senko.

The Company has earned or will be entitled to earn additional payments under the Distribution Agreement based on achieving the following defined milestones:

- Upon the Company notifying Senko of completion of the initial regulatory application to the MHLW for the Thin Film product, the Company is entitled to a nonrefundable payment of $1,250,000. The Company notified Senko of the completion of the regulatory application in September 2004, received payment in October 2004, and recorded deferred development revenue of $1,250,000. Of the amount deferred, the Company has recognized cumulative development revenues of $167,000, representing the fair value of the completed milestones relative to the fair value of the total efforts expected to be necessary to achieve regulatory approval by the MHLW.
- Upon the achievement of commercialization, the Company is entitled to a nonrefundable payment of $250,000.

As discussed in Note 16 above, the Company has granted MAST a right to acquire the Company's Thin Film-related interest in Japan.

The Company has agreed to provide back-up supply of products to Senko subject to the terms of the Distribution Agreement in the event that (a) MAST exercises its Purchase Right (see Note 16) and (b) MAST materially fails to deliver product to Senko. In this circumstance, Senko would pay any amounts due for purchases of product, as well as payments in the nature of royalties, directly to the Company. The Company would be obliged to remit 5% of the gross margin to MAST on any products sold to Senko. The Company believes that it is unlikely in practice that this contingency will materialize. Accordingly, the Company estimates the fair value of this guarantee to be de minimis as of the end of the current reporting period.

18. Aribitration and Subsequent Event Related to the Sale of Thin Film Product Line

Under the agreement to sell most, but not all, of its Thin Film product line to MAST, the Company was contractually entitled to the following additional consideration (none of this consideration has heretofore been recognized in the financial statements):

- $200,000, payable only upon receipt of 510(k) clearance from the U.S. Food and Drug Administration ("FDA") for a hernia wrap product (thin film combined product); and
- $2,000,000 on or before the earlier of (i) May 31, 2005, known as the "Settlement Date," or (ii) 15 days after the date upon which MAST has hired a Chief Executive Officer ("CEO"), provided the CEO held that position for at least four months and met other requirements specified in the sale agreement. Note that clause (ii) effectively means that the Company would not have received payment of $2,000,000 before May 31, 2005 unless MAST had hired a CEO on or before January 31, 2005 (four months prior to the Settlement Date). Moreover, in the event that MAST had not hired a CEO on or before January 31, 2005, MAST may have (at its sole option and subject to the requirements of the sale agreement) alternatively provided the Company with a 19% equity interest in the MAST business that is managing the Thin Film assets at May 31, 2005 in lieu of making the $2,000,000 payment. The Company's contention was that MAST did in fact hire a CEO on or before January 31, 2005 and, thus, the Company was entitled to a $2,000,000 cash payment on or before May 31, 2005.

MAST has not made the payments specified above. On June 14, 2005, the Company initiated arbitration proceedings against MAST, asserting that MAST was in breach of the Asset Purchase Agreement by failing to pay the final $2,000,000 in purchase price (among other issues). MAST responded asserting its own claims on or about June 23, 2005. In August 2005, the parties settled the arbitration proceedings and gave mutual releases of all claims, excepting those related to the territory of Japan, and agreed to contractual compromises, the most significant of which is the Company's waiving of the obligation for MAST to either pay the final cash purchase installment of $2,000,000 or to deliver 19% of its shares. Moreover, if MAST exercises its Purchase Right (see Note 16) and Thin Film products are marketed in Japan, MAST would no longer be obliged to share certain gross profits and royalties with the Company.

In exchange, MAST agreed to supply - at no cost to the Company - all required product for any necessary clinical study for the territory of Japan and would cooperate in the planning of such study. However, if MAST exercises its Purchase Right or if the Company and MAST enter into a supply agreement for the territory of Japan, the Company would be obliged to reimburse MAST for any Thin Film product supplied in connection with the Japanese study at a cost of $50 per sheet.

As noted above, the settlement agreement does not cover claims associated with the territory of Japan. It is possible that either or both parties could re-assert such claims.

19. Olympus Equity Investment and Potential Strategic Alliance

In the second quarter of 2005, Olympus Corporation ("Olympus") and the Company entered into a definitive Common Stock Purchase Agreement in which Cytori received $11,000,000 in cash proceeds. Olympus has also been offered a seat on the Company's Board of Directors, but has not yet exercised this right. The Company and Olympus are also seeking to enter into a strategic business alliance relating to the Company's regenerative cell technology. Olympus and the Company are now engaged in good-faith negotiations under a Collaboration Agreement toward establishing such an alliance, and are sharing technical information. As of the end of the second quarter, however, the strategic business alliance had yet to be formalized.

Under the Common Stock Purchase Agreement, the Company distributed 1,100,000 newly issued shares of common stock to Olympus. The Company reflected the common stock issued to Olympus at the market value of the Company's common stock at the time of the Purchase Agreement ($2.73 per share, or $3,003,000 in the aggregate). As of June 30, 2005, Olympus held approximately 7.3% of the Company's issued and outstanding shares.

The Company also granted Olympus an immediately exercisable option to acquire 2,200,000 shares of Cytori stock on or before December 31, 2006. The exercise price of the option shares is $10 per share. The Company has accounted for this grant as a liability in accordance with Emerging Issues Task Force Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock". The 2,200,000 option shares have been classified as a liability because from the date of grant through the expiration, the Company is required to deliver listed common stock to settle the option shares upon exercise. Accordingly, the fair value of the 2,200,000 option shares have been (and will continue to be) re-measured at the end of each reporting period, under the Black-Scholes option pricing-model, with movements in fair value

reported in the statements of operations as change in fair value of option liability. At the time the Company entered into the Purchase Agreement, the contractual term, interest rate and volatility assumptions under the Black-Scholes option pricing model were 1.67 years, 3.46% and 59.7%, respectively.

The $11,000,000 in total proceeds received by the Company exceeded the sum of the fair value of the option shares granted as well as the market price of the Company's stock at the time the Olympus share purchase was agreed upon. The difference between the proceeds received and the fair values of the Company's common stock and option liability has been recorded as deferred other on the accompanying balance sheet. This deferred other will be characterized in the future as events and circumstances dictate.

20. Subsequent Event

In August 2005, the Company's Chief Operating Officer ("COO"), ceased employment with the Company. The Company has agreed to pay the former COO a lump sum cash severance payment of $155,164 and has extended the exercise period for two years on 253,743 vested stock options, which are preliminarily valued at approximately $337,000. The Company will record an expense in the third quarter of 2005 to reflect the lump sum cash severance payment and the value of the vested stock options.

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report contains certain statements that may be deemed "forward-looking statements" within the meaning of United States securities laws. All statements, other than statements of historical fact, that address activities, events or developments that we intend, expect, project, believe or anticipate will or may occur in the future are forward-looking statements. Such statements are based upon certain assumptions and assessments made by our management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. The forward-looking statements included in this report are also subject to a number of material risks and uncertainties, including but not limited to the risks described under the "Risk Factors" section in this Management's Discussion and Analysis of Financial Conditions and Results of Operations.

We encourage you to read those descriptions carefully. We caution you not to place undue reliance on the forward-looking statements contained in this report. These statements, like all statements in this report, speak only as of the date of this report (unless an earlier date is indicated) and we undertake no obligation to update or revise the statements except as required by law. Such forward-looking statements are not guarantees of future performance and actual results will likely differ, perhaps materially, from those suggested by such forward-looking statements.

Overview

Our regenerative cell technology division is discovering and developing proprietary cell-based therapeutics utilizing adult stem cells derived from a patient's own adipose tissue, also known as fat tissue. Our investigational therapies target cardiovascular disease, spine and orthopedic conditions, gastrointestinal disorders and new approaches for aesthetic and reconstructive surgery. To facilitate processing and delivery of adipose stem cells, we are developing our proprietary Celution™ system to isolate and concentrate a patient's own stem cells in about one hour. This system will dramatically improve the speed in which personalized cell-based therapies can be delivered to patients.

We are developing therapeutic stem cells for myocardial infarction and other cardiovascular-related diseases. We are pursuing strategic alliances with biotechnology, medical device, and pharmaceutical companies to accelerate and broaden therapeutic development and commercialization for indications outside of cardiovascular disease. The commercialization of these proprietary treatments will be based on the sale of a point-of-care system and related one-time use consumables.

Our MacroPore Biosurgery division develops and manufactures innovative bioresorbable surgical implants. Specifically, the MacroPore Biosurgery division manufactures the HYDROSORB™ family of FDA-cleared bioresorbable spine and orthopedic implants, which are distributed worldwide exclusively through Medtronic, Inc. ("Medtronic"). Additionally, the MacroPore Biosurgery division is developing Thin Film bioresorbable implants exclusively for Senko Medical Trading Co. ("Senko"), which has distribution rights exclusively for Japan.

For the next several years we plan to fund the research and development of our regenerative cell technology through:

- Existing cash reserves;
- Potential future financings and/or grants;
- Profits and cash flows, if any, from the MacroPore Biosurgery division; and
- Payments, if any, related to potential regenerative cell technology partnerships.

During this time, we expect to:

- Complete the engineering and design of our point-of-care regenerative cell technology system and seek relevant regulatory clearances;
- Continue preclinical development of regenerative cell therapies for multiple therapeutic applications;
- Expand our intellectual property position related to our regenerative cell technology;
- Advance regenerative cell therapies into clinical development;
- Form at least one strategic partnership.

Recent Developments

During the second quarter of 2005, we received $11,000,000 by selling 1,100,000 shares of common stock to Olympus Corporation ("Olympus") at $10.00 per share. As part of the agreement, Olympus has been granted an option that expires December 31, 2006 to purchase an additional 2,200,000 shares of common stock at $10.00 per share. Olympus has also been offered a seat on our Board of Directors, but has not yet exercised this right. We are also seeking to enter into a strategic business alliance with Olympus relating to our regenerative cell technology. Both companies are now engaged in good-faith negotiations toward

establishing such an alliance, and are sharing technical information on a preliminary basis.

Cytori Therapeutics, Inc., formerly known as MacroPore Biosurgery, Inc., strategically reorganized the company on July 11, 2005 due to its shift in focus and progress in the development of cell-based treatments. This reorganization includes a new corporate name and the creation of a separate division for its surgical implants business. This division will now operate under the name MacroPore Biosurgery and will continue to manufacture the HYDROSORB™ family of FDA-cleared bioresorbable implants as well as continue the development of the Thin Film bioresorbable implants for Senko in Japan. The MacroPore Biosurgery division will report financial information as an operating segment of Cytori Therapeutics, Inc.

Our total revenues for the second quarter of 2005 were $1,541,000 compared to $1,540,000 for the same period in 2004. Of the total revenue for the second quarter of 2005, $1,477,000 was attributable to HYDROSORB™ spine and orthopedic implant sales, compared to $886,000 for the same period in 2004. Total revenues for the first half of 2005 were $3,330,000 compared to $3,892,000 for the first half of 2004. Of the total revenue in the first half, $3,232,000 was attributable to HYDROSORB™ revenues, compared to $2,533,000 for the same period in 2004.

The decline in overall revenues in the first half of 2005 is attributable to the absence of Craniomaxillofacial ("CMF") and Thin Film sales. We divested the CMF product line to Medtronic in 2002, and our back-up supply obligations to Medtronic ended in 2004. We sold substantially all of the Thin Film business to MAST Biosurgery AG ("MAST") in 2004. The increase in HYDROSORB™ revenues for the second quarter and first half is due predominantly

to stocking orders for the radiographically identifiable Spine System products, marketed under the name MYSTIQUE™, which Medtronic is launching in the third quarter of 2005.

Net loss for the second quarter of 2005 was $5,359,000 compared to a net loss of $3,810,000 for the same period in 2004. Net loss for the first half of 2005 was $9,886,000 compared to a net loss of $2,320,000, for the same period in 2004. Note that the first half of 2004 included a $5,000,000 gain related to the sale of the CMF product line to Medtronic. Net loss before the gain was $7,320,000 as shown in the table below[1].

	For the six months ended June 30,	
	2005	2004
Net loss GAAP	$ (9,886,000)	$ (2,320,000)
Less: Gain on sale of asset, related party	—	(5,000,000)
Adjusted net loss	$ (9,886,000)	$ (7,320,000)

(1) We believe adjusted net loss is a useful measure by which investors can evaluate our operating performance on a comparable basis, unaffected by the large payment we received in the first half of 2004.

The increase in net loss during the second quarter and first half of 2005, respectively, compared to the net loss and adjusted net loss for the second quarter and first half of 2004, respectively, is due in part to expenses related to research and development of cell-based therapeutics.

We ended the second quarter of 2005 with $14,822,000 in cash, cash equivalents and short-term investments and $491,000 in accounts receivable.

For 2005, MacroPore Biosurgery continues to expect bioresorbable technology-related revenues of $6,000,000 to $9,000,000 and research and development expenses of $11,000,000 to $13,000,000.

Disposition of Product Lines

Sale of CMF Product Line

In September 2002, we entered into an Asset Purchase Agreement (the “Agreement”) to sell assets related to our CMF implant and accessory product line to Medtronic for what resulted in total net consideration of $15,500,000. In accordance with the terms of the Agreement, we received an initial payment of $13,000,000 from Medtronic and a first milestone payment of $1,000,000 in the fourth quarter of 2002. A final milestone payment of $1,500,000 was received in 2004.

The Agreement requires us not to market in the craniomaxillofacial field, for five years, any products that compete with the acquired product line. Additionally, during the technology transfer transition period, we agreed to be a back-up supplier of CMF products to Medtronic at a price equal to our cost of manufacture.

The Agreement also allowed us to receive up to $5,000,000 if and when we completed successful clinical evaluations for a new

faster-resorbing polymer product, as defined in the Agreement. In January 2004, after we completed the successful clinical evaluations, we received a $5,000,000 milestone payment from Medtronic and it was recognized as gain on sale of assets, related party, in the accompanying statements of operations.

In a separate, but simultaneous, 2002 transaction, we paid Medtronic $4,000,000 in cash to amend an existing Development and Supply Agreement (the “Amended Development Agreement”, and collectively with the Asset Purchase Agreement, the “Agreements”) to remove a preexisting contractual right of first offer for distributorship by Medtronic of our bioresorbable thin film products for use in various types of soft tissue surgical applications. Medtronic will retain its right of first offer for distributorship of our other bioresorbable products in all fields, as well as to our bioresorbable thin film products for use in the spinal application field. In addition, the term of the Amended Development Agreement with Medtronic was extended to September 30, 2012.

We accounted for the net proceeds of the Agreements as deferred gain on sale of assets, related party. This gain was to be recognized only as certain events occurred. For instance, we recognized a portion of the deferred gain upon the sale of the CMF products to Medtronic under our back-up supply arrangement, which provided for sales of the CMF products to Medtronic at cost. The amount of the deferred gain recognized is equal to the excess of the fair value of products sold, based on historical selling prices of similar products, over our manufacturing cost. The remainder of the deferred gain was recognized in the third quarter of 2004 when the technology and know-how transfer was completed pursuant to the contract terms.

Sale of Thin Film Product Line

In May 2004, we sold most, but not all, of our intellectual property rights and tangible assets related to our Thin Film product line to MAST and one of its subsidiaries for $7,000,000 in cash.

As part of the Thin Film disposition agreement, and for a period of up to one year, we were required to provide training to MAST representatives in all aspects of the manufacturing process related to the transferred Thin Film product line, and to act in the capacity of a back-up supplier to MAST. Under the back-up supply agreement, we agreed in nearly all cases to supply product ordered by MAST at our manufacturing cost.

Because of these and other additional performance requirements, we did not initially recognize any gain on sale of the Thin Film assets in our statement of operations. Instead, we initially recorded approximately $6,450,000 as deferred gain on sale in the balance sheet. The amount recorded as deferred gain on sale does not include the potential contingent consideration described above, which would only be added to the deferred gain on sale when the contingencies are resolved.

In 2004 we recognized $772,000 of the deferred gain as revenues related to the sale of Thin Film products to MAST under the back-up supply agreement at cost. The recognition of the deferred gain was necessary in 2004 in order to state revenues at fair value of products sold, based on historical selling prices

of similar products, over the Company's manufacturing cost. No deferred gain has been recognized as revenue in 2005 because there were no shipments of product to MAST and the parties were involved in arbitration proceedings, related in part, to some of our performance requirements in the agreement, for the sale of the Thin Film assets. Moreover, we will not recognize any additional portion of the deferred gain on sale of assets in our income statement until the arbitration proceedings noted below are settled.

Even after consummation of the Thin Film asset disposition, we retained all rights to Thin Film business in Japan (subject to a purchase option of MAST, as described in the next paragraph below), and we received back a license of all rights to Thin Film technologies in the:

- Spinal field, exclusive at least until 2012, and
- Field of regenerative medicine, non-exclusive on a perpetual basis.

The sale agreement granted MAST a "Purchase Right" to acquire our Thin Film-related interests and rights for Japan at the following terms:

- From May 31, 2005 to May 31, 2007, the exercise price of the Purchase Right will be equal to the fair market value of the Japanese business, but in no event will be less than $3,000,000.
- Moreover, between June 1, 2005 and May 31, 2007, MAST will have a right of first refusal to match the terms of any outside offer to buy our Japanese Thin Film business.

If MAST exercises the Purchase Right, MAST may become obligated to reimburse us for certain costs we have incurred or will incur related to product development and protection of intellectual property rights in Japan.

Under the Thin Film sale agreement, we were potentially entitled to the following additional consideration (beyond the

$7,000,000 cash payment received at closing):

- $200,000, payable only upon receipt of 510(k) clearance from the U.S. Food and Drug Administration ("FDA") for a hernia wrap product (thin film combined product); and
- $2,000,000 on or before the earlier of (i) May 31, 2005, known as the "Settlement Date," or (ii) 15 days after the date upon which MAST has hired a Chief Executive Officer ("CEO"), provided the CEO held that position for at least four months and met other requirements specified in the sale agreement. Note that clause (ii) effectively means that we would not have received payment of $2,000,000 before May 31, 2005 unless MAST had hired a CEO on or before January 31, 2005 (four months prior to the Settlement Date). Moreover, in the event that MAST had not hired a CEO on or before January 31, 2005, MAST may have (at its sole option and subject to the requirements of the sale agreement), alternatively provide us with a 19% equity interest in the MAST business that is managing the Thin Film assets at May 31, 2005 in lieu of making the $2,000,000 cash payment.

Although we have contended that MAST did in fact hire a CEO on or before January 31, 2005, MAST did not remit to us the contingent $2,000,000 payment noted above.

Accordingly, on June 14, 2005, we initiated arbitration proceedings against MAST, asserting that MAST was in breach of the Asset Purchase Agreement by failing to pay the final $2,000,000 in purchase price (among other issues). MAST responded asserting its own claims on or about June 23, 2005. In August 2005, the parties settled the arbitration proceedings and gave mutual releases of all claims, excepting those related to the territory of Japan, and agreed to contractual compromises, the most significant of which is that we have waived the obligation for MAST to either pay the final cash purchase installment of $2,000,000 or to deliver 19% of its shares. Moreover, if MAST exercises its Purchase Right and Thin Film products are ultimately marketed in Japan, MAST would no longer be obliged to share gross profits and royalties with us, as originally contemplated in the MAST agreements.

In exchange, MAST agreed to supply- at no cost to us- all required product for any necessary clinical study for the territory of Japan and would cooperate in the planning of such study. However, if MAST exercises the Purchase Right or we enter into a supply agreement with MAST related to the territory of Japan, we would be obligated to reimburse MAST for any Thin Film product supplied in connection with the Japan study at a cost of $50 per sheet.

As noted above, the settlement agreement does not cover claims associated with the territory of Japan. It is possible that either or both parties could re-assert such claims.

As a result of the settlement agreement described above, we will recognize the deferred gain of sale of assets of $5,650,000, less $124,000 of related deferred costs, in the third quarter of 2005.

Thin Film Japan Distribution Agreement

In the third quarter of 2004, we entered into a Distribution Agreement with Senko. Under this agreement, we granted to Senko an exclusive license to sell and distribute certain Thin Film products in Japan. Specifically, the license covers Thin Film products with the following indications:

- Anti-adhesion,
- Soft tissue support, and
- Minimization of the attachment of soft tissues throughout the body.

The Distribution Agreement with Senko commences upon "commercialization." In simplest terms, commercialization occurs when one or more Thin Film product registrations are completed with the Japanese Ministry of Health, Labour and Welfare ("MHLW").

Following commercialization, the Distribution Agreement has a duration of five years and is renewable for an additional five years after reaching mutually agreed minimum purchase guarantees.

We received a $1,500,000 upfront license fee from Senko. We have recorded the $1,500,000 received as deferred license fee revenue in the accompanying balance sheet. Half of the license fee is refundable if the parties agree commercialization is not achievable and a proportional amount is refundable if we terminate the arrangement, other than for material breach by Senko, before three years post-commercialization.

Accordingly, we will begin to recognize this $1,500,000 license fee as revenues only after commercialization has been achieved. Moreover, we will not recognize all of the revenues at one time – instead, we will reflect the fee in revenues on a systematic basis over the expected period of time we anticipate that Senko will benefit from the arrangement. However, we will not recognize deferred

license fee revenue in the statements of operations if this would cause the remaining deferred license fee revenue balance to fall below the amount that we potentially would have to refund to Senko. As of June 30, 2005, commercialization had not occurred; however, commercialization is expected later in 2005 or early 2006.

We will also be entitled to earn additional payments from Senko based on achieving defined milestones. We will recognize such payments as revenues when the performance criteria for a milestone have been met, presuming that achievement of the milestone involves substantive effort and the fees received are commensurate with the level of effort expended. On September 28, 2004, we notified Senko of completion of the initial regulatory application to the MHLW for the Thin Film product. As a result, we became entitled to a nonrefundable payment of $1,250,000, which we received in October 2004 and recorded as deferred development revenue. Of the amount deferred, we have recognized a total of $167,000 ($9,000 and $158,000 in 2005 and 2004, respectively) as development revenues. The amount recognized as development revenues represents the relative fair value of the completed milestone as compared with the fair value of all milestones expected to be necessary to achieve regulatory approval by the MHLW.

Olympus Equity Investment and Potential Strategic Alliance

In the second quarter of 2005, we entered into the first part of what is expected to be a strategic alliance with Olympus, a global manufacturer of high-end medical devices. Specifically, we sold 1,100,000 newly issued shares of common stock to Olympus. We also granted Olympus an option to acquire 2,200,000 additional shares of our stock on or before December 31, 2006. The exercise price of the option shares is $10 per share.

This agreement generated $11,000,000 in cash proceeds for us, which we will use to continue our development efforts related to our adipose stem cell technology. More importantly, this agreement may serve as a first step to a larger strategic alliance with a company that has a demonstrated expertise in commercializing complex and emerging technologies.

In fact, we are continuing to work with Olympus towards the formation of the strategic alliance between our two companies. We are hopeful that this alliance will be formalized by the end of 2005.

As a result, we have accounted for the common stock purchase agreement as follows:

- We have reflected the common stock we issued to Olympus at the market value of our common stock at the time of the purchase agreement ($2.73 per share, or $3,003,000 in the aggregate).

- We have recognized the fair value of the 2,200,000 option shares granted as an initial liability of $186,000 in accordance with Emerging Issues Task Force Issue No. 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock”, since at the time of grant and thereafter until the end of the second quarter, we were required to have listed common stock to settle these option shares had they been exercised. Under EITF 00-19, the fair value of these option shares has been, and will continue to be, re-measured at the end of each subsequent reporting period, with movements in fair value reported in the statements of operations as change in fair value of option liability.

- The difference between the $11,000,000 proceeds received and the sum of the fair values of the common stock and option shares we issued has been recorded as deferred other. This deferred other will be characterized in the future as events and circumstances dictate.

Results of Operations

Revenues

The following table summarizes the components of our revenues for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30,				For the six months ended June 30,			
	2005	2004	$ Difference	% Difference	2005	2004	$ Difference	% Difference
Regenerative cell technology:								
Research grant (NIH)	$ 62,000	$ 10,000	$ 52,000	520.0%	$ 85,000	$ 100,000	$ (15,000)	(15.0)%
Regenerative cell storage services	2,000	2,000	—	—	4,000	6,000	(2,000)	(33.3)%
Total regenerative cell technology	64,000	12,000	52,000	433.3%	89,000	106,000	(17,000)	(16.0)%
MacroPore Biosurgery:								
Spine and orthopedics products	1,477,000	886,000	591,000	66.7%	3,232,000	2,533,000	699,000	27.6%
Thin Film products:								
Product sales (non-MAST-related)	—	222,000	(222,000)	—	—	559,000	(559,000)	—
Product sales to MAST	—	223,000	(223,000)	—	—	223,000	(223,000)	—
Amortization of gain on sale (MAST)	—	189,000	(189,000)	—	—	189,000	(189,000)	—
	—	634,000	(634,000)	—	—	971,000	(971,000)	—
Craniomaxillofacial (CMF)								

products:								
Product sales	—	3,000	(3,000)	—	—	126,000	(126,000)	—
Amortization of gain on sale	—	5,000	(5,000)	—	—	156,000	(156,000)	—
	—	8,000	(8,000)	—	—	282,000	(282,000)	—
Development (Senko)	—	—	—	—	9,000	—	9,000	—
Total MacroPore Biosurgery	1,477,000	1,528,000	(51,000)	(3.3)%	3,241,000	3,786,000	(545,000)	(14.4)%
Total revenues	$ 1,541,000	$ 1,540,000	$ 1,000	0.1%	$ 3,330,000	$ 3,892,000	$ (562,000)	(14.4)%
% attributable to Medtronic	95.8%	58.1%			97.1%	72.3%		

Regenerative cell technology:

- The research grant revenue relates to our agreement with the National Institutes of Health ("NIH"). Under this arrangement, the NIH reimburses us for "qualifying expenditures" related to research on Adipose-Derived Cell Therapy for Myocardial Infarction. To receive funds under the grant arrangement, we are required to (i) demonstrate that we incurred "qualifying expenses," as defined in the grant agreement between the NIH and us, (ii) maintain a system of controls, whereby we can accurately track and report all expenditures related solely to research on Adipose-Derived Cell Therapy for Myocardial Infarction, and (iii) file appropriate forms and follow appropriate protocols established by the NIH.

  During the three and six months ended June 30, 2005, we incurred $61,000 and $83,000, respectively, in qualifying expenditures. We also earned $1,000 and $2,000 in allowable NIH grant fees, for a total of $62,000 and $85,000, respectively, in reimbursements during these same periods. We have recorded revenues for the same amount. Although we had incurred $54,000 and $153,000 in costs during the three and six months ended June 30, 2004, we recorded revenues of $10,000 and $100,000 for the three and six months ended June 30, 2004, consistent with our policy to recognize revenues under the NIH grant arrangement as the lesser of (i) qualifying costs incurred (and not previously recognized), plus our allowable grant fees for which we are entitled to funding or (ii) the amount determined by comparing the outputs generated to date versus the total outputs expected to be achieved under the research arrangement.

  Although our primary focus is on discovery and development of new therapies for diseases and conditions using regenerative cell technologies, many of our development activities are still in a preclinical (or earlier) stage, and we do not expect to realize recurring revenue streams from these efforts until sometime in the future. Consequently, substantially all of our revenue is currently generated by sales of bioresorbable products, as discussed below. See also "The future" discussion below.

MacroPore Biosurgery:

- Spine and orthopedic revenues represent sales of bioresorbable implants used in spine and orthopedic surgical procedures. These revenues were dominated by stocking orders during the first half of 2005 for the pre-launch of our radiographically identifiable Spine System products, marketed under the name MYSTIQUE™, which received FDA clearance in August of 2004. This product represents the latest design enhancement to our family of HYDROSORB™ products. Its unique feature is the integration of small markers of radiographically visible resorbable material within the product. These patent pending markers enable the surgeon to preserve the benefit of fusion visualization, while simultaneously tracking the exact position of the implant during the intra-operative and post-operative periods. Because the markers are fabricated from a resorbable material, they do not pose the issues that permanent markers could pose after the implant resorbs.

  Surgeon demand for bioresorbable devices as well as the pre-launch of a new product within the HYDROSORB™ products portfolio contributed to spine and orthopedic revenues during the three and six months ended June 30, 2005.

  Refer to "The future" discussion below for our expectations regarding the outlook for spine and orthopedic revenues. Note that Medtronic owns approximately 6.6% of our outstanding common stock at June 30, 2005.

- Thin Film product revenues in 2004 represent sales of SurgiWrap™ bioresorbable Thin Film used to support and reinforce soft tissues and to minimize tissue attachment to the device in case of contact with the viscera (organs of the body). We sold most, but not all, of our intellectual property rights and tangible assets related to our Thin Film product line to MAST in the second quarter of 2004. We were obliged by contract to sell these products to MAST at our manufacturing costs. However, as MAST has assumed the manufacturing process, we believe domestic revenue from Thin Film products substantially ended in 2004. No revenues from the Thin Film product line were recognized during the first half of 2005.

- The CMF product revenues represent sales of the CMF product line used for trauma and reconstructive procedures in the mid-face and craniofacial skeleton (the head and skull). We sold this product line to Medtronic in 2002. As with the Thin Film products, we sold CMF products at cost in 2004 under a contractual back-up supply agreement with Medtronic. A portion of the deferred gain related to sale of assets was recognized in order to reflect the fair value of products sold, based on historical selling prices of similar products, over our manufacturing cost. During the third quarter of 2004, we completed all remaining performance obligations related to the 2002 sale of the CMF product line to Medtronic. Therefore, we did not earn any CMF product revenues during the first half of 2005 and will not have revenue on this product line in the future.

- Under a Distribution Agreement with Senko we are entitled to earn payments based on achieving the following defined milestones:

  - Upon notifying Senko of completion of the initial regulatory application to the MHLW for the Thin Film product, we were entitled to a nonrefundable payment of $1,250,000. We so notified Senko on September 28, 2004, received payment in October of 2004, and recorded deferred development revenue. Of the amount deferred, we have recognized development revenues of $9,000 in the first quarter of 2005, representing the relative fair value of the completed milestones completed during the periods presented as compared with the fair value of all milestones expected to be necessary to achieve regulatory approval by the MHLW;

- Upon the achievement of commercialization of the Thin Film product line in Japan, we are entitled to a nonrefundable payment of $250,000. As of June 30, 2005, commercialization had not occurred; however, commercialization is expected later in 2005 or early 2006.

The future. We are entitled to receive up to $850,000 in grants related to Adipose-Derived Cell Therapy for Myocardial Infarction as defined by the NIH grant agreement for Phase II research. To date, we have received and recognized $313,000 of such funding. We expect to incur additional "qualifying expenses" of $537,000 during the remainder of 2005 and in 2006. Subject to availability of NIH funds and satisfactory progress toward meeting the goals and objectives of our grant application, we expect to recognize any remaining grant revenues during 2005 and 2006.

We sell our spine and orthopedic products exclusively to Medtronic at fixed selling prices that are subject to adjustment biannually (based on Medtronic's selling prices to its customers). Our revenue from this product line is dependent upon the market's adoption of our technology, which is largely dependent upon Medtronic's marketing efforts and pricing strategies. To increase our revenues from spine and orthopedic products, we depend largely on Medtronic's ability and commitment to build and expand HYDROSORB™ market share. We currently anticipate additional stocking orders for the MYSTIQUE™ product of the HYDROSORB™ product line during the remainder of 2005. We have, however, been disappointed in the past by Medtronic's level of effort in marketing our HYDROSORB™ products, and if their level of effort does not improve our sales will suffer.

We will continue to recognize revenue from the milestone payment from Senko, based on the fair value of the milestones completed relative to the total efforts expected to be necessary to obtain regulatory clearance with the MHLW. Obtaining regulatory clearance with the MHLW for initial commercialization is expected in 2005 or early 2006. Accordingly, we expect to recognize approximately $1,333,000 in revenues associated with this milestone arrangement throughout 2005 and the early part of 2006.

To the extent that sales of our spine and orthopedic products to Medtronic (and to Medtronic's customers) increase, we expect the already high percentage of revenues attributable to Medtronic to increase now that domestic Thin Film revenues have ceased, although this may change when commercialization of the Thin Film products in Japan occurs and we begin Thin Film shipments to Senko.

Cost of revenues

Cost of revenues includes material, manufacturing labor, overhead costs and, in 2004, an inventory provision. The following table summarizes the components of our cost of revenues for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30,				For the six months ended June 30,			
	2005	2004	$ and% Difference	% Difference	2005	2004	$ and% Difference	% Difference
MacroPore Biosurgery:								
Cost of revenues	$ 738,000	$ 314,000	$ 424,000	135.0%	$ 1,483,000	$ 1,191,000	$ 292,000	24.5%
% of revenues	47.9%	20.4%	27.5%	134.8%	44.5%	30.6%	13.9%	45.4%
Inventory provision	—	—	—	—	—	242,000	(242,000)	—
% of revenues	—	—	—	—	—	6.2%	(6.2)%	—
Total cost of revenues	$ 738,000	$ 314,000	$ 424,000	135.0%	$ 1,483,000	$ 1,433,000	$ 50,000	3.5%
Cost of revenues as% of revenues	47.9%	20.4%			44.5%	36.8%		

MacroPore Biosurgery:

- As our revenues are currently generated through sales of bioresorbable products, cost of revenues is related only to our bioresorbable segment. Cost of revenues, as a percent of revenues (excluding inventory provision amounts), increased 134.8% and 45.4% in the three and six months ended June 30, 2005, respectively, as compared to the same periods in 2004. The percentage increase in 2005 from 2004 was due to the product mix, sales volume, and the insufficient production of inventory to absorb fixed manufacturing and labor expense. The CMF and Thin Film product lines had higher margins than the HYDROSORB™ products. Since the CMF and Thin Film product lines generated no product revenues in 2005, margins in 2005 were diminished due to the change in product mix.

- Excess manufacturing capacity expensed in the three and six months ended June 30, 2005 was $89,000 and $191,000, respectively, as compared to $93,000 and $199,000 in the same periods in 2004.

- The $242,000 inventory provision during 2004 with no comparable charges in 2005 related to excess inventory. Such inventory was produced in consideration of our responsibility to be a back-up supplier for the CMF product line. We sold the assets related to this product line to a subsidiary of Medtronic in September 2002. In April of 2004, Medtronic indicated that it would no longer purchase CMF inventory from us under the back-up supply arrangement, leading to our determination that the remaining CMF inventory on hand would not be recoverable.

The future. Ceasing to manufacture the CMF product line and the non-Japan bioresorbable Thin Film product line deprives us of economies of scale and will negatively impact our margins until other sources of revenue grow large enough to compensate for the lost revenue.

Research and development expenses

Research and development expenses include costs associated with the design, development, testing and enhancement of our products, regulatory fees, the purchase of laboratory supplies and preclinical studies. It excludes related stock based compensation expenses. The following table summarizes the components of our research and development expenses for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30,				For the six months ended June 30,			
	2005	2004	$ Difference	% Difference	2005	2004	$ Difference	% Difference
Regenerative cell technology:								
Regenerative cell technology	$ 2,762,000	$ 1,795,000	$ 967,000	53.9%	$ 5,302,000	$ 3,259,000	$ 2,043,000	62.7%
Research grants (NIH)	61,000	54,000	7,000	13.0%	83,000	153,000	(70,000)	(45.8)%
Total regenerative cell technology	2,823,000	1,849,000	974,000	52.7%	5,385,000	3,412,000	1,973,000	57.8%
MacroPore Biosurgery:								
Bioresorbable polymer implants	743,000	819,000	(76,000)	(9.3)%	1,417,000	1,763,000	(346,000)	(19.6)%
Development milestone-Senko	30,000	—	30,000	—	67,000	—	67,000	—
Total MacroPore Biosurgery	773,000	819,000	(46,000)	(5.6)%	1,484,000	1,763,000	(279,000)	(15.8)%
Total research and development expenses	$ 3,596,000	$ 2,668,000	$ 928,000	34.8%	$ 6,869,000	$ 5,175,000	$ 1,694,000	32.7%

Regenerative cell technology:

- Regenerative cell technology expenses relate to the development of a technology platform that involves using adipose (fat) tissue as a source for autologous regenerative cells for therapeutic applications. The increases in regenerative cell technology expenses from 2004 to 2005 resulted primarily from the hiring of additional researchers, engineers and support staff. We incurred an additional $578,000 and $854,000 in labor-related expenses in the three and six months ended June 30, 2005, respectively, as compared with 2004. The remainder of the increases as compared with 2004 related to increases in legal, research supplies, consulting fees and facility expenses of $389,000 and $1,189,000 in the three and six months ended June 30, 2005, respectively.

- In 2004, we entered into an agreement with the NIH to reimburse us for up to $950,000 (Phase I $100,000 and Phase II $850,000) in "qualifying expenditures" related to research on Adipose-Derived Cell Therapy for Myocardial Infarction. In the three and six months ended June 30, 2005, we incurred $61,000 and $83,000, respectively, of direct qualifying expenses relating entirely to Phase II. In the three and six months ended June 30, 2004, we incurred $54,000 and $153,000, respectively, of direct qualifying expenses relating to both Phases I and II of the agreement.

MacroPore Biosurgery:

- Our bioresorbable polymer surgical implants platform technology is used for development of spine and orthopedic products. The decrease in research and development costs associated with bioresorbable polymer implants in 2005 as compared with

2004 was a result of a strategic decision to strongly focus our research and development efforts on our regenerative cell technology.

- Under a Distribution Agreement with Senko we are responsible for the completion of the initial regulatory application to the MHLW and commercialization of the Thin Film product line in Japan. Commercialization occurs when one or more Thin Film product registrations are completed with the MHLW. During the three and six months ended June 30, 2005, we incurred $30,000 and $67,000, respectively, of expenses related to this regulatory and registration process. There were no comparable costs in 2004.

The future. We are developing a system to isolate autologous, homologous-use, regenerative cells. Simultaneously, we are generating scientific knowledge through internal research to support the clinical use of these cells and have made significant progress in understanding the potential clinical applications. Our most advanced stem and regenerative cell therapy currently in preclinical testing is for the repair of cardiovascular muscle tissue that is damaged after a heart attack. Our strategy is to continue to increase our research and development efforts in this field and we anticipate expenditures in this area of research to be approximately $11,000,000 to $13,000,000 in 2005. We are also researching therapies for spine and orthopedic conditions, gastrointestinal disorders and new approaches for aesthetic and reconstructive surgery. The expenditures will primarily relate to developing therapeutic applications and conducting preclinical studies on harvesting therapeutically useful quantities of regenerative cells for orthopedic hard and soft tissue regeneration.

We were successful with Phase I of the NIH research on Adipose-Derived Cell Therapy for Myocardial Infarction. Therefore, we were awarded Phase II of the NIH research grant. We expect additional research expenses to be incurred related to Phase II of this project during the remainder of 2005 and 2006.

We expect that our current research and development expenditures in the bioresorbable platform technology will decrease as compared with past levels because of the sale of our CMF and Thin Film (non-Japan territory) product lines and our increased strategic focus on regenerative cell research and development. However, we will continue to invest in product development for biomaterial/polymer products to develop our pipeline of new and next generation spine and orthopedic products.

Sales and marketing expenses

Sales and marketing expenses include costs of marketing personnel, tradeshows, and promotional activities and materials. It excludes related stock based compensation expenses. Medtronic is responsible for the distribution, marketing and sales support of our spine and orthopedic devices. Our bioresorbable Thin Film product line (before the sale of the non-Japan Thin Film business to MAST in May 2004) was distributed domestically through a dedicated sales force, independent sales representatives and internationally through independent distributors. The following table summarizes the components of our sales and marketing expenses for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30,				For the six months ended June 30,			
	2005	2004	$ Difference	% Difference	2005	2004	$ Difference	% Difference
Regenerative cell technology:								
Total regenerative cell technology	$ —	$ —	$ —	—	$ —	$ —	$ —	—
MacroPore Biosurgery:								
General corporate marketing	103,000	188,000	(85,000)	(45.2)%	251,000	381,000	(130,000)	(34.1)%
Domestic sales and marketing	—	286,000	(286,000)	—	—	846,000	(846,000)	—
International sales and marketing	234,000	180,000	54,000	30.0%	477,000	385,000	92,000	(23.9)%
Total MacroPore Biosurgery	337,000	654,000	(317,000)	(48.5)%	728,000	1,612,000	(884,000)	(54.8)%
Total sales and marketing expenses	$ 337,000	$ 654,000	$ (317,000)	(48.5)%	$ 728,000	$ 1,612,000	$ (884,000)	(54.8)%

MacroPore Biosurgery:

- General corporate marketing expenditures relate to expenditures for maintaining our corporate image and reputation within the research and surgical communities. The decrease in 2005 as compared to 2004 was due to one-time costs incurred for an educational program we created in 2004 to inform end-users and distributors of the benefits and surgical applications for our biomaterials products. Additionally, in 2005 we allocated fewer personnel resources to general corporate marketing.

- Domestic sales and marketing relate to expenses associated with managing our domestic bioresorbable Thin Film product distribution, which included independent sales representatives and our domestic Thin Film sales consultants and marketing staff. The elimination of such expenses in 2005 as compared to 2004 was due to the transfer of our sales force and marketing staff to MAST upon the sale of the Thin Film product line to MAST in May 2004.

- International sales and marketing relate to costs associated with developing an international bioresorbable Thin Film

distributor and supporting a bioresorbable Thin Film sales office in Japan. The increased spending in 2005 as compared to 2004 relates to an increase in personnel resources currently dedicated to this marketing group.

The future. We project that general corporate marketing as well as our international sales and marketing expenditures will remain reasonably stable for the balance of 2005. In the future, we also expect to incur sales and marketing expenditures related to the regenerative cell technology as we continue to expand this business segment.

General and administrative expenses

General and administrative expenses include costs for administrative personnel, legal and other professional expenses and general corporate expenses. These costs are not broken out for segment management or reporting purposes. They exclude related stock based compensation expenses. The following table summarizes the general and administrative expenses for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30,				For the six months ended June 30,			
	2005	2004	$ Difference	% Difference	2005	2004	$ Difference	% Difference
General and administrative expenses	$ 2,098,000	$ 1,575,000	$ 523,000	33.2%	$ 4,007,000	$ 2,801,000	$ 1,206,000	43.1%

- $347,000 of the increase for the six months ended June 30, 2005, as compared to the same period in 2004, was the result of salary costs; however, for the three months ended June 30, 2005 as compared to the same period in 2004, the salary costs actually decreased. The remainder of the increases in the three and six months ended June 30, 2005 related to administrative, legal, and professional services expenditures of $552,000 and $859,000, respectively, as compared to the same periods in 2004.

The future. We expect general and administrative expenses to increase as we incur costs for professional services related to Sarbanes-Oxley compliance as well as salary costs related to hiring and retaining a qualified management team to implement our strategic plan. Also, although we are not litigants, and are not responsible for any settlement costs, we are responsible for and expect to incur additional legal expenses in connection with the University of Pittsburgh's recently filed lawsuit challenging inventorship of our licensor's U.S. patent relating to adult stem cells isolated from adipose tissue. We may also incur legal expenses if we cannot resolve our disagreements with MAST associated with the territory of Japan.

Stock based compensation expenses

Stock based compensation expenses include charges related to options issued to employees, directors and non-employees. The stock based compensation expenditures connected to options granted to employees and directors (in their capacity as board members) is the difference between the exercise price of the stock based awards and the deemed market value of the underlying common stock on the date of the grant. The stock based compensation expenditures connected to options granted to non-employees initially is the fair value of the underlying common stock on the initial date of grant, but such amount is updated over the vesting period until the non-employee has met the performance commitment. Stock based compensation expense related to common stock granted to non-employees is the fair value of the stock on the date of grant. Unearned employee stock based compensation is amortized over the remaining vesting periods of the options, which generally vest over a four-year period from the date of grant. The following table summarizes the components of our stock based compensation expenses (excluding cost of revenues), for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30,				For the six months ended June 30,			
	2005	2004	$ Difference	% Difference	2005	2004	$ Difference	% Difference
Regenerative cell technology:								
Research and development related	$ 63,000	$ —	$ 63,000	—	$ 63,000	$ —	$ 63,000	—
MacroPore Biosurgery:								
Research and development related	—	32,000	(32,000)	—	—	32,000	(32,000)	—
Sales and marketing related	—	11,000	(11,000)	—	—	22,000	(22,000)	—
Total MacroPore Biosurgery	—	43,000	(43,000)	—	—	54,000	(54,000)	—
General and administrative related	—	36,000	(36,000)	—	—	71,000	(71,000)	—
Total stock based compensation expenses	$ 63,000	$ 79,000	$ (16,000)	(20.3)%	$ 63,000	$ 125,000	$ (62,000)	(49.6)%

Regenerative cell technology:

- In the second quarter of 2005, we granted 20,000 shares of restricted common stock to a non-employee scientific advisor. Because the shares granted are not subject to additional future vesting or service requirements, the stock based compensation

expense recorded in the second quarter of 2005 constitutes the entire expense related to this grant, and no future period charges will be required. The stock is restricted only in that it cannot be sold for a specified period of time. There are no vesting requirements. This scientific advisor will also be receiving cash consideration as services are performed.

MacroPore Biosurgery:

- All unearned stock based compensation was fully expensed by the end of 2004 (prior to 2004, all such stock based compensation was granted to personnel associated with our bioresorbable implants segment).

The future. We may from time to time grant stock based awards to consultants, in lieu of, or in addition to, cash compensation. In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-based Payment" ("FAS 123R"). As amended by Securities and Exchange Commission Release No. 33-8586,"Amendment to Rule 4-01(a) of Regulation S-X Regarding the Compliance Date for Statement of Financial Accounting Standards No. 123 (Revised 2004), Share-Based Payment," FAS 123R is effective for annual periods beginning after June 15, 2005 (January 1, 2006 for us). Upon adoption, FAS 123R will require us to measure all share-based payment transactions, including those with employees, at fair value. Moreover, the fair value of share-based payment awards will be recognized as expense in the statements of operations over the requisite service period of each award. Employee stock options will, to the extent they vest after December 31, 2005, result in stock-based compensation expense charges beginning in 2006. FAS 123R also changes the manner in which deferred taxes are recognized on share-based payment awards, as well as the accounting for award modifications. Even with our adoption of FAS 123R we plan to continue to grant options (which will result in an expense) to our employees and as appropriate, to non-employee service providers.

Change in fair value of option liability

The following is a table summarizing the change in fair value of option liability for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30,				For the six months ended June 30,			
	2005	2004	$ Difference	% Difference	2005	2004	$ Difference	% Difference
Change in fair value of option liability	$ 60,000	$ —	$ 60,000	—	$ 60,000	$ —	$ 60,000	—

We granted Olympus an option to acquire 2,200,000 shares of our common stock on or before December 31, 2006. The exercise price of the option shares is $10 per share. We have accounted for this grant as a liability because from the date of grant through the expiration we are required to deliver listed common stock to settle the option shares upon exercise. Under EITF 00-19, the fair value of these option shares has been re-measured at the end of the second quarter, under the Black-Scholes option pricing model, with the movement in fair value reported in the statement of operations as a change in fair value of option liability. At June 30, 2005, the contractual term, interest rate and volatility assumptions under the Black-Scholes option pricing model were 1.5 years, 3.55% and 61.1%, respectively.

The future. Until its expiration on December 31, 2006, the fair value of the 2,200,000 option shares will continue to be re-measured at the end of each reporting period, with movements in fair value reported in the statements of operations as changes in the fair value of option liability. Note that if the market price of our common stock increases, the option shares will become more valuable, resulting in an additional charge in our statement of operations.

Restructuring charge

The following table summarizes the restructuring charges for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30,				For the six months ended June 30,			
	2005	2004	$ Difference	% Difference	2005	2004	$ Difference	% Difference
Restructuring charge	$ —	$ 70,000	$ (70,000)	—	$ —	$ 70,000	$ (70,000)	—

- In September 2003, we closed an administrative office in Königstein, Germany an effort to reduce costs and consolidate operation in the United States. The office was rented under a operating lease. The restructuring charge in 2004 was a result of a change in the estimated timeframe for when we would be able to sublease or exit the lease on the Germany office space.

The future. The restructuring charge relating to the Germany office was finalized in 2004.

Other income

The following is a table summarizing the gain on sale of assets, related party for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30,				For the six months ended June 30,			
	2005	2004	$ Difference	% Difference	2005	2004	$ Difference	% Difference
Gain on sale of assets, related party	$ —	$ —	$ —	—	$ —	$ 5,000,000	$ (5,000,000)	—

- The $5,000,000 gain on sale of assets, related party in 2004 related to a $5,000,000 milestone payment from Medtronic relating to the disposition of our CMF product line. Specifically, as part of the disposal arrangement, we agreed to complete clinical research regarding Faster Resorbable Polymer, an area that directly relates to the CMF product line we transferred to Medtronic. We became entitled to the $5,000,000 payment after fulfilling the research requirements set out in the CMF sale agreement. We have no further performance obligations related to this aspect of the CMF sale agreement.

The future. We will recognize the deferred gain on sale of the Thin Film assets of $5,650,000, less $124,000 of related deferred costs, in the third quarter of 2005.

Financing items

The following table summarizes interest income, interest expense, and other expense for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30,				For the six months ended June 30,			
	2005	2004	$ Difference	% Difference	2005	2004	$ Difference	% Difference
Interest income	$ 54,000	$ 57,000	$ (3,000)	(5.3)%	$ 109,000	$ 112,000	$ (3,000)	(2.7)%
Interest expense	(36,000)	(48,000)	12,000	(25.0)%	(76,000)	(87,000)	11,000	(12.6)%

Other income (expense)	(26,000)	1,000	(27,000)	(2,700.0)%	(39,000)	(21,000)	(18,000)	(85.7)%
Total	$ (8,000)	$ 10,000	$ (18,000)	(180.0)%	$ (6,000)	$ 4,000	$ (10,000)	(250.0)%

- Interest income remained consistent from 2004 to 2005, while interest expense decreased due to payments made on our long-term borrowings.

- The changes in other income (expense) in 2005 as compared to 2004 resulted primarily from changes in foreign currency exchange rates.

Deferred other

In the second quarter of 2005, we entered into a definitive Common Stock Purchase Agreement with Olympus in which we received $11,000,000 in cash proceeds. Under the Common Stock Purchase Agreement, we distributed 1,100,000 newly issued shares of common stock to Olympus, as well as 2,200,000 option shares to purchase additional shares of common stock at a fixed price of $10.00 per share.

The $11,000,000 in total proceeds we received exceeded the sum of the fair value of the option shares granted as well as the market price of our stock at the time the Olympus share purchase was agreed upon. The difference between the proceeds received and the sum of the fair values of our common stock and option liability has been recorded as deferred other. Deferred other will be characterized in the future as events and circumstances dictate; for example, in the future it may be characterized as a partial prepayment of the future services that we will perform on behalf of the Olympus strategic alliance once formalized.

Deferred gain on sale of assets

At June 30, 2005, we have reflected $5,650,000 of unamortized deferred gain on sale of assets on our balance sheet. This deferred gain related to the sale of our Thin Film product line to MAST in May 2004. Because of additional performance requirements required under the disposition arrangement, we did not initially recognize any gain on sale of the Thin Film assets in our statement of operations. Instead, we initially recorded approximately $6,450,000 as deferred gain on sale in the balance sheet.

These performance requirements include training to MAST representatives in all aspects of the manufacturing process related to the transferred Thin Film product line, transfer of Thin Film tangible assets, rights to intangible assets, and acting in the capacity of a back-up supplier to MAST for a period of one year. Under the back-up supply agreement, we have agreed to supply product ordered by MAST at our manufacturing cost.

We previously recognized a portion of the deferred gain as revenues as and when we sell products to MAST under the back-up supply agreement. This is necessary to state revenues at fair value of products sold, based on historical selling prices of similar

products, over our manufacturing cost. No deferred gain on sale of assets was recognized as revenue during the six months ended June 30, 2005, as no products were sold to MAST under the backup supply agreement.

As a result of the arbitration proceedings discussed earlier in this section, we will complete our remaining performance obligations during the third quarter of 2005 and, accordingly, will recognize the remaining deferred gain on sale of assets of $5,650,000, less $124,000 of related deferred costs, at that time.

Deferred license fee revenue

In the third quarter of 2004, we entered into a Distribution Agreement with Senko. Under this agreement, we granted to Senko an exclusive license to sell and distribute certain Thin Film products in Japan.

The Distribution Agreement with Senko commences upon “commercialization.” In simplest terms, commercialization occurs when one or more Thin Film product registrations are completed with the MHLW.

Following commercialization, the Distribution Agreement has a duration of five years and is renewable for an additional five years after reaching mutually agreed minimum purchase guarantees. We received a $1,500,000 upfront license fee from Senko and recorded it as deferred license fee revenue. Half of the license fee is refundable if the parties agree commercialization is not achieved, and a proportional amount is refundable if we terminate the arrangement, other than for material breach by Senko, before three years post-commercialization.

We will begin to recognize this $1,500,000 Deferred license fee as revenues only after commercialization has been achieved. We will recognize the revenues on a systematic basis over the expected period of time we anticipate that Senko will benefit from the arrangement. However, we will not recognize deferred license fee revenue if this would cause the remaining deferred license fee revenue balance to fall below the amount that we potentially would have to refund to Senko.

We do not expect commercialization to be achieved until later in 2005 or early 2006.

Deferred development revenue

Under the Distribution Agreement with Senko we are entitled to earn additional payments based on achieving the following defined milestones:

- Upon our notification to Senko of completion of the initial regulatory application to the MHLW for the Thin Film product, we were entitled to a nonrefundable payment of $1,250,000.
- Upon the achievement of commercialization, we are entitled to a nonrefundable payment of $250,000.

We notified Senko on September 28, 2004 regarding the completion of the initial regulatory application and recorded deferred development revenue of $1,250,000. Of the amount deferred, we have recognized development revenues totaling $167,000 ($9,000 in 2005 and $158,000 during the third and fourth quarters of 2004). These revenues represent the fair value of the completed milestone relative to the fair value of the total efforts expected to be necessary to achieve regulatory approval by the MHLW.

Option liability

We granted Olympus Corporation an option to acquire 2,200,000 shares of Cytori stock on or before December 31, 2006. The exercise price of the option shares is $10 per share. We accounted for this grant as a liability in accordance with Emerging Issues Task Force Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock". The 2,200,000 option shares have been classified as a liability because from the date of grant through the end of the reporting period, we are required to deliver listed common stock to settle the option shares upon exercise. Accordingly, the fair value of the 2,200,000 option shares have been (and will continue to be) re-measured at the end of each reporting period, with movements in fair value reported in the statements of operations as changes in the fair value of option liability.

Liquidity and Capital Resources

The following is a summary of our key liquidity measures at June 30, 2005 and December 31, 2004:

	June 30, 2005	December 31, 2004	$ Difference	% Difference
Cash and cash equivalents	$ 3,076,000	$ 2,840,000	$ 236,000	8.3%
Short-term investments, available for sale	11,746,000	10,579,000	1,167,000	11.0%
Total cash and cash equivalents and short-term investments, available for sale	$ 14,822,000	$ 13,419,000	$ 1,403,000	10.5%
Current assets	$ 16,746,000	$ 15,645,000	$ 1,101,000	7.0%
Current liabilities	3,262,000	3,267,000	(5,000)	(0.2)%
Working capital	$ 13,484,000	$ 12,378,000	$ 1,106,000	8.9%

We believe that existing funds, cash generated by operations, and existing and accessible sources of financing are adequate to satisfy our working capital, capital expenditures, debt service and other financial commitments at least through June 30, 2006. However, in order to provide greater financial flexibility and liquidity, and in view of the substantial cash needs of our regenerative cell business during its development stage, we will need to raise additional capital.

From inception to June 30, 2005, we have financed our operations primarily by:

- Issuing our stock,
- Generating revenues,
- Selling the CMF product line in September 2002,
- Selling the Thin Film product line (except for the territory of Japan), in May 2004,
- Entering into a Distribution Agreement for the distribution rights to Thin Film in Japan, in which we received an upfront license fee in July 2004 and an initial development milestone payment in October 2004,
- Obtaining a modest amount of capital equipment long-term financing, and
- Entering into a Stock Purchase Agreement in April of 2005 with Olympus.

We increased our cash position by $11,000,000 in May of 2005 through an equity placement agreement we entered into in April 2005. This agreement covers the sale of 1.1 million shares of our common stock to Olympus Corporation at $10.00 per share. Also as part of the agreement, Olympus has been granted an option that expires December 31, 2006 to purchase an additional 2,200,000 shares of common stock at $10.00 per share. We also offered Olympus one seat on our board of directors, but Olympus has not yet exercised this right. We are seeking to enter into a strategic business alliance relation to our regenerative cell technology. Both parties are now engaged in good-faith negotiations under a Collaboration Agreement toward establishing such an alliance, and are sharing technical information. As of the end of the second quarter, however, the strategic business alliance had yet to be formalized.

We believe that our near-term borrowing requirements and debt repayments will continue to involve a relatively small amount of cash. To fund 2005 expected capital expenditures of $1,500,000, we intend to use available working capital and if available, borrow under our Amended Master Security Agreement.

Any excess funds will be invested in short-term available-for-sale investments. We believe that it is necessary to maintain a large amount of cash and short-term available-for-sale investments on hand to ensure that we have adequate resources to fund future research and development, and to manage legal and regulatory risks and challenges to our business model.

Our capital requirements for the remainder of 2005 and beyond will depend on numerous factors, including the resources we devote to developing and supporting our products, Medtronic's marketing efforts, market acceptance of our developed products, regulatory approvals and other factors. We have positioned ourselves to expand our cash position through actively pursuing co-development and marketing agreements, research grants, and licensing agreements related to our technology platforms. Moreover, we are committed to increasing revenues from our bioresorbable products and reinvesting any profits into our regenerative cell therapy research. The revenue generated from our bioresorbable products will depend in large part on the success of Medtronic's (our sole distributor of spine and orthopedics implants) marketing efforts in the bioresorbable spine and orthopedics arena.

We expect to incur research and development expenses, well beyond our current level, in our regenerative cell platform for an extended period of time. This will occur whether or not our spine and orthopedics biomaterials business returns to profitability. We will continue to seek collaborations and new sources of financing, such as through additional sales of equity securities, in order to fund operations, satisfy financial obligations, and achieve our research and development objectives.

The following summarizes our contractual obligations and other commitments at June 30, 2005, and the effect such obligations could have on our liquidity and cash flow in future periods:

		Payments due by period			
Contractual Obligations	**Total**	**Less than 1**	**1 – 3 years**	**3 – 5 years**	**More than**

		year			5 years
Long-term debt obligations	$ 1,592,000	$ 773,000	$ 819,000	$ —	$ —
Interest commitment on debt	166,000	108,000	58,000	—	—
Operating lease obligations	8,175,000	1,664,000	5,108,000	1,403,000	—
Research study obligations	391,000	241,000	150,000	—	—
Total	$ 10,324,000	$ 2,786,000	$ 6,135,000	$ 1,403,000	$ —

Cash provided by (used in) operating, investing and financing activities for the six months ended June 30, 2005 and 2004, is summarized as follows:

	For the six months ended June 30, 2005	2004
Net cash used in operating activities	$ (8,606,000)	$ (6,984,000)
Net cash (used in) provided by investing activities	(1,699,000)	6,934,000
Net cash provided by (used in) financing activities	10,541,000	(677,000)

Operating activities

Net cash used in operating activities during the six months ended June 30, 2005 resulted from our net loss of $9,886,000 and changes in working capital due to the timing of product shipments (accounts receivable) and payment of liabilities.

Net cash used in operating activities in the six months ended June 30, 2004 primarily resulted from our negative cash flow from operations. We reported net loss of $2,320,000 for this period, including a one-time $5,000,000 gain related to the sale of the CMF product line to Medtronic. Without this gain, our adjusted net loss for the period would have been $7,320,000.

Our net losses (as adjusted) for both periods resulted largely from expenses related to our research and development efforts for regenerative cell therapies.

Investing activities

Net cash used in investing activities in the six months ended June 30, 2005 resulted primarily from the sale and maturity of our short-term investments, the proceeds from which were used to fund operating activities during the first half of 2005.

Net cash provided by investing activities in the six months ended June 30, 2004 primarily resulted from the receipt of the non-recurring payment of $5,000,000 for the completion of the CMF Faster Resorbable Polymer clinical research.

Capital spending is essential to our product innovation initiatives and to maintain our operational capabilities. In the six months ended June 30, 2005 and 2004, we used cash to purchase $546,000 and $463,000 respectively, of property and equipment to support manufacturing of our bioresorbable implants and for the research and development of the regenerative cell technology platform.

Financing Activities

The net cash provided by financing activities in the six months ended June 30, 2005 related mainly to the proceeds from the Olympus transaction applicable to the sale of common stock of $11,000,000. The composition of the $11,000,000 in proceeds includes $3,003,000 for the sale of common stock, $186,000 for the issuance of options, and $7,811,000 for the issuance of common stock in excess of fair market value, which may be re-characterized in the future as events and circumstances dictate.

The net cash used in financing activities in the six months ended June 30, 2004 related to:

- The repurchase of 286,602 shares of our common stock for $1,043,000; and
- The payment of $382,000 on our long term obligations.

Net cash used in financing activities in 2004 was offset by proceeds from an Amended Master Security Agreement we entered in September 2003 to provide financing for equipment purchases. In the first six months of 2004, in connection with this agreement, we issued promissory notes with principal amounts totaling approximately $722,000.

Critical Accounting Policies and Significant Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of our assets, liabilities, revenues and expenses, and that affect our recognition and disclosure of contingent assets and liabilities.

While our estimates are based on assumptions we consider reasonable at the time they are made, our actual results may differ from our estimates, perhaps significantly. If results differ materially from our estimates, we will make adjustments to our financial statements prospectively, as we become aware of the necessity for an adjustment.

We believe it is important for you to understand our most critical accounting policies. These are our policies that require us to

make our most significant judgments and, as a result, could have the greatest impact on our future financial results.

Revenue Recognition

We derive our revenue from a number of different sources, including but not limited to:

- Product sales,
- Upfront payments from license or distribution agreements, and
- Fees for achieving certain defined milestones under development or commercialization arrangements.

Many of our revenue generating arrangements are relatively simple in nature, meaning that there is little judgment necessary with regard to the timing of when we recognize revenues or how such revenues are presented in the financial statements.

However, we have also entered into more complex arrangements, including but not limited to our contracts with the NIH and Senko. Moreover, some of our non-recurring transactions, such as our disposition of the majority of our Thin Film business to MAST or our sale of our CMF product line to Medtronic, contain elements that relate to our core revenue producing activities.

As a result, some of our most critical accounting judgments relate to the identification, timing, and presentation of revenue-related activities. These critical judgments are discussed further in the paragraphs that follow.

Multiple-elements

Some of our revenue generating arrangements contain a number of distinct revenue streams, known as "elements." For example, our Distribution Agreement with Senko contains direct or indirect future revenue streams related to:

- A distribution license fee (which was paid at the outset of the arrangement),
- Milestone payments for achieving commercialization of the Thin Film product line in Japan,
- Training for representatives of Senko,
- Sales of Thin Film products to Senko, and
- Payments in the nature of royalties on future product sales made by Senko to its end customers.

Emerging Issues Task Force Issue 00-21, Revenue Arrangements with Multiple Deliverables ("EITF 00-21"), governs whether each of the above elements in the arrangement should be accounted for individually, or whether the entire contract should be treated as a single unit of accounting.

EITF 00-21 indicates that individual elements may be separately accounted for only when:

- The delivered element has stand alone value to the customer,
- There is objective evidence of the fair value of the remaining undelivered elements, and
- If the arrangement contains a general right of return related to any products delivered, delivery of the remaining goods and services is probable and within the complete control of the seller.

In the case of the Senko Distribution Agreement, we determined that (a) the milestone payments for achieving commercialization and (b) the future sale of Thin Film products to Senko were "separable" elements. That is, each of these elements, upon delivery, will have stand alone value to Senko and there will be objective evidence of the fair value of any remaining undelivered elements at that time. The arrangement does not contain any general right of return, and so this point is not relevant to our analysis.

On the other hand, we concluded that (a) the upfront distribution license fee, (b) the revenues from training for representatives of Senko, and (c) the payments in the nature of royalties on future product sales are not separable elements under EITF 00-21.

In arriving at our conclusions, we had to consider whether our customer, Senko, would receive stand alone value from each delivered element. We also, in some cases, had to look to third party evidence to support the fair value of certain undelivered elements – notably, training – since we as a company do not routinely deliver this service on a stand alone basis. Finally, we had to make assumptions about how the non-separable elements of the arrangement are earned, particularly the estimated period over which Senko will benefit from the arrangement (refer to the "Recognition" discussion below for further background).

Our conclusions, in effect, cause us to recognize certain revenues from the Senko Distribution Agreement sooner than if we had alternatively concluded that none of the elements in the arrangement were separable. Notably, we have recognized $167,000 in cumulative development revenues from the Senko Distribution Agreement, mostly related to achieving certain milestones related to the commercialization of Thin Film products in Japan. Had our judgments regarding the separation of elements been different, we

likely would have recognized as revenues an amount less than this.

Recognition

Besides determining whether to account separately for components of a multiple-element arrangement, we also use judgment in determining the appropriate accounting period in which to recognize revenues that we believe (a) have been earned and (b) are realizable. The following describes a small sampling of the recognition issues we have considered during the reporting period.

- Upfront License Fees

- As part of the Senko Distribution Agreement, we received an upfront fee upon execution of the arrangement. We concluded that such fee was not earned at that time and, instead, reported the cash as deferred license fee revenue. We then had to consider over what period the upfront fee should be recognized as revenue, especially considering that the fee was refundable under certain conditions. We ultimately concluded that the fee would be earned — and, thus recognized as revenues — beginning when regulatory approval was received to market Thin Film products in Japan. We further concluded that revenues would be reported on a straight-line basis over a five year period. We selected the straight-line method because we otherwise could not reliably estimate the manner in which Senko would benefit from the terms of the Distribution Agreement. The license fees will be recognized over a five year period as this corresponds to the initial term of the Distribution Agreement. We note that the Distribution Agreement is renewable for an additional five year period upon mutual consent of Senko and MacroPore. However, we believe that it is too soon to judge whether Senko will benefit from the upfront license fee payment for longer than the initial five year term; we will re-examine this assumption each reporting period and make any necessary adjustments on a prospective basis.

- Government Grants

  - We are eligible to receive grants from the NIH related to our research on adipose derived cell therapy to treat myocardial infarctions. There are no specific standards under U.S. GAAP that prescribe the recognition or classification of these grants in the income statement. Absent such guidance, we have established an accounting policy to recognize NIH grant revenues at the lesser of:

    - Qualifying costs incurred (and not previously recognized), plus any allowable grant fees, for which Cytori is entitled to grant funding; or,
    - The amount determined by comparing the research outputs generated to date versus the total outputs that are expected to be achieved under the research arrangement.

  - Our accounting policy could theoretically defer revenue recognition beyond the period in which we have earned the rights to such fees. However, we selected this accounting policy to counteract the possibility of recognizing revenues from the NIH arrangement too early. For instance, if our policy permitted revenues to be recognized solely as qualifying costs were incurred, we could alter the amount of revenue recognized by incurring more or less cost in a given period, irrespective of whether these costs correlate to the research outputs generated. On the other hand, if revenue recognition were based on output measures alone, it would be possible to recognize revenue in excess of costs actually incurred; this is not appropriate since qualifying costs remain the basis of our funding under the NIH grant. The application of our accounting policy, nonetheless, involves significant judgment, particularly in estimating the percentage of outputs realized to date versus the total outputs expected to be achieved under the grant arrangement.

- Milestones

  - In certain of our non-governmental development arrangements, we receive payments upon the achievement of certain defined milestones. Our accounting policy is to recognize milestone payments as revenues when received if:

    - Substantive effort is required to achieve the milestone,
    - The amount of the milestone payments appear reasonably commensurate with the effort expended, and
    - Collection (or retention) of the payment is reasonably assured.

  - Determining whether each of these criteria has been satisfied requires significant judgment. For example, our Distribution Agreement with Senko calls for payments to us when certain defined milestones are achieved. The first such milestone payment for $1,250,000 became payable to us when we filed a commercialization application with the Japanese regulatory authorities. However, we determined that the payment received was not commensurate with

the level of effort expended, particularly compared with other steps we believe are necessary to commercialize the Thin Film product line in Japan. Accordingly, we did not recognize the $1,250,000 received as revenues, but instead recorded all but $167,000 of this amount as deferred development revenue. The $167,000 ($9,000 in 2005 and $158,000 in 2004) was recognized as development revenues based on our estimates of the level of effort expended as compared with the total level of effort we expect to incur under the arrangement to successfully achieve regulatory approval of the Thin Film product line in Japan. These estimates were subject to judgment and there may be changes in estimates regarding the total level of effort as we continue to seek regulatory approval. Indeed, there can be no assurance that commercialization in Japan will ever be achieved.

- Back-up Supply Arrangements

  - We agreed to serve as a backup supplier of products in connection with our dispositions of both:

    - The CMF product line to Medtronic; and
    - Specific Thin Film assets to MAST.

  Specifically, we agreed to supply CMF or Thin Film product to Medtronic and MAST, respectively, at our cost for a defined period of time. When we actually delivered products under the backup supply arrangements, however, we recognized revenues in the financial statements at the estimated selling price which we would receive in the marketplace. We used judgment, based on historical data and expectations about future market trends, in determining the estimated market selling price of products subject to the backup supply arrangements. The amount of the deferred gain recognized as revenue is equal to the excess of the fair value of products sold, based on historical selling prices of similar products, over the Company's manufacturing cost.

Presentation

We have presented amounts earned under our NIH research arrangement as research grant revenue. Simply, we believe that the activities underlying the NIH agreement constitute our ongoing major or central operations. Moreover, the government obtains rights under the arrangement, in the same manner (but perhaps not to the same extent) as a commercial customer that similarly contracts with Cytori Therapeutics, Inc. to perform research activities. For instance, the government and any authorized third parties may use our federally funded research and/or inventions without payment of royalties to us. We recognize that others may conclude that the receipt of amounts under the NIH royalty arrangement should be presented as a reduction of any qualifying expenses incurred — that is, reported in the income statement on a net basis.

Warranty Provisions

At the time of sale, we grant customers the right to a full refund if (and only if) the purchased medical device does not meet all of the agreed upon specifications and expectations. Accordingly, we established a liability for the estimated cost of honoring this warranty at the same time we record revenues from the sale of the related medical device.

We believe the accounting estimate related to our warranty liability is a "critical accounting estimate" because changes in the related warranty provision can materially affect our operating results. Moreover, because of our limited history and our continual development of new products, estimating our expected warranty costs requires significant judgment.

In the past, our warranty provision was based primarily on actual history of warranty claims submitted by our customers. Prior to the third quarter of 2003, we had de minimis warranty claims despite recognizing approximately $27 million in cumulative sales of medical devices. Accordingly, we had no warranty reserves prior to the third quarter of 2003.

In the third quarter of 2003, we determined that some of the products we sold did not meet certain customer expectations, based on criteria previously communicated to our customer (Medtronic). After detecting this matter, we elected to replace all lots of affected inventory that were on hand at the customer, and we subsequently modified our procedures to alleviate similar occurrences in the future.

As a result, we recorded a warranty charge of $243,000 in the third quarter of 2003. We have incorporated this new historical warranty data into our determination of appropriate warranty reserves to record prospectively and will continue to evaluate the adequacy and accuracy of our warranty obligations on a quarterly basis. There have been no material warranty claims since the third quarter of 2003.

Goodwill Impairment Testing

In late 2002, we purchased StemSource and recognized over $4,600,000 in goodwill associated with the acquisition, of which $4,387,000 remains on our balance sheet as of June 30,2005. As required by Statement of Financial Accounting Standard No. 142, Goodwill and Other Intangible Assets ("SFAS 142"), we must test this goodwill at least annually for impairment. Moreover, this testing must be performed at a level of the organization known as the reporting unit. A reporting unit is at least the same level as a company's operating segments, and sometimes even one level lower.

Specifically, the process for testing goodwill for impairment under SFAS 142 involves the following steps:

- Company assets and liabilities, including goodwill, are allocated to each reporting unit for purposes of completing the goodwill impairment test.
- The carrying value of each reporting unit — that is, the sum of all of the net assets allocated to the reporting unit — is then compared to its fair value.
- If the fair value of the reporting unit is lower than its carrying amount, goodwill may be impaired — additional testing is required.

When we completed our goodwill impairment testing in 2004, the fair values of our two reporting units each exceeded their respective carrying values. Accordingly, we determined that none of our reported goodwill was impaired.

The application of the goodwill impairment test involves a substantial amount of judgment. For instance, SFAS 142 requires that assets and liabilities be assigned to a reporting unit if both of the following criteria are met:

- The asset will be employed in or the liability relates to the operations of a reporting unit.
- The asset or liability will be considered in determining the fair value of the reporting unit.

This allocation process involves judgment. We developed mechanisms to assign company-wide assets like shared property and equipment, as well as company-wide obligations such as borrowings under our GE Loan Facility, to our two reporting units. In some cases, certain assets were not allocable to either reporting unit and were left unassigned.

The most complex and challenging asset to assign to each reporting unit was our acquired goodwill. As noted previously, all of our recorded goodwill was generated in connection with our acquisition of StemSource in 2002. All of the StemSource assets and liabilities still on hand at our 2004 testing date were allocated to our regenerative cell reporting unit. However, when we first acquired StemSource, we determined that a portion of the goodwill related to the bioresorbable reporting unit. The amount of goodwill allocated represented our best estimate of the synergies (notably future cost savings from shared research and development activities) that the bioresorbable reporting unit would obtain by virtue of the acquisition.

Finally, with the consultation and assistance of a third party, we estimated the fair value of our reporting units by using various estimation techniques. In particular, we estimated the fair value of our bioresorbable reporting unit based on an equal weighting of the market values of comparable enterprises and discounted projections of estimated future cash flows. Clearly, identifying comparable companies and estimating future cash flows as well as appropriate discount rates involves judgment. On the contrary, we estimated the fair value of our regenerative cell reporting unit solely using an income approach, as we believe there are no comparable enterprises on which to base a valuation. The assumptions underlying this valuation method involve a substantial amount of judgment, particularly since our regenerative cell business has yet to generate any revenues and does not have a commercially viable product.

Again, the manner in which we assigned assets, liabilities, and goodwill to our reporting units, as well as how we determined the fair value of such reporting units, involves significant uncertainties and estimates. The judgments employed may have an effect on whether a goodwill impairment loss is

recognized. Notably, the carrying value of our regenerative cell reporting unit, including assigned goodwill, totaled $7,100,000 as of the 2004 testing date. Furthermore, we estimated the fair value of this reporting unit to be $12,600,000 as of this date, meaning that a change in how certain assets and liabilities were allocated to our reporting units, or the manner in which we estimated fair value, could have resulted in a different conclusion as to whether some of our goodwill was impaired.

Dispositions

In 2002, we sold our CMF (skull and face) bone fixation implant and accessory product line to Medtronic.

Moreover, in 2004, we sold most of the assets and intellectual property rights in our (non-Japan) Thin Film business to MAST.

As is common in the life sciences industry, the sale agreements contained provisions beyond the simple transfer of net assets to the acquiring enterprises for a fixed price. Specifically, as part of the arrangement, we also agreed to perform the following services:

- Provide training to Medtronic or MAST personnel on production and other aspects of the CMF and Thin Film product lines, respectively.
- Provide a back-up supply of CMF product to Medtronic and Thin Film products to MAST, at cost, for a specified period of time,
- In the case of Medtronic, perform clinical evaluations for a new faster-resorbing polymer product.

Disposing assets and product lines is not one of our core ongoing or central activities. Accordingly, determining the appropriate accounting for these transactions involved some of our most difficult, subjective and complex judgments. In particular, we made assumptions around the appropriate manner and timing in which to recognize the gain on disposal for each transaction in the statement of operations. Moreover, we considered whether the dispositions should be reflected as discontinued operations in accordance with Statement of Financial Accounting Standard No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.”

For instance, upon the closing of the CMF sale agreement on September 30, 2002, we received net cash of $9,000,000, and transferred assets to Medtronic with a net carrying value of $476,000. The net difference of $8,524,000 was recorded as part of a Deferred gain on sale of assets, related party on our balance sheet. We deferred recognition of the majority of this gain until Medtronic accepted the transferred net assets, which was demonstrated only when Medtronic had:

- Stopped relying on us to provide product under the back-up supply agreement,
- Integrated the acquired CMF manufacturing equipment into its operations, and
- Permitted us to deliver training to Medtronic personnel on production and other aspects of the CMF product line.

Until those events occurred, we did not believe that we have transferred all risk and rewards related to the CMF product line to Medtronic and, accordingly, recognition of the deferred gain in earnings would be inappropriate.

The risks and rewards of ownership related to the CMF product line ultimately passed to Medtronic in August 2004. The remainder of the deferred gain was recognized in the third quarter of 2004 when the technology and know-how transfer was completed pursuant to the contract terms.

Conversely, we have yet to recognize the majority of the deferred gain related to our disposition of certain Thin Film assets, which occurred in May 2004. Again, the Asset Purchase Agreement governing the Thin Film sale obligated us to perform certain actions for the benefit of the buyer – MAST – for a defined period of time, such as serving as a back-up supplier. As of June 30, 2005, we have not performed all of our obligations under the arrangement (as evidenced by the arbitration proceedings) and, thus, believe that recognition of the majority of the deferred gain is not appropriate at this time. Due to the settlement in August 2005, we believe that we will have completed our remaining performance obligations during the third quarter of 2005 and, accordingly, will recognize the remaining deferred gain on sale of assets at that time.

We have, however, recognized a portion of the deferred gains when we sell product to Medtronic and MAST under the respective back-up supply agreements. Refer to the “Revenue Recognition” section of this Critical Accounting Policies and Significant Estimates discussion for further details.

Recent Accounting Pronouncements

In November 2004, the FASB issued SFAS No. 151, “Inventory Costs-An Amendment of ARB No. 43, Chapter 4” (“FAS 151”). FAS 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs and spoilage should be expensed as incurred and not included in overhead. Further, FAS 151 requires that allocation of fixed and production facilities overhead to conversion costs should be based on normal capacity of the production facilities. The provisions in FAS 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not believe that the adoption of FAS 151 will have a significant effect on our financial statements.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), “Share-based Payment” (“FAS 123R”). As amended by Securities and Exchange Commission Release No. 33-8568, “Amendment to Rule 4-01(a) of Regulation S-X Regarding the Compliance Date for Statement of Financial Accounting Standards No. 123 (Revised 2004), Share-Based Payment”, FAS 123R is effective for us on January 1, 2006 and will have a material effect on our results of operations. Upon adoption, FAS 123R will require us to measure all share-based payment transactions, including those with employees, at fair value (most notably, this includes employee stock option grants, even where the exercise price is equal to the grant date fair market value). Moreover, the fair value of share-based payment awards will be recognized as expense in the statements of operations over the requisite service period of each award. FAS 123R also changes the manner in which deferred taxes are recognized on share-based payment awards, as well as the accounting for award modifications.

Based on pro forma amounts for historical periods presented in note 4 of our consolidated financial statements, our net loss will increase (or our net income will be reduced) each annual period as a result of adopting FAS 123R.

Risk Factors

In analyzing our company, you should consider carefully the following risk factors, together with all of the other information included in this quarterly report on Form 10-Q. Factors that could cause or contribute to differences in our actual results include those discussed in the following subsection, as well as those discussed above in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere throughout this quarterly report on Form 10-Q. Each of the following risk factors, either alone or taken together, could adversely affect our business, operating results and financial condition, as well as adversely affect the value of an investment in our common stock.

We are subject to the following significant risks, among others:

We have a limited operating history; our operating results can be volatile

Our prospects must be evaluated in light of the risks and difficulties frequently encountered by emerging companies and particularly by such companies in rapidly evolving and technologically advanced fields such as the medical device and biotechnology field. Due to our limited operating history, comparisons of our year-to-year operating results are not necessarily meaningful and the results for any periods should not necessarily be relied upon as an indication for future performance. Since our limited operating history makes the prediction of future results difficult or impossible, our recent revenue results should not be taken as an indication of any future growth or of a sustainable level of revenue. This was demonstrated by our revenue decline in the second, third, and fourth quarters of 2004 and the first half of 2005.

Moreover, our operating results can vary substantially from our previously published financial guidance (such as occurred in the second quarter of 2004), from analyst expectations and from previous periodic results for many reasons, including the timing of product introductions and distributor purchase orders. Also, the 2002 sale of our CMF bone fixation implant and accessory product line, which had represented a large portion of our revenues, plus the 2004 sale of our (non-Japan) Thin Film surgical implants for separation of soft tissues, will distort quarterly and annual earning comparisons through 2004 and 2005. Earnings surprises can have a disproportionate effect on the stock prices of emerging companies such as ours. Also, our stock price is likely to be disproportionately affected by changes which generally affect the economy, the stock market or the medical device and biotechnology industries.

We had tried to influence our investors' expectations as to our 2004 operating results by periodically announcing financial guidance. However, due to our disappointing revenues in the second quarter of 2004 and our conclusion that we did not have sufficient visibility on the timing and size of end customer demand for the HYDROSORB™ bioresorbable implants which we distribute through Medtronic, we withdrew our previously issued guidance on July 19, 2004. We have advised the markets that revenues for these products in 2005 are expected to be in the range of $6,000,000 to $9,000,000.

We have never been profitable on an operational basis

We have incurred net losses in each year since we started doing business. These losses have resulted primarily from expenses associated with our research and development activities and general and administrative expenses. We anticipate that our recurring operating expenses will increase for the next several years, due to the continued need to develop new products and fund additional preclinical research and possibly clinical trials. We expect to continue to incur operational losses in our spine and orthopedics business at least through the end of 2005, and the amount of future net losses and time necessary to reach operational profitability are somewhat uncertain. Development-stage losses related to our development of regenerative cell technology are expected to keep us in a loss position on a consolidated basis for several years.

We are adopting a high-risk strategy

We intend to use cash from any profits of the HYDROSORB™ products and the Japan Thin Film products, the proceeds of the sale of the (non-Japan) Thin Film product line, and cash raised from future financings or any other source to finance the regenerative cell technology and its development-stage cash needs. This is a high-risk strategy because there can be no assurance that our regenerative cell technology will ever be developed into commercially viable products (scientific risk), that we will be able to preclude other companies from depriving us of market share and profit margins by selling products based on our inventions and developments (legal risk), that we will be able to successfully manage a company in a different business than we have operated in the past (operational risk), that we will be able to successfully deliver regenerative cells where needed in the body (scientific risk), or that our cash resources will be adequate to develop the regenerative cell technology until it becomes profitable (if ever) while still serving the cash needs of our biomaterials medical device product lines (financial risk). Instead of using the cash to reinvest in our biomaterials business, we are using it in one of the riskiest industries in the economy (strategic risk). This has fundamentally changed our

risk/reward profile and may make our stock an unsuitable investment for some investors.

The financial risk in this strategy is significant, particularly if our bioresorbable products are not independently cash-flow-positive. Although we eliminated the negative cash flow of the early commercialization stage of the (non-Japan) Thin Film business by selling that business to MAST in May 2004, even our core spine and orthopedics implants business fell back into a negative cash flow position in the second quarter of 2004 due to the sharp reduction in orders from and sales to Medtronic. This was followed by an even sharper reduction in third and fourth quarter 2004 spine and orthopedics implant product orders from our sales to Medtronic. With the CMF and (non-Japan) Thin Film product lines sold and the Japanese Thin Film products not yet approved for commercialization, our only remaining bioresorbable implants business from which to derive product revenues in the short term is our spine and orthopedic implants product line.

Further legal risk arises from a lawsuit, filed by the University of Pittsburgh in the fourth quarter of 2004, seeking a determination that its assignors, rather than the University of California's assignors, are the true inventors of U.S. Patent No. 6,777,231. We are the exclusive, worldwide licensee from the University of California under this patent, which relates to adult stem cells isolated from adipose tissue that can differentiate into two or more of a variety of cell types. If the University of Pittsburgh wins the lawsuit, our license rights to this patent could be nullified or rendered non-exclusive with respect to any third party that might license rights from the University of Pittsburgh, and our regenerative cell strategy could be materially adversely affected.

We rely on Medtronic to distribute a majority of our products

We have limited control over sales, marketing and distribution. Our strategy for sales and marketing of our bioresorbable products has included entering into agreements with other companies having large distribution networks to market many of our current and certain future products incorporating our technology. We have derived the vast majority of our revenues from the sale of hard-tissue-fixation bioresorbable implant products to our distribution partner, Medtronic.

We remain significantly dependent on Medtronic to generate sales revenues for all of our spine and orthopedics bioresorbable products. The amount and timing of resources which may be devoted to the performance of Medtronic's contractual responsibilities are not within our control. There can be no guarantee that Medtronic will perform its obligations as expected or pay us any additional option or license fees. There is also no guarantee that it will market any new products under the distribution agreements or that we will derive any significant revenue from such arrangements. Medtronic's sale of our products to end customers in 2004, and its rate of product orders placed with us in the same period, disappointed our expectations. 2004 results were exceptionally weak, and we are significantly disappointed with the marketing efforts of Medtronic for our products at this time.

Our dependence upon Medtronic to market and sell our bioresorbable products places us in a position where we cannot accurately predict the extent to which our products will be actively and effectively marketed, depriving us of some of the reliable data we need to make optimal operational and strategic decisions. The consequent lack of visibility resulted in our second quarter 2004 falling short of our own and the market's expectations and compelled us to, on July 19, 2004, withdraw our previously announced financial guidance for the remainder of 2004. Our third and fourth quarter 2004 sales were worse than expected as well, further demonstrating the lack of control and visibility. We have advised the markets that revenues for these products in 2005 are expected to be in the range of $6,000,000 to $9,000,000.

The prices which Medtronic pays us are fixed (pending biannual price reviews), based on a percentage of Medtronic's historic selling price to its customers. If our costs increase but our selling prices remain fixed, our profit margin will suffer.

Medtronic owns 6.6% of our stock, which may limit our ability to negotiate commercial arrangements optimally with Medtronic. Although Medtronic has exclusive distribution rights to our co-developed spinal implants, it also distributes other products that are competitive to ours. Medtronic might choose to develop and distribute existing or alternative technologies in preference to our technology in the spine or preferentially market competitive products that can achieve higher profit margins.

There can be no assurance that our interests will continue to coincide with those of Medtronic or that disagreement over rights or technology or other proprietary interests will not occur. The loss of the marketing services provided by Medtronic, or the loss of revenues generated by Medtronic, could have a substantial negative effect on the results of our operations and financial condition.

We are vulnerable to competition and technological change, and also to physicians' inertia

We compete with many domestic and foreign companies in developing our technology and products, including medical device, pharmaceutical and biopharmaceutical companies. Many of our competitors and potential competitors have substantially greater financial, technological, research and development, marketing and personnel resources than we do. There can be no assurance that our competitors will not succeed in developing alternative technologies and products that are more effective, easier to use or more economical than those which we have developed or are in the process of developing or that would render our technology and products

obsolete and non-competitive in these fields. In general, we do not have the legal right to preclude other companies from making bioresorbable products that are similar to ours or perform similar functions.

These competitors may also have greater experience in developing products, conducting clinical trials, obtaining regulatory clearances or approvals, and manufacturing and marketing such products. It is possible that certain of these competitors may obtain patent protection, approval or clearance by the U.S. Food and Drug Administration "FDA" or product commercialization earlier than we, any of which could have a substantial negative effect on our business. Finally, Medtronic and our other partners may pursue parallel development of other technologies or products, which may result in a partner developing additional products that will compete with our products.

We also compete with manufacturers of traditional non-bioresorbable implants, such as titanium implants. Doctors have historically been slow to adopt new technologies such as ours, whatever the merits, when older technologies continue to be supported by established providers. Overcoming such inertia often requires other very significant marketing expenditures or definitive product superiority. Such inertia may be one reason why demand for the HYDROSORB™ implants we sell through Medtronic was lower in 2004 than we had expected.

We expect physicians' inertia and skepticism to also be a significant barrier as we attempt to gain market penetration with our future regenerative cell products. We may need to finance lengthy time-consuming clinical studies (so as to provide convincing evidence of the medical benefit) in order to overcome this inertia and skepticism.

We depend on recently introduced products and anticipated new products, which subject us to development and marketing risks

We are in a relatively early stage of commercialization with many of our products although we have derived revenue from sales of certain products to our distributors, particularly Medtronic. We believe that our long-term viability and growth will depend in large part on receiving additional regulatory clearances or approvals for our products and expanding our sales and marketing for our spine and orthopedics implants and other new products that may result from our research and development activities. We are presently pursuing bioresorbable implant opportunities in spine and orthopedics and other tissue repair and regeneration throughout the body that may require extensive additional capital investment, research, development, clinical testing and regulatory clearances or approvals prior to commercialization. There can be no assurance that our product development programs will be successfully completed or that required regulatory clearances or approvals will be obtained on a timely basis, if at all. The path to commercial profit from our regenerative cell technology is unclear even if we demonstrate the medical benefit of our regenerative cell technology in various applications. There is no proven path for commercializing the technology in a way to earn a durable profit commensurate with the medical benefit. Most of our cell-related products and/or services are at least three to five years away.

Moreover, the various applications and uses of our bioresorbable surgical implants are relatively new and evolving. The successful development and market acceptance of our products are subject to inherent developmental risks, including ineffectiveness or lack of safety, unreliability, failure to receive

necessary regulatory clearances or approvals, high commercial cost and preclusion or obsolescence resulting from third parties' proprietary rights or superior or equivalent products, as well as general economic conditions affecting purchasing patterns. There can be no assurance that we or our distribution partners will be able to successfully commercialize or achieve market acceptance of our technologies or products, or that our competitors will not develop competing technologies that are less expensive or otherwise superior to ours. The failure to successfully develop and market our new products or receive the required regulatory clearances or approvals could have a substantial negative effect on the results of our operations and financial condition.

We will need to raise more cash in the future

As of June 30, 2005, we had $14,822,000 of cash, cash equivalents and short-term investments; we have always had negative cash flow from operations. Our regenerative cell business will continue to result in a substantial requirement for research and development expenses for several years, during which it could bring in no significant revenues. There can be no guarantee that adequate funds for our operations from any additional debt or equity financing, our operating revenues, arrangements with distribution partners or from other sources will be available when needed or on terms attractive to us. The inability to obtain sufficient funds may require us to delay, scale back or eliminate some or all of our research or product development programs, manufacturing operations, clinical studies or regulatory activities as well as our ability to license third parties to commercialize products or technologies that we would otherwise seek to develop ourselves, thus having a substantial negative effect on the results of our operations and financial condition.

We have limited manufacturing experience

We have a limited manufacturing history and limited experience in manufacturing some of our products. In part, our future success is significantly dependent on our ability to manufacture products in commercial quantities, in compliance with regulatory requirements and in a cost-effective manner. Production of some of our products in commercial-scale quantities may involve

unforeseen technical challenges and may require significant scale-up expenses for additions to facilities and personnel. There can be no guarantee that we will be able to achieve large-scale manufacturing capabilities for some of our products or that we will be able to manufacture these products in a cost-effective manner or in quantities necessary to allow us to achieve profitability. Our 2002 sale of CMF production assets to Medtronic and our 2004 sale of the (non-Japan) Thin Film product line deprived us of some economies of scale in manufacturing. Current demand for spine and orthopedics products from Medtronic is so low that economies of scale are in some instances lacking in regard to that product line as well.

If we are unable to sufficiently meet Medtronic's requirements for certain products as set forth under its agreement, Medtronic itself may then manufacture and sell such product and only pay us royalties on the sales. The resulting loss of payments from Medtronic for the purchase of these products would have a substantial negative effect on the results of our operations and financial condition.

We have to maintain quality assurance certification and manufacturing approvals

The manufacture of our bioresorbable products is subject to periodic inspection by regulatory authorities and distribution partners. The manufacture of those used for human use is subject to regulation and inspection from time to time by the FDA for compliance with the FDA's Quality System Regulation "QSR" requirements, as well as equivalent requirements and inspections by state and non-U.S. regulatory authorities. There can be no guarantee that the FDA or other authorities will not, during the course of an inspection of existing or new facilities, identify what they consider to be deficiencies in our compliance with QSRs or other requirements and request, or seek, remedial action.

Failure to comply with such regulations or a potential delay in attaining compliance may adversely affect our manufacturing activities and could result in, among other things, injunctions, civil penalties, FDA refusal to grant pre-market approvals or clearances of future or pending product submissions, fines, recalls or seizures of products, total or partial suspensions of production and criminal prosecution. There can be no assurance that we will be able to obtain additional necessary regulatory approvals or clearances on a timely basis, if at all. Delays in receipt of or failure to receive such approvals or clearances or the loss of previously received approvals or clearances could have a substantial negative effect on the results of our operations and financial condition.

We depend on a sole source supplier for our crucial raw material for our bioresorbable products

We currently purchase the high molecular weight, medical grade, lactic acid copolymer used in manufacturing most of our bioresorbable products, from a single qualified source. Although we have a contract with B.I. Chemicals, Inc., which guarantees continuation of supply through August 15, 2006, we cannot guarantee that they will elect to continue the contract beyond that date, or that they will not elect to discontinue the manufacture of the material. They have agreed that if they discontinue manufacturing they will either find a replacement supplier, or provide us with the necessary technology to self-manufacture the material, either of which could mean a substantial increase in material costs. Also, despite this agreement they might fail to do these things for us. Under the terms of the contract, B.I. Chemicals, Inc. may choose to raise their prices upon nine months prior notice which may also result in a substantially increased material cost. Although we believe that we would be able to obtain the material from at least one other source in the event of a failure of supply, there can be no assurance that we will be able to obtain adequate increased commercial quantities of the necessary high quality within a reasonable period of time or at commercially reasonable rates. Lack of adequate commercial quantities or the inability to develop alternative sources meeting regulatory requirements at similar prices and terms within a reasonable time or any interruptions in supply in the future could have a significant negative effect on our ability to manufacture products, and, consequently, could have a material adverse effect on the results of our operations and financial condition.

We may not be able to protect our proprietary rights

Our success depends in part on whether we can obtain additional patents, maintain trade secret protection and operate without infringing on the proprietary rights of third parties. We have various U.S. patents for the design of our bioresorbable plates and high torque screws and devices and we have filed applications for numerous additional U.S. patents, as well as certain corresponding patent applications outside the United States, relating to our technology. However, we believe we cannot patent the use of our lactic acid copolymer for surgical implants, nor are many of our particular implants generally patentable. There can be no assurance that any of the pending patent applications will be approved or that we will develop additional proprietary products that are patentable. There is also no assurance that any patents issued to us will provide us with competitive advantages, will not be challenged by any third parties or that the patents of others will not prevent the commercialization of products incorporating our technology. Furthermore, there can be no guarantee that others will not independently develop similar products, duplicate any of our products or design around our patents.

Our regenerative cell technology license agreement with the Regents of the University of California contains certain developmental milestones, which if not achieved could result in the loss of exclusivity or loss of the license rights. The loss of such rights could significantly impact our ability to continue the development of the regenerative cell technology and commercialize related

products. Also, our power as licensee to successfully use these rights to exclude competitors from the market is untested. In addition, further legal risk arises from a lawsuit, recently filed by the University of Pittsburgh, seeking a determination that its assignors, rather than the University of California's assignors, are the true inventors of U.S. Patent No. 6,777,231. We are the exclusive, worldwide licensee from the University of California under this patent, which relates to adult stem cells isolated from adipose tissue that can differentiate into two or more of a variety of cell types. If the University of Pittsburgh wins the lawsuit, our license rights to this patent could be nullified or rendered non-exclusive with respect to any third party that might license rights from the University of Pittsburgh, and our regenerative cell strategy could be materially adversely affected.

Our commercial success will also depend, in part, on our ability to avoid infringing patents issued to others. If we were judicially determined to be infringing any third party patent, we could be required to pay damages, alter our products or processes, obtain licenses or cease certain activities. If we are required in the future to obtain any licenses from third parties for some of our products, there can be no guarantee that we would be able to do so on commercially favorable terms, if at all. U.S. patent applications are not immediately made public, so we might be surprised by the grant to someone else of a patent on a technology we are actively using. As noted above as to the University of Pittsburgh lawsuit, even patents issued to us or our licensors might be judicially determined to belong in full or in part to third parties.

Litigation, which would result in substantial costs to us and diversion of effort on our part, may be necessary to enforce or confirm the ownership of any patents issued or licensed to us or to determine the scope and validity of third party proprietary rights. If our competitors claim technology also claimed by us and prepare and file patent applications in the United States, we may have to participate in interference proceedings declared by the U.S. Patent and Trademark Office or a foreign patent office to determine priority of invention, which could result in substantial costs to and diversion of effort, even if the eventual outcome is favorable to us.

Any such litigation or interference proceeding, regardless of outcome, could be expensive and time consuming. We may incur substantial legal costs as a result of the University of Pittsburgh lawsuit, and our president Marc Hedrick is a named individual defendant in that lawsuit because he is one of the inventors identified on the patent. Litigation could subject us to significant liabilities to third parties and require disputed rights to be licensed from third parties or require us to cease using certain technology.

In addition to patents, which as noted cannot protect the fundamentals of our bioresorbable technology and our bioresorbable business, we also rely on unpatented trade secrets and proprietary technological expertise. We rely, in part, on confidentiality agreements with our distribution partners, employees, advisors, vendors and consultants to protect our trade secrets and proprietary technological expertise. There can be no guarantee that these agreements will not be breached, or that we will have adequate remedies for any breach, or that our unpatented trade secrets and proprietary technological expertise will not otherwise become known or be independently discovered by competitors.

Failure to obtain or maintain patent protection, or protect trade secrets, for any reason (third party claims against our patents, trade secrets or proprietary rights, or our involvement in disputes over our patents, trade secrets or proprietary rights, including involvement in litigation), could have a substantial negative effect on the results of our operations and financial condition.

We may not be able to protect our intellectual property in countries outside the United States

Intellectual property law outside the United States is uncertain and in many countries is currently undergoing review and revisions. The laws of some countries do not protect our patent and other intellectual property rights to the same extent as United States laws. We currently have pending patent applications in Europe, Australia, Japan, Canada, China, Korea, and Singapore among others.

We are subject to intensive FDA regulation

As newly developed medical devices, our bioresorbable surgical implants and our regenerative cell harvesting, isolation and delivery devices must receive regulatory clearances or approvals from the FDA and, in many instances, from non-U.S. and state governments, prior to their sale. Our current and future bioresorbable surgical implants for humans and our regenerative cell harvesting, isolation and delivery devices are subject to stringent government regulation in the United States by the FDA under the Federal Food, Drug and Cosmetic Act. The FDA regulates the design/development process, clinical testing, manufacture, safety, labeling, sale, distribution and promotion of medical devices and drugs. Included among these regulations are pre-market clearance and pre-market approval requirements, design control requirements, and the Quality System Regulations / Good Manufacturing Practices. Other statutory and regulatory requirements govern, among other things, establishment registration and inspection, medical device listing, prohibitions against misbranding and adulteration, labeling and post market reporting.

The regulatory process can be lengthy, expensive and uncertain. Before any new medical device may be introduced to the United States market, the manufacturer generally must obtain FDA clearance or approval through either the 510(k) pre-market notification process or the lengthier pre-market approval application "PMA" process. It generally takes from three to 12 months from submission

to obtain 510(k) pre-market clearance although it may take longer. Approval of a PMA could take four or more years from the time the process is initiated. The 510(k) and PMA processes can be expensive, uncertain and lengthy, and there is no guarantee of ultimate clearance or approval. We expect that some of our future products under development will be subject to the lengthier PMA process. Securing FDA clearances and approvals may require the submission of extensive clinical data and supporting information to the FDA, and there can be no guarantee of ultimate clearance or approval. Failure to comply with applicable requirements can result in application integrity proceedings, fines, recalls or seizures of products, injunctions, civil penalties, total or partial suspensions of production, withdrawals of existing product approvals or clearances, refusals to approve or clear new applications or notifications and criminal prosecution.

Medical devices are also subject to post market reporting requirements for deaths or serious injuries when the device may have caused or contributed to the death or serious injury, and for certain device malfunctions that would be likely to cause or contribute to a death or serious injury if the malfunction were to recur. If safety or effectiveness problems occur after the product reaches the market, the FDA may take steps to prevent or limit further marketing of the product. Additionally, the FDA actively enforces regulations prohibiting marketing and promotion of devices for indications or uses that have not been cleared or approved by the FDA.

Our current medical implants are at different stages of FDA review. We currently have 510(k) clearances for a wide variety of bioresorbable surgical implant products and we are constantly engaged in the process of obtaining additional clearances for new and existing products. There can be no guarantee that we will be able to obtain the necessary 510(k) clearances or PMA approvals to market and manufacture our other products in the United States for their intended use on a timely basis, if at all. The FDA approval process may be particularly problematic for our regenerative cell technology products in view of the novel nature of the technology. Delays in receipt of or failure to receive such clearances or approvals, the loss of previously received clearances or approvals, or failure to comply with existing or future regulatory requirements could have a substantial negative effect on the results of our operations and financial condition.

To sell in international markets will subject us to intensive regulation in foreign countries

In cooperation with our distribution partners, particularly Medtronic and Senko (and, hopefully Olympus), we intend to market our current and future products both domestically and in many foreign markets. A number of risks are inherent in international transactions. In order for us to market our products in Europe, Canada, Japan and certain other non-U.S. jurisdictions, we need to obtain and maintain required regulatory approvals or clearances and must comply with extensive regulations regarding safety, manufacturing processes and quality. These regulations, including the requirements for approvals or clearances to market, may differ from the FDA regulatory scheme. International sales also may be limited or disrupted by political instability, price controls, trade restrictions and changes in tariffs. Additionally, fluctuations in currency exchange rates may adversely affect demand for our products by increasing the price of our products in the currency of the countries in which the products are sold.

There can be no assurance that we will obtain regulatory approvals or clearances in all of the countries where we intend to market our products, or that we will not incur significant costs in obtaining or maintaining its foreign regulatory approvals or clearances, or that we will be able to successfully commercialize its current or future products in any foreign markets. Delays in receipt of approvals or clearances to market our products in foreign countries, failure to receive such approvals or clearances or the future loss of previously received approvals or clearances could have a substantial negative effect on the results of our operations and financial condition.

We depend on a few key officers

Our performance is substantially dependent on the performance of our executive officers and other key scientific staff, including Christopher J. Calhoun, our Chief Executive Officer, and Marc Hedrick, MD, our President. We rely upon them for strategic business decisions and guidance. We believe that our future success in developing marketable products and achieving a competitive position will depend in large part upon whether we can attract and retain additional qualified management and scientific personnel. Competition for such personnel is intense, and there can be no assurance that we will be able to continue to attract and retain such personnel. The loss of the services of one or more of our executive officers or key scientific staff or the inability to attract and retain additional personnel and develop expertise as needed could have a substantial negative effect on our results of operations and financial condition.

We may not have enough product liability insurance

The testing, manufacturing, marketing and sale of our surgical implant products involve an inherent risk that product liability claims will be asserted against us, our distribution partners or licensees. There can be no guarantee that our current clinical trial and commercial product liability insurance is adequate or will continue to be available in sufficient amounts or at an acceptable cost, if at all. A product liability claim, product recall or other claim, as well as any claims for uninsured liabilities or in excess of insured liabilities, could have a substantial negative effect on the results of our operations and financial condition. Also, well publicized

claims could cause our stock to fall sharply, even before the merits of the claims are decided by a court.

Our charter documents contain anti-takeover provisions and we have adopted a Stockholder Rights Plan to prevent hostile takeovers

Our Amended and Restated Certificate of Incorporation and Bylaws contain certain provisions that could prevent or delay the acquisition of the Company by means of a tender offer, proxy contest or otherwise. It could discourage a third party from attempting to acquire control of us, even if such events would be beneficial to the interests of our stockholders. Such provisions may have the effect of delaying, deferring or preventing a change of control of us and consequently could adversely affect the market price of our shares. Also, in 2003 we adopted a Stockholder Rights Plan, of the kind often referred to as a poison pill. The purpose of the Stockholder Rights Plan is to prevent coercive takeover tactics that may otherwise be utilized in takeover attempts. The existence of such a rights plan may also prevent or delay the change in control of the Company which could adversely affect the market price of our shares.

We cannot guarantee a liquid trading market for our stock.

Our common stock is listed on the “Prime Standard” segment of the Frankfurt Stock Exchange. We cannot assure that this will result in a satisfactory trading market, particularly for United States investors. Also, there can be no assurance that we will achieve our goal to list our common stock on NASDAQ or a major United States stock exchange.

We pay no dividends

We currently do not intend to pay any cash dividends for the foreseeable future.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk related to fluctuations in interest rates and in foreign currency exchange rates.

Interest Rate Exposure

Our exposure to market risk due to fluctuations in interest rates relates primarily to short-term investments. These short-term investments, reported at an aggregate fair market value of $11,746,000 as of June 30, 2005, consist primarily of investments in debt instruments of financial institutions and corporations with strong credit ratings and United States government obligations. These securities are subject to market rate risk inasmuch as their fair value will fall if market interest rates increase. If market interest rates were to increase immediately and uniformly by 100 basis points from the levels prevailing at June 30, 2005, for example, and assuming average investment duration of seven months, the fair value of the portfolio would not decline by a material amount. We do not use derivative financial instruments to mitigate the risk inherent in these securities. However, we do attempt to reduce such risks by generally limiting the maturity date of such securities, diversifying our investments and limiting the amount of credit exposure with any one issuer. While we do not always have the intent, we do currently have the ability to hold these investments until maturity and, therefore, believe that reductions in the value of such securities attributable to short-term fluctuations in interest rates would not materially affect our financial position, results of operations or cash flows. Changes in interest rates would, of course, affect the interest income we earn on our cash balances after re-investment.

Foreign Currency Exchange Rate Exposure

Our exposure to market risk due to fluctuations in foreign currency exchange rates relates primarily to our cash balances in Europe and Japan. Although we transacted business in various foreign countries before the May 2004 sale of our non-Japan Thin Film business to MAST, settlements were usually based on the U.S. dollar. Transaction gains or losses resulting from cash balances and revenues have not been significant in the past and we are not engaged in any hedging activity in the Euro, the Yen or other currencies. Based on our cash balances and revenues derived from markets other than the United States for the second quarter ended June 30, 2005, a hypothetical 10% adverse change in the Euro or Yen against the U.S. dollar would not result in a material foreign currency exchange loss. Consequently, we do not expect that reductions in the value of such sales denominated in foreign currencies resulting from even a sudden or significant fluctuation in foreign exchange rates would have a direct material impact on our financial position, results of operations or cash flows.

Notwithstanding the foregoing, the indirect effect of fluctuations in interest rates and foreign currency exchange rates could have a material adverse effect on our business, financial condition and results of operations. For example, foreign currency exchange rate fluctuations may affect international demand for our products. In addition, interest rate fluctuations may affect our customers' buying patterns. Furthermore, interest rate and currency exchange rate fluctuations may broadly influence the United States and foreign economies resulting in a material adverse effect on our business, financial condition and results of operations.

Under our Japanese Thin Film agreement with Senko, we would receive payments in the nature of royalties based on Senko's net sales, which would be Yen denominated. We expect such sales or royalties to begin later in 2005 or early 2006.

Foreign currency exchange rates can be obtained from the website at www.oanda.com.

Item 4. Controls and Procedures

Christopher J. Calhoun, our Chief Executive Officer, and Mark E. Saad, our Chief Financial Officer, after evaluating the effectiveness of our "disclosure controls and procedures" (as defined in Securities Exchange Act Rule 13a-15(e)), have concluded that as of June 30, 2005, our disclosure controls and procedures are effective.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On June 14, 2005, we initiated arbitration proceedings against MAST, asserting that MAST is in breach of the Asset Purchase Agreement by failing to pay the final $2,000,000 in purchase price (among other issues). MAST responded asserting their own claims for damages under the Asset Purchase Agreement, for breaches of representations, warranties and covenants, on or about June 23, 2005. In August 2005, the parties settled the arbitration proceedings and gave mutual releases of all claims, excepting those related to the territory of Japan, and agreed to contractual compromises, the most significant of which is our waiving of the obligation for MAST to either pay the final cash purchase installment of two million dollars or to deliver 19% of its shares. Moreover, MAST agreed to supply all required product for any necessary clinical study for the territory of Japan and cooperate in the planning of such study. Neither party paid any cash to the other in the settlement.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Previously reported

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

We held our annual meeting of stockholders on June 28, 2005. Of the 13,972,184 shares of our common stock which could be voted at the annual meeting, 4,893,060 shares of our common stock were represented at the annual meeting in person or by proxy, which constituted a quorum. Voting results were as follows:

a. Election of the following persons to our Board of Directors to hold office until the next annual meeting of stockholders:

	For	Against
Christopher J. Calhoun	4,876,159	16,901
Marshall G. Cox	4,875,059	18,001

Marc H. Hedrick, MD	4,875,059	18,001
Ronald D. Henriksen	4,875,059	18,001
E. Carmack Holmes, MD	4,875,059	18,001
David M. Rickey	4,875,059	18,001
Paul W. Hawran	4,875,059	18,001

b. The proposal to ratify the selection of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2005, received the following votes:

For	Against	Abstain
4,859,129	2,368	31,563

Item 5. Other Information

Material Agreements

On April 28, 2005, we entered into a Common Stock Purchase Agreement with the Olympus Corporation (attached hereto as Exhibit 10.21) which provided for the sale on May 31, 2005 by MacroPore of 1,100,000 shares to Olympus at a price of $10 per share. The agreement also provided Olympus a call option (expiring December 31, 2006) to purchase up to an additional 2,200,000 shares at $10 per share, and the right to a Board appointee/nominee. This Agreement was entered into with the understanding that the parties would use good faith efforts to pursue a strategic alliance relating to our regenerative cell technology.

On May 24, 2005, we entered into a sublease with Biogen Idec, Inc. (attached hereto as Exhibit 10.22) for a 91,000 square foot facility located at 3020 and 3030 Callan Road, San Diego, California. The agreement bears rent at a rate of $1.15 per square foot, with annual increases of 3%. The lease term is 57 months, commencing on October 1, 2005 and expiring on June 30, 2010. In addition, we are committed to providing a minimum of $837,000 in improvements to the facility.

On February 1, 2005, we entered into an agreement with Douglas M. Arm, Ph.D. (attached hereto as Exhibit 10.23) to join us as our Vice-President of Development- Biologics at a salary of $13,333 per month. Dr. Arm's employment is "at will" and includes a car allowance and a grant of 50,000 stock options pursuant to our 1997 Stock Option and Stock Purchase Plan.

On May 1, 2005, we entered into an agreement with Alexander M. Milstein, M.D. (attached hereto as Exhibit 10.24) to join us as our Vice-President of Clinical Research at a salary of $15,000 per month. Dr. Milstein's employment is "at will" and includes an annual target bonus of 15% of his annual salary, a car allowance, and a grant of 50,000 stock options pursuant to our 1997 Stock Option and Stock Purchase Plan.

Property

Our main facility which we use for our corporate headquarters and for manufacturing is located at 6740 Top Gun Street, San Diego, California. We currently lease approximately 27,000 square feet of space at this location of which approximately 6,000 square feet is laboratory space, 12,000 square feet is office space and 9,000 square feet is manufacturing space. Our lease has a five-year term, expiring in 2008. We also lease:

- 14,000 square feet, of which approximately 4,000 square feet is for research and development and 10,000 square feet is office space, at 6749 Top Gun Street, San Diego, California for a five-year term expiring in 2006. We currently sublease 6,000 square feet of this office and warehouse space at the rate charged per square foot in our current lease agreement. We sublease approximate 5,000 square feet to MAST and the remainder to another unrelated party.
- 16,000 additional square feet for research and development activities located at 6749 Top Gun Street, San Diego, California for a five-year term expiring 2008.

On the properties stated above, we pay an aggregate of approximately $60,000 in rent per month. The aggregate sublease amount is $6,000 per month.

On May 24, 2005, we entered into a new lease for 91,000 square feet located at 3020 and 3030 Callan Road, San Diego, California. We intend to move the majority of our operations to this new facility over the next year. The agreement bears rent at a rate of $1.15 per square foot, with annual increases of 3%. The lease term is 57 months, commencing on October 1, 2005 and expiring on June 30, 2010. In addition, we are committed to providing a minimum of $837,000 in improvements to the facility.

Staff

As of June 30, 2005, we had 120 full-time employees, comprised of 73 employees in research and development, 18 employees in manufacturing, 23 employees in management and finance and administration and 6 employees in sales and marketing. From time to time, we also employ independent contractors to support our administrative organizations. Our employees are not represented by any collective bargaining unit and we have never experienced a work stoppage.

Item 6. Exhibits

4.1.1	Amendment No. 1 to Rights Agreement, dated as of May 12, 2005, between Cytori and Computershare Trust Company, as Rights Agent (Incorporated by reference to our Form 8-K filed May 18, 2005).
10.21	Common Stock Purchase Agreement dated April 28, 2005, between Olympus Corporation and Cytori
10.22	Sublease Agreement dated May 24, 2005, between Biogen Idec, Inc. and Cytori

10.23	Employment Offer Letter to Vice President of Development—Biologics, dated February 1, 2005
10.24	Employment Offer Letter to Vice-President of Clinical Research, dated May 1, 2005
15.1	Letter re unaudited interim financial information
31.1	Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a) As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a) As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to 18 U.S.C. Section 1350/ Securities Exchange Act Rule 13a-14(b), as Adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002

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, in San Diego, California, on August 15, 2005.

CYTORI THERAPEUTICS, INC.

Dated: August 15, 2005

By: /s/ Christopher J. Calhoun
Christopher J. Calhoun
Chief Executive Officer

Dated: August 15, 2005

By: /s/ Mark E. Saad
Mark E. Saad
Chief Financial Officer

CYTORI THERAPEUTICS, INC.

EXHIBIT INDEX

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COMMON STOCK PURCHASE AGREEMENT

This Common Stock Purchase Agreement (the "Agreement") is made as of April 28, 2005, by and between MacroPore Biosurgery, Inc., a Delaware corporation (the "Company"), and Olympus Corporation, a Japanese corporation ("Purchaser").

1. **Sale of Stock**. Subject to the terms and conditions of this Agreement, the Company will issue and sell to Purchaser, and Purchaser agrees to purchase from the Company, 1,100,000 shares of the Company's Common Stock (the "Shares") from the Company's treasury at a purchase price of U.S.$10.00 per Share for a total of U.S.$11,000,000 ("Purchase Price") . Immediately upon issuance the Shares will be listed and freely tradeable on the Frankfurt Stock Exchange. The Company has a sufficient number of shares of Common Stock authorized for issuance to issue the Shares.

2. **Purchase**. The purpose of this Agreement is to make joint venture arrangements related to "Memorandum of Agreement for Common Stock Acquisition" and "Memorandum of Agreement for Exclusive Right for Negotiation" which were agreed by and between Company and Purchaser (the "Purpose"), and Company understands that Purchaser's acquisition of the Shares at Purchase Price is for fulfillment of the Purpose. Both parties shall continue to negotiate for the Purpose in good faith. The purchase and sale of the Shares under this Agreement shall occur on May 31, 2005 at a closing at the principal office of the Company by the parties. At the closing, the Company shall deliver to Purchase documentation from Company's transfer agent certifying the completion of the electronic transfer of the Shares into the account specified by Purchaser, and Purchaser shall immediately deliver the Purchase Price therefor by (a) check made payable to the Company, or (b) wire transfer. The purchase of Option Shares (defined below) shall occur upon Company's receipt from Purchaser of a notice of exercise of all or part of the call option which notice shall be accompanied by (a) check made payable to the Company, or (b) wire transfer to the Company, for the full amount of the purchase price of such Option Shares. Upon receipt of the exercise notice Company shall immediately transfer the corresponding number of shares to the account specified by Purchaser.

3. **Option Shares**. Purchaser is granted a call option to purchase an additional 2,200,000 shares of the Company's Common Stock at a purchase price of U.S.$10.00 per share, which option shall expire on December 31, 2006 ("Option Shares") if the company has not received notice by Purchaser of it's 90 days prior notice of intent to exercise. Immediately upon issuance the Option Shares will be listed and freely tradeable on the Frankfurt Stock Exchange. If at the time of issuance of the Option Shares the Company has any securities registered under the U.S. federal Securities Act of 1933, as amended (the "Securities Act"), other than related to stock options, the stock purchase plan or equity incentive plan shares which are registered on form S-8, then immediately upon issuance the Option Shares also will be registered by the Company under the Securities Act and freely tradeable, provided the Company was granted notice of Purchaser's intent to exercise 90 days prior to the exercise of Option Shares.

4. **Limitations on Transfer**. Purchaser shall not assign, encumber or dispose of any interest in the Shares and Option Shares except in compliance with applicable securities laws and regulations of applicable countries and stock exchanges.

5. **Investment Representations**. In connection with the purchase of the Shares, Purchaser represents to the Company the following:

(a) Purchaser is aware of the Company's business affairs and financial condition and has acquired sufficient information about the Company to reach an informed and knowledgeable decision to acquire the Shares. The Company is a reporting company under the U.S. Securities and Exchange Act of 1934, as amended (the "Exchange Act"), and its various periodic reports and other filings made with the U.S. Securities and Exchange Commission (the "Commission") are available for public inspection on the EDGAR system at www.sec.gov. The Company afforded Purchaser and Purchaser's advisors full and complete access to all additional information with respect to the Company and the Company's operations that Purchaser and Purchaser's advisors deemed necessary to evaluate the merits and risks of an investment in the Company. Purchaser further acknowledges that Purchaser and Purchaser's advisors have had the opportunity to ask questions of and receive answers from the Company's management concerning this investment.

(b) Purchaser understands that the Shares have not been registered under the Securities Act and are being offered pursuant to an exemption from the registration requirements thereunder, which exemption depends upon, among other things, the bona fide nature of Purchaser's investment intent as expressed herein.

(c) Purchaser understands that the Shares are "restricted securities" within the meaning of applicable U.S. federal and state securities laws and that, pursuant to these laws, Purchaser must hold the Shares unless the Shares are registered with the Commission and qualified by state authorities, or an exemption from such registration and qualification requirements is available (e.g., Rule 144 or Regulation S). Purchaser further acknowledges that if an exemption from registration or qualification is available, it

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may be conditioned on various requirements including, but not limited to, the time and manner of sale, the holding period for the Shares. The Company shall reasonably cooperate with Purchaser to effect any secondary transfer of the Shares and/or Option Shares.

(d) Purchaser is an "accredited investor," as defined in Rule 501 promulgated pursuant to the Securities Act.

(e) Purchaser has not entered into any agreement to pay commissions to any persons with respect to the purchase or sale of the Shares, except commissions for which Purchaser will be responsible.

(f) Purchaser understands and acknowledges that no Japanese, German or United States federal or state agency, governmental authority, regulatory body, stock exchange or other entity has made any finding or determination as to the merits of this investment, nor have any such agencies, governmental authorities, regulatory bodies, stock exchanges or other entities made any recommendation or endorsement with respect to the Shares.

(g) Purchaser, in evaluating the merits of an investment in the Shares, is not relying on the Company, its counsel, or any financial or other advisor to the Company for an evaluation of the tax, legal or other consequences of an investment in the Shares.

(h) Purchaser is purchasing the Shares for investment for its own account only and not with a view to, or for resale in connection with, any "distribution" thereof within the meaning of the Securities Act.

6. **Restrictive Legends**. The global certificates overlying the Shares shall bear the following legends:

"The shares of common stock of MacroPore, Inc. represented hereby have not been and will not be registered under the United States Securities Act of 1933, as amended (the "Securities Act"). These securities may not be offered, sold, pledged or otherwise transferred (nor may exposure with respect to the shares otherwise be hedged) except (A)(1) in an offshore transaction complying with Rule 903 or Rule 904 of Regulation S under the Securities Act, (2) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available), or (3) pursuant to another valid exemption from registration under the Securities Act (if available), and (B) in each case in accordance with all applicable securities laws of the States of the United States. No representation can be made as to the availability of the exemption provided by Rule 144 under the Securities Act for resales of the shares.

This certificate also evidences and entitles the holder hereof to certain rights as set forth in a Rights Agreement between MacroPore Biosurgery, Inc. and Computershare Trust Company, Inc., a Colorado corporation, as Rights Agent, dated as of May 29, 2003 (the "Rights Agreement"), the terms of which are hereby incorporated herein by reference and a copy of which is on file at the principal executive offices of MacroPore Biosurgery, Inc. Under certain circumstances, as set forth in the Rights Agreement, such Rights will be evidenced by separate certificates and will no longer be evidenced by this certificate. MacroPore Biosurgery, Inc. will mail to the holder of this certificate a copy of the Rights Agreement without charge after receipt of a written request therefor. Under certain circumstances set forth in the Rights Agreement, Rights issued to, or held by, any Person who is, was or becomes an Acquiring Person or an Affiliate or Associate of an Acquiring Person (as defined in the Rights Agreement) and certain related persons, whether currently held by or on behalf of such Person or by any subsequent holder, may become null and void."

7. **Registration**. The Company shall use reasonable efforts to, within 30 business days after the Company's common stock is first listed on Nasdaq or on any U.S. national securities exchange, prepare and file with the Commission a Registration Statement covering the resale of the Shares for an offering to be made on a continuous basis pursuant to Rule 415. The Registration Statement shall be on Form S-3 (except if the Company is not then eligible to register for resale the Shares on Form S-3, in which case such registration shall be on another appropriate form in accordance with the U.S. Securities Act and the rules promulgated thereunder). The Company shall use its reasonable efforts to cause the Registration Statement to be declared effective under the U.S. Securities Act within 60 business days after such filing. The Company shall keep such Registration Statement continuously effective under the Securities Act for a period of two years (the "Effectiveness Period").

8. **Registration Procedures; Company's Obligations**. In connection with the registration of the Shares, the Company shall:

(a) Furnish to the Purchaser a copy of the Registration Statement as proposed to be filed.

(b) Prepare and file with the Commission such amendments, including post-effective amendments, to the Registration Statement as may be necessary to keep the Registration Statement continuously effective as to the applicable Shares for the Effectiveness Period; (ii) cause the related prospectus of the Company (the "Prospectus") to be amended or supplemented by any required Prospectus supplement, and as so supplemented or amended to be filed pursuant to Rule 424 (or any similar provisions then in force) promulgated under the Securities Act; and (iii) respond promptly to any comments received from the Commission with

respect to the Registration Statement or any amendment thereto and promptly provide the Purchaser true and complete copies of all correspondence from and to the Commission relating to the Registration Statement.

(c) Notify the Purchaser (i)(A) when a Prospectus or any Prospectus supplement or post-effective amendment to the Registration Statement is proposed to be filed, (B) when the Commission notifies the Company whether there will be a "review" of such Registration Statement and whenever the Commission comments in writing on such Registration Statement, and (C) with respect to the Registration Statement or any post-effective amendment, when the same has become effective; (ii) of any request by the Commission or any other Federal or state governmental authority for amendments or supplements to the Registration Statement or Prospectus or for additional information; (iii) of the issuance by the Commission of any stop order suspending the effectiveness of the Registration Statement covering any or all of the Shares or the initiation of any proceedings for that purpose; (iv) of the receipt by the Company of any notification with respect to the suspension of the qualification or exemption from qualification of any of the Shares for sale in any State of the U.S., or the initiation or threatening of any proceeding for such purpose; and (v) of the occurrence of any event that makes any statement made in the Registration Statement or Prospectus or any document incorporated or deemed to be incorporated therein by reference untrue in any material respect or that requires any revisions to the Registration Statement, Prospectus or other documents so that, in the case of the Registration Statement or the Prospectus, as the case may be, it will not contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

(d) Use its reasonable commercial efforts to avoid the issuance of, or, if issued, obtain the withdrawal of, (i) any order suspending the effectiveness of the Registration Statement, or (ii) any suspension of the qualification (or exemption from qualification) of any of the Shares for sale in any State of the U.S., at the earliest practicable moment.

(e) If requested by the Purchaser, (i) promptly incorporate in a Prospectus supplement or post-effective amendment to the Registration Statement such information as the Company reasonably agrees should be included therein, and (ii) make all required filings of such Prospectus supplement or such post-effective amendment as soon as practicable after the Company has received notification of the matters to be incorporated in such Prospectus supplement or post-effective amendment.

(f) Furnish to the Purchaser, without charge, at least one conformed copy of the Registration Statement and each amendment thereto, including financial statements and schedules, all documents incorporated or deemed to be incorporated therein by reference, and all exhibits to the extent requested by such Person (including those previously furnished or incorporated by reference) promptly after the filing of such documents with the Commission.

(g) Promptly deliver to the Purchaser, without charge, as many copies of the Registration Statement, Prospectus or Prospectuses (including each form of prospectus) and each amendment or supplement thereto as Purchaser may reasonably request; and the Company hereby consents to the use of such Prospectus and each amendment or supplement thereto by the Purchaser in connection with the offering and sale of the Shares covered by such Prospectus and any amendment or supplement thereto. Should the Purchaser offer or sell the Shares, such Purchaser agrees to comply with all applicable securities laws.

(h) Use its reasonable commercial efforts to register or qualify or cooperate with the selling Purchaser in connection with the registration or qualification (or exemption from such registration or qualification) of such Shares for offer and sale under the securities (or "Blue Sky") laws of each State of the U.S. as the Purchaser reasonably requests in writing, to keep each such registration or qualification (or exemption therefrom) effective during the Effectiveness Period and to do any and all other acts or things necessary or advisable to enable the disposition in such States of the Shares covered by a Registration Statement; provided, however, that the Company shall not be required to qualify generally to do business in any jurisdiction where it is not then so qualified or to take any action that would subject it to general service of process in any such jurisdiction where it is not then so subject or subject the Company to any tax in any such jurisdiction where it is not then so subject.

(i) Upon the occurrence of any event contemplated by Section 8(c)(v), promptly prepare a supplement or amendment, including a post-effective amendment, to the Registration Statement or a supplement to the related Prospectus or any document incorporated or deemed to be incorporated therein by reference, and file any other required document so that, as thereafter delivered, neither the Registration Statement nor such Prospectus will contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

(j) Use its reasonable efforts to cause all Shares to be listed on any U.S. national securities exchange, U.S. quotation system, or U.S. over the counter bulletin board, if any, on which the same securities issued by the Company are then listed.

(k) If (i) there is material non-public information regarding the Company which the Company's Board of Directors reasonably determines not to be in the Company's best interest to disclose and which the Company is not otherwise required to disclose, or (ii) there is a significant business opportunity (including, but not limited to, the acquisition or disposition of assets (other than in the ordinary course of business) or any merger, consolidation, tender offer or other similar transaction) available to the Company which the Company's Board of Directors reasonably determines not to be in the Company's best interest to disclose and

which the Company would be required to disclose under the Registration Statement, then the Company may suspend effectiveness of the Registration Statement and suspend the sale of Shares under the Registration Statement one time every three months or three times in any twelve month period, provided that the Company may not suspend its obligation for more than 60 days in the aggregate in any 12 month period.

9. **Registration Procedures; Purchaser's Obligations**. In connection with the registration of the Shares, the Purchaser shall:

(a) (i) not sell any Shares under the Registration Statement until it has received copies of the Prospectus as then amended or supplemented as contemplated in Section 8(g) and notice from the Company that such Registration Statement and any post-effective amendments thereto have become effective as contemplated by Section 8(c), (ii) comply with the prospectus delivery requirements of the Securities Act as applicable to it in connection with sales of Shares pursuant to the Registration Statement, and (iii) furnish to the Company information regarding such Purchaser and the distribution of such Shares as is required by law to be disclosed in the Registration Statement.

(b) upon receipt of a notice from the Company of the occurrence of any event of the kind described in Section 8(c)(ii), 8(c)(iii), 8(c)(iv), 8(c)(v) or 8(k), forthwith discontinue disposition of such Shares under the Registration Statement until the Purchaser's receipt of the copies of the supplemented Prospectus and/or amended Registration Statement contemplated by Section 8(i), or until it is advised in writing by the Company that the use of the applicable Prospectus may be resumed, and, in either case, has received copies of any additional or supplemental filings that are incorporated or deemed to be incorporated by reference in such Prospectus or Registration Statement.

10. Registration Expenses.

All reasonable fees and expenses incident to the performance of or compliance with this Agreement by the Company shall be borne by the Company whether or not any Shares are sold pursuant to the Registration Statement. The fees and expenses referred to in the foregoing sentence shall include, without limitation, the following: (i) all registration and filing fees; (ii) printing expenses; (iii) messenger, telephone and delivery expenses of the Company; (iv) fees and disbursements of counsel for the Company; and (v) fees and expenses of all other persons retained by the Company in connection with the consummation of the transactions contemplated by this Agreement, including, without limitation, the Company's independent public accountants. In addition, the Company shall be responsible for all of its internal expenses incurred in connection with the consummation of the transactions contemplated by this Agreement (including, without limitation, all salaries and expenses of its officers and employees performing legal or accounting duties), and the expense of any annual audit.

11. Indemnification.

(a) Indemnification by the Company. The Company shall indemnify and hold harmless Purchaser, its permitted assignees, officers, directors, agents, brokers, investment advisors and employees, each person who controls Purchaser or a permitted assignee (within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act) and the officers, directors, agents and employees of each such controlling person, and the respective successors, assigns, estate and personal representatives of each of the foregoing, to the fullest extent permitted by applicable law, from and against any and all claims, losses, damages, liabilities, penalties, judgments, costs (including, without limitation, costs of investigation) and expenses (including, without limitation, reasonable attorneys' fees and expenses) (collectively, "Losses"), as incurred, arising out of or relating to any untrue or alleged untrue statement of a material fact contained in the Registration Statement, any Prospectus, as supplemented or amended, if applicable, or arising out of or relating to any omission or alleged omission of a material fact required to be stated therein or necessary to make the statements therein (in the case of any Prospectus or supplement thereto, in the light of the circumstances under which they were made) not misleading, except (i) to the extent, but only to the extent, that such untrue statements or omissions are based solely upon information regarding the Purchaser furnished in writing to the Company by the Purchaser expressly for use therein, or (ii) as a result of the failure of the Purchaser to deliver a Prospectus, as amended or supplemented, to a purchaser in connection with an offer or sale. The Company shall notify the Purchaser promptly of the institution, threat or assertion of any Proceeding of which the Company is aware in connection with the transactions contemplated by this Agreement. Such indemnity shall remain in full force and effect regardless of any investigation made by or on behalf of an Indemnified Party (as defined in Section 11(c) hereof) and shall survive the transfer of the Shares by the Purchaser.

(b) Conduct of Indemnification Proceedings. If any Proceeding shall be brought or asserted against any Person entitled to indemnity pursuant to Section 11(a) or 11(b) hereunder (an "Indemnified Party"), such Indemnified Party promptly shall notify the Person from whom indemnity is sought (the "Indemnifying Party) in writing, and the Indemnifying Party shall assume the defense thereof, including the employment of counsel reasonably

satisfactory to the Indemnified Party and the payment of all fees and expenses incurred in connection with defense thereof; provided, that the failure of any Indemnified Party to give such notice shall not relieve the Indemnifying Party of its obligations or liabilities pursuant to this Agreement, except (and only) to the extent that it shall be finally determined by a court of competent jurisdiction (which determination is not subject to appeal or further review) that such

failure shall have materially and adversely prejudiced the Indemnifying Party.

An Indemnified Party shall have the right to employ separate counsel in any such Proceeding and to participate in the defense thereof, but the fees and expenses of such counsel shall be at the expense of such Indemnified Party or Parties unless: (i) the Indemnifying Party has agreed in writing to pay such fees and expenses; or (ii) the Indemnifying Party shall have failed promptly to assume the defense of such Proceeding and to employ counsel reasonably satisfactory to such Indemnified Party in any such Proceeding; or (iii) the named parties to any such Proceeding (including any impleaded parties) include both such Indemnified Party and the Indemnifying Party, and such Indemnified Party shall have been advised by counsel that a conflict of interest is likely to exist if the same counsel were to represent such Indemnified Party and the Indemnifying Party (in which case, if such Indemnified Party notifies the Indemnifying Party in writing that it elects to employ separate counsel at the expense of the Indemnifying Party, the Indemnifying Party shall not have the right to assume the defense thereof and such counsel shall be at the expense of the Indemnifying Party). The Indemnifying Party shall not be liable for any settlement of any such Proceeding effected without its written consent, which consent shall not be unreasonably withheld, conditioned or delayed. No Indemnifying Party shall, without the prior written consent of the Indemnified Party, which consent shall not unreasonably be withheld, conditioned or delayed, effect any settlement of any pending Proceeding in respect of which any Indemnified Party is a party, unless such settlement includes an unconditional release of such Indemnified Party from all liability on claims that are the subject matter of such Proceeding.

All reasonable fees and expenses of the Indemnified Party (including reasonable fees and expenses to the extent incurred in connection with investigating or preparing to defend such Proceeding in a manner not inconsistent with this Section) shall be paid to the Indemnified Party, as incurred, within 10 business days of written notice thereof to the Indemnifying Party (regardless of whether it is ultimately determined that an Indemnified Party is not entitled to indemnification hereunder; provided, that the Indemnifying Party may require such Indemnified Party to undertake to reimburse all such fees and expenses to the extent it is finally judicially determined that such Indemnified Party is not entitled to indemnification hereunder or pursuant to applicable law).

(c) The indemnity agreement contained in this Section is in addition to any liability that the Indemnifying Parties may have to the Indemnified Parties.

12. **Board Seat**. Promptly after the closing of Purchaser's purchase of the Shares, the Company's Board of Directors shall elect a candidate, designated by Purchaser, to serve as a member of the Company's Board of Directors. So long as Purchaser continues to own all of the Shares specified in Section 1 of this Agreement, the Company shall, at each election of directors by its stockholders, include on the Board-of-Directors-recommend slate of director nominees in the proxy statement, one director nominee designated by Purchaser (unless a Purchaser designee would continue to serve on the Board of Directors after such election even if not elected at such election).

13. **Miscellaneous**.

(a) **Governing Law**. This Agreement and all acts and transactions pursuant hereto and the rights and obligations of the parties hereto shall be governed, construed and interpreted in accordance with the laws of the State of California, without giving effect to principles of conflicts of law.

(b) **Entire Agreement; Enforcement of Rights**. This Agreement sets forth the entire agreement and understanding of the parties relating to the subject matter herein and merges all prior discussions between them with regard to such subject matter. No modification of or amendment to this Agreement, nor any waiver of any rights under this Agreement, shall be effective unless in writing signed by the parties to this Agreement. The failure by either party to enforce any rights under this Agreement shall not be construed as a waiver of any rights of such party.

(c) **Severability**. If one or more provisions of this Agreement are held to be unenforceable under applicable law, the parties agree to renegotiate such provision in good faith. In the event that the parties cannot reach a mutually agreeable and enforceable replacement for such provision, then (i) such provision shall be excluded from this Agreement, (ii) the balance of the Agreement shall be interpreted as if such provision were so excluded and (iii) the balance of the Agreement shall be enforceable in accordance with its terms.

(d) **Construction**. This Agreement is the result of negotiations between and has been reviewed by both of the parties hereto and their respective counsel, if any; accordingly, this Agreement shall be deemed to be the product of both of the parties hereto, and no ambiguity shall be construed in favor of or against either one of the parties hereto.

(e) **Notices**. Any notice required or permitted by this Agreement shall be in writing and shall be deemed sufficient when delivered personally or sent by fax or 48 hours after being deposited in the U.S. mail, as certified or registered mail, with postage prepaid, and addressed to the party to be notified at such party's address or fax number as set forth below or as subsequently modified by written notice.

(f) **Counterparts.** This Agreement may be executed in counterparts, each of which shall be deemed an original and all of which together shall constitute one instrument.

[Signature Page Follows]

The parties have executed this Common Stock Purchase Agreement as of the date first set forth above.
MACROPORE BIOSURGERY, INC.

By: /s/ Christopher J. Calhoun
Title: Chief Executive Officer
Address:
6740 Top Gun Street
San Diego, CA 92121

Fax: U.S. 858-458-0994

PURCHASER:
OLYMPUS CORPORATION

By: /s/ Tsuyoshi Kikukawa
Title: President

Address:
43-2 Hatagaya 2-chome,
Shibuya-ku, Tokyo,
JAPAN

Fax: Japan 03-3340-2062

SUBLEASE AGREEMENT

This SUBLEASE AGREEMENT ("Sublease") is made and entered into as of May 24, 2005 by and between BIOGEN IDEC INC., a Delaware corporation ("Sublandlord"), and MACROPORE BIOSURGERY, INC., a Delaware corporation ("Subtenant").

WHEREAS, BIODEC, LLC, a California limited liability company (as successor to Professors Fund I, L.P., as Managing Agent for All Spectrum Services, Inc.), as Landlord ("Landlord"), and Sublandlord, as Tenant, are parties to a certain Lease Agreement dated as of August 13, 1996 ("Original Lease"), as amended by that certain First Amendment to Lease ("First Amendment") dated as of October 1, 1999, that certain Second Amendment to Lease ("Second Amendment") dated as of June 16, 2000, that certain Third Amendment to Lease ("Third Amendment") dated as of October 13, 2000, and that certain Fourth Amendment to Lease ("Fourth Amendment") dated as of March 5, 2004 (collectively, as amended, the "Master Lease"), whereby Landlord leased to Sublandlord the buildings located at 3020 Callan Road (the "3020 Building") and 3030 Callan Road (the "3030 Building," and together with the 3020 Building, collectively, the "Buildings"), San Diego, CA ("Master Premises"), as more particularly described in the Master Lease, upon the terms and conditions contained therein. All initially capitalized terms used herein shall have the same meanings ascribed to them in the Master Lease unless otherwise defined herein. A copy of the Master Lease is attached hereto as Exhibit "A" and made a part hereof. Sublandlord is vested with the leasehold estate described in the Master Lease.

WHEREAS, Sublandlord and Subtenant are desirous of entering into a sublease of the entirety of the Master Premises so indicated on the demising plan annexed hereto as Exhibit "B" and made a part hereof ("Sublease Premises") on the terms and conditions hereafter set forth.

NOW, THEREFORE, in consideration of the mutual covenants herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto mutually covenant and agree as follows:

1. Demise. Sublandlord hereby subleases and demises to Subtenant and Subtenant hereby hires and subleases from Sublandlord the Sublease Premises consisting of approximately 45,117 rentable square feet ("RSF") of the entirety of the 3020 Building, and approximately 45,883 RSF of the entirety of the 3030 Building, or approximately 91,000 RSF of space in the aggregate, subject to the terms, covenants and conditions hereinafter set forth. The parties stipulate that the square footage of the Sublease Premises shall be as specified above.

2. Sublease Term.

   a. *Sublease Term. The term of this Sublease ("Term") shall commence on October 1, 2005 ("Sublease Commencement Date"), and end, unless sooner terminated as provided herein, on June 30, 2010 ("Sublease Expiration Date")*

   b. *License for Early Entry Period. Prior to the Sublease Commencement Date and not later than ten (10) days following the full execution of this Sublease and Sublandlord's receipt Landlord's consent to this Sublease, Subtenant shall have a license (the "License") to enter onto and occupy the Sublease Premises (the "License Area"). The License shall be limited to the use and occupancy of the Licensed Area solely for purposes of construction of the Tenant Improvements (defined below) and installing data and telecommunications cabling and equipment. Subtenant's use and occupancy of the License Area shall be substantially on all the terms and provisions of this Sublease, as the same apply to the Sublease Premises, including, without limitation, provisions requiring maintenance of insurance by Subtenant and indemnity obligations in favor of Sublandlord and payment of utilities used by Subtenant during such occupancy; provided, however, Subtenant shall not be required to pay Rent (defined below) during the term of the License. The Deposit shall secure performance of Subtenant with respect to its obligations in connection with the License and, effective on the Sublease Commencement Date, the License shall automatically terminate. Sublandlord has no obligation to prepare the License Area for Subtenant's use or occupancy other than the removal of the furniture, fixtures and equipment identified on the attached Schedule 2(b) within thirty (30) days of the commencement of the License. Except for the removal of such items, the License Area shall be tendered to Subtenant in its "as-is" condition with Building systems in working order and condition. Subtenant shall not undertake any action with respect to the License Area which is incompatible with the duration and scope of the License. Subtenant agrees that the License does not constitute a leasehold interest in the License Area and Subtenant agrees not to assert any leasehold interest rights in or to the License Area. Notwithstanding anything to the contrary in this Section 2(b), in the event Subtenant commences normal operation of its business*

(i.e., activities other than readying the Sublease Premises for Subtenant's occupancy as described hereinabove) in any portion of the Sublease Premises prior to the Sublease Commencement Date, Subtenant shall pay to Sublandlord all additional rent payable pursuant to the Master Lease, including Operating Expenses (as defined in Section 4(c) below), applicable to such portion of the Sublease Premises, such payment to be made in advance, for each month (or portion thereof) of such occupancy; provided, however, Subtenant shall not be required to pay Base Rental (as defined in Section 4(a) below) prior to the Sublease Commencement Date.

3. Use. The Sublease Premises shall be used and occupied by Subtenant solely for office, laboratory and research and development uses, and any other uses permitted under the Master Lease.

4. Subrental.

   a. *Base Rental. Subject to the provisions of Section 4(f) below, beginning with the Sublease Commencement Date and thereafter during the Term of this Sublease and ending on the Sublease Expiration Date, Subtenant shall pay to Sublandlord monthly installments of base rent of initially calculated at the rate of One and 15/100 Dollars ($1.15) per RSF of Sublease Premises ("Base Rental"). Base Rental shall initially be One Hundred Four Thousand Six Hundred Fifty and 00/100 Dollars ($104,650.00). Commencing as of the first (1st) anniversary of the Sublease Commencement Date, Base Rental shall increase by three percent (3%), and shall increase by three percent (3%) each anniversary of the Sublease Commencement Date thereafter. Base Rental and additional rent (including Operating Expenses) shall hereinafter be collectively referred to as "Rent." Sublandlord and Subtenant intend that Subtenant's obligations under this Sublease shall be on a "triple net" basis.*

   b. *Prorations. If the Sublease Commencement Date is not the first (1st) day of a month, or if the Sublease Expiration Date is not the last day of a month, a prorated installment of monthly Base Rental based on a thirty (30) day month shall be paid for the fractional month during*

which the Term commenced or terminated.

c. *Additional Rent. Beginning with the Sublease Commencement Date and continuing to the Sublease Expiration Date, Subtenant shall also pay as additional rent all Operating Expenses and the full amount of additional rent payable by Sublandlord as Tenant pursuant to the Master Lease. The term "Operating Expenses" shall mean the full cost of all operating expenses applicable to the Sublease Premises, including Building maintenance, common area expenses, insurance premiums for casualty insurance maintained with respect to the Buildings (but excluding any insurance coverages for Subtenant's personal property), security services provided by Sublandlord, real estate taxes, and utilities. Subtenant shall also pay to Sublandlord as additional rent for this subletting the cost of all additional expenses, costs and charges other than Operating Expenses which are incurred: (i) in connection with any additional services requested by Subtenant, (ii) in connection with any act performed by Sublandlord at Subtenant's request or on Subtenant's behalf if Subtenant fails to perform an act which Subtenant is required to perform under this Sublease, (iii) as a result of Subtenant's usage of services or utilities outside the Buildings' standard hours of operation, or (iv) as a result of Subtenant's misuse of or damage to the Sublease Premises.*

d. *Payment of Rent. Except as otherwise specifically provided in this Sublease, Rent shall be payable in lawful money without demand, and without offset, counterclaim, or setoff in monthly installments, in advance, on the first day of each and every month during the Term of this Sublease. All of said Rent is to be paid to Sublandlord at its office at the address set forth in Section 13 herein, or at such other place or to such agent and at such place as Sublandlord may designate by notice to Subtenant. Any additional rent payable on account of items which are not payable monthly by Subtenant to Sublandlord under this Sublease is to be paid to Sublandlord as and when such items are payable by Sublandlord to third parties or to Landlord under the Master Lease unless a different time for payment is elsewhere stated herein. Upon written request therefor, Sublandlord agrees to provide Subtenant with copies of any statements or invoices received by Sublandlord from Landlord pursuant to the terms of the Master Lease. Sublandlord reserves the right to collect from Subtenant, and Subtenant shall pay to Sublandlord within thirty (30) days of receipt of an invoice therefor, the amount of any underpayment revealed after the Sublease Expiration Date or earlier termination of this Sublease pursuant to Section 17 by a statement of actual costs incurred by Sublandlord.*

e. *Late Charge. Subtenant shall pay to Sublandlord an administrative charge at an annual interest rate equal to the Prime Rate (as stated under the column "Money Rates" in the Wall Street Journal) plus three percent (3%) on all amounts of Rent payable hereunder which are not paid within three (3) days of the date on which such payment is due, such charge to accrue from the date upon which such amount was due until paid.*

f. *Rental Abatement. Provided Subtenant shall not be in default of any provision of this Sublease, Subtenant shall receive a credit ("T/I Credit") against the payment of Base Rental for certain tenant improvements described in the attached Exhibit "C" (the "Tenant Improvements") in an amount equal to Eight Hundred Thirty-Seven Thousand*

Two Hundred and 00/100 Dollars ($837,200.00). The T/I Credit shall be given in the form of an abatement of Base Rental in months one (1) through eight (8) of the Term ("T/I Credit Period"). Subtenant shall be obligated to pay all additional rent during the T/I Credit Period. The grant of the T/I Credit does not constitute Sublandlord's consent to the Tenant Improvements proposed to be installed in the Sublease Premises by Subtenant, such approval to be governed by Section 20 of this Sublease. If Subtenant fails to construct the Tenant Improvements, Sublandlord may recover from Subtenant the T/I Credit. Additionally, upon any default by Subtenant of its obligations under this Sublease during the Term, in addition to all other remedies available to Sublandlord at law or in equity, Sublandlord may recover from Subtenant the remaining unamortized portion of the T/I Credit, amortized over the Term.

5. Security Deposit. Concurrently with the execution of this Sublease, Subtenant shall deposit with Sublandlord the sum of One Hundred Forty-Eight Thousand One Hundred Forty-Eight and 00/100 Dollars ($148,148.00) ("Deposit"), which shall be held by Sublandlord as security for the full and faithful performance by Subtenant of its covenants and obligations under this Sublease. The Deposit is not an advance Rent deposit, an advance payment of any other kind, or a measure of Sublandlord's damages in case of Subtenant's default. If Subtenant defaults in the full and timely performance of any or all of Subtenant's covenants and obligations set forth in this Sublease, then Sublandlord may, from time to time, without waiving any other remedy available to Sublandlord, use the Deposit, or any portion of it, to the extent necessary to cure or remedy the default or to compensate Sublandlord for all or a part of the damages sustained by Sublandlord resulting from Subtenant's default. Subtenant shall immediately pay to Sublandlord within five (5) days following demand, the amount so applied in order to restore the Deposit to its original amount, and Subtenant's failure to immediately do so shall constitute a default under this Sublease. If Subtenant is not in default with respect to the covenants and obligations set forth in this Sublease at the expiration or earlier termination of the Sublease, Sublandlord shall return the Deposit to Subtenant after the expiration or earlier termination of this Sublease in accordance with the provisions of California Civil Code Section 1950.7. Sublandlord's obligations with respect to the Deposit are those of a debtor and not a trustee. Sublandlord shall not be required to maintain the Deposit separate and apart from Sublandlord's general or other funds and Sublandlord may commingle the Deposit with any of Sublandlord's general or other funds. Subtenant shall not at any time be entitled to interest on the Deposit.

6. Signage. Subtenant shall have such rights to maintain Subtenant identification signs in any location in, on, or about the Sublease Premises as are granted to Sublandlord under the Master Lease, subject to all of the terms and provisions thereof. The size, appearance and location of all such signs shall be subject to Sublandlord's prior approval, and shall be subject to Subtenant's receipt of all require governmental permits and approvals. The cost of such signs, including the installation, maintenance and removal thereof, shall be at Subtenant's sole cost and expense. If Subtenant fails to maintain its Sublease Premises sign, or if Subtenant fails to remove same upon the expiration or earlier termination of this Sublease and repair any damage caused by such removal, Sublandlord may do so at Subtenant's expense and Subtenant shall reimburse Sublandlord for all actual costs incurred by Sublandlord to effect such removal within five (5) days after Subtenant's receipt of an invoice therefor.

7. Parking. At no additional rent or charge other than payment of Operating Expenses therefor, Subtenant shall have the right, during the Term of this Sublease, to use on a non-reserved basis parking spaces in the parking facilities servicing the Buildings in the number permitted under the Master Lease applicable to the Sublease Premises. All such parking privileges shall be subject to the terms and conditions set forth in the Master Lease.

8. Incorporation of Terms of Master Lease.

a. *This Sublease is subject and subordinate to the Master Lease. Subject to the modifications set forth in this Sublease, the terms of the Master Lease are incorporated herein by reference, and shall, as between Sublandlord and Subtenant (as if they were "Landlord" and "Tenant,"*

respectively, under the Master Lease) constitute the terms of this Sublease except to the extent that they are inapplicable to, inconsistent with, or modified by, the terms of this Sublease. Notwithstanding the foregoing, to the extent provisions of the Master Lease are unique and personal to Sublandlord's interest in the Buildings pursuant to the Master Lease, Subtenant shall not be required to comply with such provisions. In the event of any inconsistencies between the terms and provisions of the Master Lease and the terms and provisions of this Sublease, the terms and provisions of this Sublease shall govern. Subtenant acknowledges that it has reviewed the Master Lease and is familiar with the terms and conditions thereof.

b. For the purposes of incorporation herein, the terms of the Master Lease are subject to the following additional modifications:

i. In all provisions of the Master Lease (under the terms thereof and without regard to modifications thereof for purposes of incorporation into this Sublease) requiring the approval or consent of Landlord, Subtenant shall be required to obtain the approval or consent of both Sublandlord and Landlord.

ii. In all provisions of the Master Lease requiring Tenant to submit, exhibit to, supply or provide Landlord with evidence, certificates, or any other matter or thing, including, without limitation, the provisions of Paragraph 12.1 thereof, Subtenant shall be required to submit, exhibit to, supply or provide, as the case may be, the same to both Landlord and Sublandlord. In any such instance, Sublandlord shall determine if such evidence, certificate or other matter or thing shall be satisfactory.

iii. In the event of any taking by eminent domain or casualty to the Sublease Premises such that Subtenant is deprived of the use and occupancy of greater than fifty percent (50%) of the Sublease Premises for a period in excess of sixty (60) days, Subtenant and Sublandlord shall each have the right to terminate this Sublease upon not less than thirty (30) days written notice to the other. In the event of any such taking by eminent domain or casualty such that Subtenant is deprived of fifty percent (50%) or less of the use and occupancy of the Sublease Premises, or in the event Subtenant elects to continue occupancy of the remaining portion of the Sublease Premises after the occurrence of a taking or casualty giving Subtenant a right to terminate this Sublease, the Rent shall be proportionally reduced for the portion of the Term during which Subtenant is prevented from using and occupying the damaged or taken portion of the Sublease Premises. Sublandlord shall have no obligation to restore or rebuild any portion of the Sublease Premises after any destruction or taking by eminent domain, and Subtenant shall have no rights to any portion of the award in any eminent domain proceeding affecting the Sublease Premises.

iv. The following provisions of the Master Lease shall not be incorporated into this Sublease:

1. Paragraphs 1.1, 1.3-1.8, inclusive, 1.10, 1.12, 4.1, 4.2, 4.5, 4.7, 6.1, 6.2, and 17.7 of the Original Lease;

2. Articles 2, 3, 19, 30, 32, 37.3, 41 and 42 of the Original Lease;

3. Paragraph 4.3(b)(15) of the Original Lease relating to operating expense exclusions, except to the extent such coolant replacement costs are not passed through to Sublandlord as Tenant;

4. Paragraph 5.2 of the Original Lease, solely with respect to any obligation of Sublandlord to bring the Buildings into compliance with the ADA;

5. Paragraphs 1-5, inclusive, 8, 10, 12 and 14-18, inclusive, of the First Amendment, and Exhibit "B" of the First Amendment;

6. Paragraph 6 of the First Amendment, except that Subtenant shall be obligated to comply with all applicable laws, including the ADA, and shall be responsible for compliance with the ADA for any alterations to the Sublease Premises made by Subtenant, including the Tenant Improvements;

7. The entirety of each of the Second Amendment, Third Amendment and Fourth Amendment; and

8. All references to "Tenant's Pro-Rata Share," "Tenant Improvements," and "Tenant Work Letter."

c. During the Term, Subtenant shall not be required to maintain casualty insurance policies and coverages with respect to the Sublease Premises and Subtenant shall be named as an additional insured under such policies maintained by Sublandlord (to the extent of Subtenant's interest in the Sublease Premises), evidence of such coverage to be in the form of a certificate of insurance provided by Sublandlord to Subtenant; provided, however, such policies and coverages maintained by Sublandlord with respect to the Buildings and the Sublease Premises shall not include coverage for Subtenant's personal property and Subtenant, at its sole cost and expense, shall maintain such policies and coverages with respect to its personal property as it may elect. During the Term, Subtenant shall maintain policies of insurance as required pursuant to Paragraph 12.1 of the Master Lease (including fire insurance covering the Tenant Improvements and the FF&E (as defined below)), which coverage shall be subject to any required waivers of subrogation as are described under Paragraph 12.5 of the Master Lease. All such policies shall name Sublandlord, Landlord and any other party required to be so named under the Master Lease as additional insureds thereunder and shall be with carriers reasonably acceptable to Sublandlord and, in all events, in accordance with the requirements of the Master Lease. Subtenant hereby waives all rights of subrogation against Sublandlord with respect to claims covered by the property insurance carried by Subtenant pursuant to the terms of this Sublease.

d. Sublandlord and Subtenant acknowledge that this Sublease is of short duration in relation to the term of the Master Lease and, as a result, the parties do not intend that, as between Sublandlord and Subtenant, Subtenant shall be required to comply with any obligations or requirements under the Master Lease (except those which are

specifically referenced as an obligation of Subtenant under this Sublease) which are of a character or nature as is reasonably determined to be inconsistent with the scope and Term of occupancy of the Sublease Premises by Subtenant under this Sublease. In the event of a dispute regarding Subtenant's obligation to comply with any such obligations or requirements of the Master Lease, as between Sublandlord and Subtenant, the determination of the applicability of such obligations or requirements shall be made by Sublandlord and Subtenant in good faith with reference to current statutory and case law in California interpreting the relative obligations of a landlord and tenant in circumstances similar to the Sublease with respect to the nature of the obligation for which compliance is sought.

9. Subtenant's Obligations. Subtenant covenants and agrees that all obligations of Sublandlord under the Master Lease shall be done or performed by Subtenant with respect to the Sublease Premises, except as otherwise provided by this Sublease, and Subtenant's obligations shall run to Sublandlord and Landlord as Sublandlord may determine to be appropriate or be required by the respective interests of Sublandlord and Landlord. Subtenant agrees to indemnify Sublandlord, and hold it harmless, from and against any and all claims, damages, losses, expenses and liabilities (including reasonable attorneys' fees) incurred as a result of the non-performance, non-observance or non-payment of any of Sublandlord's obligations under the Master Lease which, as a result of this Sublease, became an obligation of Subtenant. If Subtenant makes any payment to Sublandlord pursuant to this indemnity, Subtenant shall be subrogated to the rights of Sublandlord concerning said payment. Subtenant shall not do, nor permit to be done, any act or thing which is, or with notice or the passage of time would be, a default under this Sublease or the Master Lease.

10. Sublandlord's Obligations. Sublandlord covenants and agrees that all obligations of Sublandlord under the Master Lease, other than those which are to be done or performed by Subtenant, with respect to the Sublease Premises shall be done or performed by Sublandlord. Sublandlord agrees that Subtenant shall be entitled to receive all services and repairs to be provided by Landlord to Sublandlord under the Master Lease. Subtenant shall look solely to Landlord for all such services and shall not, under any circumstances, seek nor require Sublandlord to perform any of such services, nor shall Subtenant make any claim upon Sublandlord for any damages which may arise by reason of Landlord's default under the Master Lease; provided, however, Sublandlord shall provide all necessary assistance and cooperation to Subtenant (at no material cost or liability to Sublandlord) to enforce Sublandlord's rights under the Master Lease to compel performance by Landlord with respect to such services or repairs to which Subtenant is entitled. Any condition resulting from a default by Landlord shall not constitute, as between Sublandlord and Subtenant, an eviction, actual or constructive, of Subtenant and no such default shall excuse Subtenant from the performance or observance of any of its obligations to be performed or observed under this Sublease, or entitle Subtenant to receive any reduction in or abatement of the Rent provided for in this Sublease unless and to the extent Sublandlord is excused from performance, or entitled to a reduction or abatement of its rental obligations to Landlord under the Master Lease also. In furtherance of the foregoing, Subtenant does hereby waive any cause of action and any right to bring any action against Sublandlord by reason of any act or omission of Landlord under the Master Lease, subject to the right of assistance and cooperation from Sublandlord described above. Sublandlord covenants and agrees with Subtenant that Sublandlord will pay all fixed rent and additional rent payable by Sublandlord pursuant to the Master Lease to the extent that failure to perform the same would adversely affect Subtenant's use or occupancy of the Sublease Premises. Sublandlord shall extend all reasonable cooperation to Subtenant (at no material cost or liability to Sublandlord) to enable Subtenant to receive the benefits under this Sublease, as the same are dependent upon performance under the Master Lease.

11. Default by Subtenant. In the event Subtenant shall be in default of any covenant of, or shall fail to honor any obligation under, this Sublease, Sublandlord shall have available to it against Subtenant all of the remedies available to Landlord under the Master Lease in the event of a similar default on the part of Sublandlord thereunder or at law.

12. Quiet Enjoyment. So long as Subtenant pays all of the Rent due hereunder and performs all of Subtenant's other obligations hereunder, Sublandlord shall do nothing to affect Subtenant's right to peaceably and quietly have, hold and enjoy the Sublease Premises.

13. Notices. Anything contained in any provision of this Sublease to the contrary notwithstanding, Subtenant agrees, with respect to the Sublease Premises, to comply with and remedy any default in this Sublease or the Master Lease which is Subtenant's obligation to cure, within the period allowed to Sublandlord under the Master Lease, even if such time period is shorter than the period otherwise allowed therein due to the fact that notice of default from Sublandlord to Subtenant is given after the corresponding notice of default from Landlord to Sublandlord. Sublandlord agrees to forward to Subtenant, promptly upon receipt thereof by Sublandlord, a copy of each notice of default received by Sublandlord in its capacity as Tenant under the Master Lease. Subtenant agrees to forward to Sublandlord, promptly upon receipt thereof, copies of any notices received by Subtenant from Landlord or from any governmental authorities. All notices, demands and requests shall be in writing and shall be sent either by hand delivery or by a nationally recognized overnight courier service (e.g., Federal Express), in either case return receipt requested, to the address of the appropriate party. Notices, demands and requests so sent shall be deemed given when the same are received.

Notices to Sublandlord shall be sent to the attention of:
Biogen Idec Inc.
P.O. Box 229008
5200 Research Place
San Diego, CA 92129-9008
Attn: Paul Draper

Notices to Subtenant shall be sent to the attention of:

MacroPore Biosurgery, Inc.
6740 Top Gun Street
San Diego, CA 92121
Attn: J. Peter Amis

14. Broker. Sublandlord and Subtenant represent and warrant to each other that no brokers other than John Burnham Real Estate Services, Inc., acting on behalf of Sublandlord, and Irving Hughes, acting on behalf of Subtenant, were involved in connection with the negotiation or consummation of this Sublease. Each party agrees to indemnify the other, and hold it harmless, from and against any and all claims, damages, losses, expenses and liabilities (including reasonable attorneys' fees) incurred by said party as a result of a breach of this representation and warranty by the other party.

15. Condition of Premises.

a. *Commencement. Subtenant acknowledges that (i) it is subleasing the Sublease Premises in an "as-is" condition, unfurnished except for certain furniture, fixtures and equipment of Sublandlord (the "FF&E") which exists in the Sublease Premises as of the date hereof, expressly excluding those items to be removed by Sublandlord as identified on the attached Schedule 2(b), (ii) Sublandlord is not making any representation or warranty concerning the condition of the Sublease Premises, and (iii) Sublandlord is not obligated to perform any work to prepare the Sublease Premises for Subtenant's occupancy other than to effect removal of the items identified on the attached Schedule 2(b) as contemplated under Section 2(b) above and to deliver the Sublease Premises in broom-clean condition; provided, however, all Building systems servicing the Sublease Premises shall be in working order and condition on the Sublease Commencement Date. Subtenant acknowledges that the FF&E shall be delivered to Subtenant on the Sublease Commencement Date (or such earlier date of Subtenant's occupancy of the Sublease Premises as is provided under Section 2(b) above with respect to the License) in their "as is," "where is," "with all faults" condition, without any warranty or representation as to condition by Sublandlord. Subtenant further acknowledges that it is not authorized to make or do any alterations or improvements in or to the Sublease Premises without Sublandlord's prior written consent, which consent may not be unreasonably withheld and which may impose additional requirements applicable to the construction and completion of such alterations or improvements in addition to requiring Subtenant's compliance with the requirements of the Master Lease. Sublandlord shall not be deemed to be unreasonable in withholding its consent to any alteration or improvement which does not conform with the use requirements under this Sublease or which is materially different from alterations or improvements customarily seen in first-class office space or first-class laboratory space, as applicable.*

b. *Vacation. Subtenant further acknowledges that it must deliver the Sublease Premises to Sublandlord on the Sublease Expiration Date in the condition substantially the same as that on the Sublease Commencement Date (or such earlier date of Subtenant's occupancy of the Sublease Premises as is provided under Section 2(b) above with respect to the License), reasonable wear and tear excepted, and excepting permitted alterations to the Sublease Premises made by Subtenant during the Sublease Term, including the Tenant Improvements, which Landlord has not required be removed in connection with providing its consent under the terms of the Master Lease. Subtenant shall also remedy any Hazardous Substance contamination which is the result of the act or omission of Subtenant, its agents, employees, contractors, invitees or licensees, by promptly remediating or removing such contamination in its entirety. Effective upon the Sublease Expiration Date, Sublandlord's title to the FF&E, in its then as-is condition, shall automatically pass to Subtenant without any representation or warranty from Sublandlord except that the FF&E shall be free of adverse interest to title created by or through Sublandlord.*

c. *Inspection Rights. In addition to all other rights under the provisions of the Master Lease incorporated into this Sublease, Sublandlord expressly reserves the right to conduct the inspections in the Sublease Premises during the Term as described in Article 22 of the Master Lease.*

16. Consent of Landlord. Paragraph 17.1 of the Master Lease requires Sublandlord to obtain the written consent of Landlord to this Sublease. The effectiveness of this Sublease shall be conditioned upon Sublandlord's receipt of such consent. To the

extent agreed to by Landlord, such consent will include a right on behalf of Subtenant to cure defaults of Sublandlord under the Master Lease on such terms and conditions as are reasonably satisfactory to Sublandlord and Subtenant in order to preserve Subtenant's occupancy of the Premises.

17. Termination of the Lease. If for any reason the term of the Master Lease shall terminate prior to the Sublease Expiration Date, this Sublease shall automatically be terminated and Sublandlord shall not be liable to Subtenant by reason thereof unless said termination is the result of a Sublandlord Termination Event (as defined below). "Sublandlord Termination Event" shall mean a termination of the Master Lease where Subtenant is not permitted or offered the opportunity to remain in the Sublease Premises on substantially the same terms as this Sublease which termination is the result of: (i) a default of Sublandlord under the Master Lease, and said Sublandlord default was not as a result of a Subtenant default under this Sublease; (ii) the result of any election or exercise of a right or option held by Sublandlord under the Master Lease to effect such termination other than as a result of the occurrence of damage or destruction or eminent domain; or (iii) Sublandlord's mutual agreement with Landlord to terminate the Master Lease outside the parameters of the Master Lease. In the event of any Sublandlord Termination Event, Sublandlord shall be liable for, and Subtenant shall be entitled to recover, Subtenant's actual out-of-pocket costs incurred to secure substantially comparable alternative space resulting from the termination of this Sublease due to such Sublandlord Termination Event. In no event shall Subtenant's damages include any consequential, indirect or punitive damages.

18. Assignment and Subletting.

a. *Independent of and in addition to any provisions of the Master Lease, including without limitation the obligation to obtain Landlord's consent to any sublease or assignment, it is understood and agreed that, except as expressly provided herein, Subtenant shall have no right to assign or sublet the Sublease Premises or any portion thereof or any right or privilege appurtenant thereto and any such assignment or subletting shall be void. Subtenant shall have the right to assign this Sublease or any interest therein, and to suffer or permit any other person (other than agents, servants or associates of the Subtenant) to occupy or use the Sublease Premises, only upon the prior written consent of Sublandlord, which consent shall not be unreasonably withheld, and to the extent required under the Master Lease, the prior written consent of Landlord. Any assignment or subletting by Subtenant without Sublandlord's prior written consent shall be void and shall, at the option of Sublandlord, terminate this Sublease.*

b. *Subtenant shall advise Sublandlord by notice of (i) Subtenant's intent to assign or sublease this Sublease, (ii) the name of the proposed assignee or subtenant and evidence reasonably satisfactory to Sublandlord that such proposed assignee or subtenant is comparable in reputation, stature and financial condition to tenants then leasing comparable space in comparable buildings, and (iii) the terms of the proposed assignment or sublease. Sublandlord shall, within twenty (20) days of receipt of such notice, and any additional information requested by Landlord concerning the proposed assignee's or sublessee's financial responsibility, elect one of the following:*

1. Consent to such proposed assignment or sublease;

2. Refuse such consent, which refusal shall be on reasonable grounds; or

3. Elect to terminate this Sublease in the event the proposed transfer is for all or substantially all of Subtenant's rights and/or obligations under this Sublease.

c. *In the event that Sublandlord shall consent to an assignment or sublease under the provisions of this Section 18, Subtenant shall pay Sublandlord's reasonable and actual processing costs and reasonable attorneys' fees incurred in giving such consent. Notwithstanding any permitted assignment or sublease, Subtenant shall at all times remain directly, primarily and fully responsible and liable for all payments owed by Subtenant under the Sublease and for compliance with all obligations under the terms, provisions and covenants of the Sublease. If for any proposed assignment or sublease, Subtenant receives Rent or other consideration, either initially or over the term of the assignment or sublease, in excess of the Rent required by this Sublease, after a deduction for the following: (a) any brokerage commission paid by Subtenant in connection therewith, (b) any free rent concessions or tenant improvement allowances, and (c) any reasonable attorneys' fees in connection with preparing and negotiating an assignment or sublease document ("Profit"), Subtenant shall pay to Sublandlord as additional Rent, fifty percent (50%) of such Profit or other consideration received by Subtenant within five (5) days of its receipt by Subtenant or, in the event the assignee or sublessee makes payment directly to Sublandlord, Sublandlord shall refund fifty percent (50%) of the Profit to Subtenant after deducting (a), (b) and (c) above.*

19. Environmental Condition.

a. *Base Line Study*. Sublandlord shall provide Subtenant with a Phase I environmental assessment (the "Base Line

Study") with respect to the Sublease Premises in accordance with ASTM Standard E 1527-00 which, pursuant to such standard, shall not include any surface or subsurface testing on the Sublease Premises. The Base Line Study shall assess the condition of the Sublease Premises as it exists prior to any occupancy thereof by Subtenant and shall be approved by Subtenant within ten (10) days of receipt thereof by Subtenant as a condition to the Sublease Commencement Date. Subtenant's failure to approve the results of such Base Line Study within such ten (10)-day period shall permit either Sublandlord or Subtenant to terminate this Sublease by written notice to the other within three (3) business days of the expiration of such ten (10)-day period, subject, however, to Sublandlord's right (without any obligation of exercise) to cure such disapproved matter to Subtenant's reasonable satisfaction within a reasonable period of time after Sublandlord's receipt of notice of such disapproval. During the Term of the Sublease, Subtenant shall deliver to Sublandlord, upon Sublandlord's request therefor, copies of all notices, filings and permits delivered to, or received from, regulatory and governmental entities having jurisdiction over Subtenant's operations on the Sublease Premises with respect to the use, storage or disposal of Hazardous Substances and a current inventory of all Hazardous Substances used and/or stored on the Sublease Premises.

b. *Vacation*. Subtenant, at Subtenant's sole cost and expense, shall conduct an exit environmental assessment (the "Subtenant Exit Study") substantially the same in scope as the Base Line Study (collectively, the "Studies") prior to the Sublease Expiration Date as a condition of vacation of the Sublease Premises. The Subtenant Exit Study shall be conducted not earlier than fifteen (15) days prior to Subtenant's vacation of the Sublease Premises. In the event the Subtenant Exit Study reveals contamination not described in the Base Line Study, then Subtenant shall promptly remediate or remove such contamination in its entirety. Subtenant shall maintain the results of the Base Line Study and the Subtenant Exit Study in strict confidence and shall not, without Sublandlord's prior written consent, which may be withheld in its sole discretion, disclose the results thereof, or any portion thereof to any third party, excepting Subtenant's directors, officers, employees, representatives and consultants on a need-to-know basis, unless Subtenant is compelled under applicable law to disclose all or any portion of the Studies. All such Studies shall be delivered to Sublandlord.

20. Tenant Improvements. Subtenant shall have the right to select a general contractor, and architectural and engineering firms for the construction of the Tenant Improvements, subject to Landlord's and Sublandlord's approval of any such selection. The Tenant Improvements shall be constructed by Subtenant at its sole cost and expense, subject to the provisions of Section 4(f), and further subject to Article 7 of the Master Lease and Landlord's approval, in accordance with the following:

a. *Plans. Subtenant shall prepare and submit to Sublandlord plans and working drawings for the construction of the Tenant Improvements, such plans to contain all such information as may be required for the construction of the Tenant Improvements. Sublandlord shall approve the plans within five (5) business days after receipt of same or designate specific changes required to be made to the plans. Subtenant shall make the required changes, and resubmit the revised plans to Sublandlord. The revised plans shall be approved or disapproved by Sublandlord within five (5) business days of receipt of the same. This procedure shall be repeated until the plans are finally approved by Sublandlord ("Final Plans").*

b. *Procedure for Construction of Tenant Improvements. Subtenant shall begin the construction of the Tenant Improvements within thirty (30) days of Sublandlord's approval of the Final Plans and shall complete the construction of the Tenant Improvements in a good, workmanlike and lien-free manner in compliance with all applicable laws, codes and private restrictions. Subtenant shall only use contractors acceptable to Sublandlord, in its sole discretion, who shall maintain customary policies of "All Risk" insurance with respect to such construction with such carriers and in such amounts as are acceptable to Sublandlord in its sole but reasonable discretion consistent with customary market terms and conditions commonly required by landlords for installation of work of the size and scope of the Tenant Improvements, and otherwise meeting the requirements of the Master Lease. All such policies shall name each of Sublandlord and Landlord as "additional insureds," evidence of which shall be provided to Sublandlord prior to commencement of construction. Subtenant hereby indemnifies, defends and holds Sublandlord and Landlord harmless from and against all claims or liabilities arising from such construction.*

c. *Changes. If Subtenant requires any change, addition or alteration to the Final Plans ("Changes"), and the cost to complete such Changes, individually or in the aggregate, is equal to or greater than Fifty Thousand Dollars ($50,000), Subtenant shall submit a written request to Sublandlord setting forth in reasonable detail the description of the proposed change. If Sublandlord approves such Changes, which approval shall not be unreasonably withheld on the basis described in Section 15(a), Subtenant shall, at Subtenant's sole cost and expense, promptly make such Changes.*

d. *Removal. Subtenant shall be required to remove the Tenant Improvements upon the Sublease Expiration Date (or earlier termination of this Sublease) to the extent such removal is required by Landlord of Sublandlord under the Master Lease.*

21. Limitation of Estate. Subtenant's estate shall in all respects be limited to, and be construed in a fashion consistent with, the estate granted to Sublandlord by Landlord. Subtenant shall stand in the place of Sublandlord and shall defend, indemnify and hold Sublandlord harmless with respect to all covenants, warranties, obligations, and payments made by Sublandlord under or required of Sublandlord by the Master Lease with respect to the Sublease Premises. In the event Sublandlord is prevented from performing any of its obligations under this Sublease by a breach by Landlord of a term of the Master Lease, then Sublandlord's sole obligation in regard to its obligation under this Sublease shall be to use reasonable efforts in diligently pursuing the correction or cure by Landlord of Landlord's breach.

22. Entire Agreement. It is understood and acknowledged that there are no oral agreements between the parties hereto affecting this Sublease and this Sublease supersedes and cancels any and all previous negotiations, arrangements, brochures, agreements and understandings, if any, between the parties hereto or displayed by Sublandlord to Subtenant with respect to the subject matter thereof, and none thereof shall be used to interpret or construe this Sublease. This Sublease, and the exhibits and schedules attached hereto, contain all of the terms, covenants, conditions, warranties and agreements of the parties relating in any manner to the rental, use and occupancy of the Sublease Premises and shall be considered to be the only agreements between the parties hereto and their representatives and agents. None of the terms, covenants, conditions or provisions of this Sublease can be modified, deleted or added to except in writing signed by the parties hereto. All negotiations and oral agreements acceptable to both parties have been merged into and are included herein. There are no other representations or warranties between the parties, and all reliance with respect to representations is based totally upon the representations and agreements contained in this Sublease.

23. Acceptance. The submission of this Sublease to Subtenant does not constitute an offer to lease. This Sublease shall become effective only upon the execution and delivery thereof by both Sublandlord and Subtenant. Sublandlord shall have no liability or obligation to Subtenant by reason of Sublandlord's rejection of this Sublease or a failure to execute, acknowledge and deliver same to Subtenant.

24. Miscellaneous. This Sublease shall be governed by and interpreted in accordance with the laws of the State of California, except as they may be preempted by federal law. In any action brought or arising out of this Sublease, the parties hereto hereby consent to the jurisdiction of any federal or state court having proper venue within the State of California and also consent to the service of process by any means authorized by California or federal law. The parties hereby agree that any proceeding relating to any dispute under this Sublease or with respect to the interpretation of any provision of this Sublease shall be conducted in San Diego, California. The headings used in this Sublease are for convenience only and shall be disregarded in interpreting the substantive provisions of this Sublease. Time is of the essence of each term of this Sublease. If any provision of this Sublease shall be determined by a court of competent jurisdiction to be invalid, illegal or unenforceable, that portion shall be deemed severed therefrom and the remaining parts shall remain in full force as though the invalid, illegal, or unenforceable portion had never been a part thereof. This Sublease may be executed in one or more counterparts, all of which, taken together, shall constitute one and the same Sublease. In the event of any litigation or similar proceeding, action or arbitration between the parties with respect to this Sublease, the prevailing party shall be entitled to recover reasonable attorney's fees and cost incurred in connection therewith. Each of Sublandlord and Subtenant, respectively, warrant that it has the authority to enter into and perform its respective obligations under this Sublease, subject to the terms of the Master Lease, and that the individual executing this Sublease on behalf of Sublandlord and Subtenant, respectively, has the authority to enter into this Sublease and to execute all other documents and perform all other acts as contemplated herein.

[Remainder of page intentionally left blank.]

IN WITNESS WHEREOF, the parties have entered into this Sublease as of the date first written above.

SUBLANDLORD:

BIOGEN IDEC INC.,
a Delaware corporation

By: /s/ Edward M. Rodriguez
Name: Edward M. Rodriguez
Title: Vice President, Finance

SUBTENANT:

MACROPORE BIOSURGERY, INC.,
a Delaware corporation

By: /s/ Marc Hedrick
Name: Marc Hedrick
Title: President

EXHIBIT 10.23

January 28, 2005

Doug Arm, Ph. D.

Dear Dr. Arm:

We are pleased to offer you the position of Vice-President of Development - Biologics at a salary of $13,333 per month (which, if computed on an annual basis, would be equivalent to $160,000), payable semi-monthly. You will report to me, and your start date will be Monday, February 15th, 2005. Both the device development groups in Engineering and Biologics will report to you. You will also primarily manage outside relationships relative to this project. In effect, you will, in conjunction with me, have overall responsibility for the current engineering development and future direction of the stem cell device projects. You will have primary project management duties and responsibility to interact with quality, regulatory, production as well as related outside groups. In addition, you will likely be called upon to interact with marketing, clinical trials coordinators and clinicians. Clearly this will be a very challenging but very rewarding opportunity.

You will receive MacroPore's employee benefits comparable to MacroPore's standard package, including PPO medical insurance for you and your family, group life insurance, group long-term disability insurance, and participation in our flexible spending account and 401(k) plan. Your paid time off will be four (4) weeks per year.

We will propose to reimburse you for all expenses incurred related to your move to San Diego of up to $40,000. You will receive a car allowance of $400/month.

We will recommend to the Board of Directors that it grant to you, under our Amended and Restated 1997 Stock Option and Stock Purchase Plan, 50,000 stock options. These stock options, if granted by the Board, would vest monthly over four years (subject to a 1-year cliff) starting from your first day of employment. The exercise price would be equal to 100% of the fair market value of our stock as of the date the Board acts to grant the options. The options will be exercisable once they vest, subject to your remaining an employee of the Company, as described in the stock option agreement you will receive from the Company. (Please see attached addendum form Incentive Stock Option Agreement.)

Employment with MacroPore is "at will" and may be terminated without cause by either party. This letter describes a written offer of employment and does not constitute a contract.

Doug, we would be delighted to have someone of your caliber join our company. Please sign below as acceptance of this offer and return a copy to me at your earliest convenience.

Sincerely,

/s/ Marc Hedrick

Marc Hedrick
President

Acceptance:
I understand and accept the above offer.

Signature:

/s/ Douglas M. Arm
Doug Arm, Ph.D.

2/1/05
Date

EXHIBIT 10.24

March 14, 2005

Alexander M. Milstein, M. D.

Dear Dr. Milstein:

We are pleased to offer you the position of Vice-President of Clinical Research at a salary of $15,000 per month (which, if computed on an annual basis, would be equivalent to $180,000), payable semi-monthly. You will report to me, and your start date will be as soon as possible. This offer has been approved by the MacroPore Board of Directors.

You will receive MacroPore's employee benefits comparable to MacroPore's standard package, including PPO medical insurance for you and your family, group life insurance, group long-term disability insurance, and participation in our flexible spending account and 401(k) plan. Your paid time off will be four (4) weeks per year.

I understand that you will remain in the Boston area for up to a year but then will relocate to San Diego. During that time your expenses incurred in traveling to San Diego from Boston to work in our office will be reimbursed to you as business travel expenses. To assist in your relocation to San Diego, we will reimburse you for reasonable expenses incurred related to your move to San Diego up to $45,000. You may at your discretion have this payable to you in a lump sum to cover payments previously incurred by your recent move from California to Boston. Please be advised that some of this amount may be taxable income to you, and subject to withholding. You will also receive a car allowance of $400/month upon your relocation to San Diego.

We will recommend to the Board of Directors that it grant to you, under our Amended and Restated 1997 Stock Option and Stock Purchase Plan, 50,000 stock options. These stock options, if granted by the Board, would vest monthly over four years (subject to a 1-year cliff) starting from your first day of employment. The exercise price would be equal to 100% of the fair market value of our stock as of the date the Board acts to grant the options. The options will be exercisable once they vest, subject to your remaining an employee of the Company, as described in the stock option agreement you will receive from the Company.

You will have a target annual bonus of 15% of your base salary, prorated for 2005 for the number of months you are an employee. The bonus is usually paid in the first quarter of each year, and is based upon your achievement of mutually agreed-upon performance objectives during the preceding year.

Employment with MacroPore is "at will" and may be terminated without cause by either party. This letter describes a written offer of employment and does not constitute a contract.

Dr. Milstein, we would be delighted to have someone of your caliber join our company. Please sign below as acceptance of this offer and return a copy to me at your earliest convenience. As discussed, your compensation package is subject to board approval. Once you have accepted our offer, we will then move your package to the board for their approval.

Sincerely,

/s/ Marc Hedrick

Marc Hedrick
President

Acceptance:
I understand and accept the above offer.

Signature:

Signature:

/s/ Alex Milstein	01-May-2005
Alexander M. Milstein, M. D.	Date

EXHIBIT 15.1

Letter Re Unaudited Interim Financial Information

August 12, 2005

Cytori Therapeutics, Inc.
6740 Top Gun Street
San Diego, CA 92121

Re: Registration Statement No. 333-82074 and No. 333-122691

With respect to the subject registration statements, we acknowledge our awareness of the use therein of our report dated August 12, 2005 related to our review of interim financial information.

Pursuant to Rule 436 under the Securities Act of 1933 (the "Act"), such report is not considered part of a registration statement prepared or certified by an independent registered public accounting firm, or a report prepared or certified by an independent registered public accounting firm within the meaning of Sections 7 and 11 of the Act.

/s/ KPMG LLP

San Diego, California

EXHIBIT 31.1

Certification of Chief Executive Officer Pursuant to
Securities Exchange Act Rule 13a-14(a)
As Adopted Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002

I, Christopher J. Calhoun, the Chief Executive Officer of Cytori Therapeutics, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cytori Therapeutics, Inc.;

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

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

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

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

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 15, 2005
/s/ Christopher J. Calhoun
Christopher J. Calhoun,
Chief Executive Officer

EXHIBIT 31.2

Certification of Chief Financial Officer Pursuant to
Securities Exchange Act Rule 13a-14(a)
As Adopted Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002

I, Mark E. Saad, the Chief Financial Officer of Cytori Therapeutics, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cytori Therapeutics, Inc.;

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

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

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

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

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 15, 2005
/s/ Mark E. Saad
Mark E. Saad,
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350/ SECURITIES EXCHANGE ACT RULE 13a-14(b), AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES – OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Cytori Therapeutics, Inc. for the quarterly period ended June 30, 2005 as filed with the Securities and Exchange Commission on the date hereof, Christopher J. Calhoun, as Chief Executive Officer of Cytori Therapeutics, Inc., and Mark E. Saad, as Chief Financial Officer of Cytori Therapeutics, Inc., each hereby certifies, respectively, that:

1. The Form 10-Q report of Cytori Therapeutics, Inc., that this certification accompanies fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934.

2. The information contained in the Form 10-Q report of Cytori Therapeutics, Inc., that this certification accompanies fairly presents, in all material respects, the financial condition and results of operations of Cytori Therapeutics, Inc.

By: /s/ Christopher J. Calhoun
Christopher J. Calhoun
Chief Executive Officer

Dated: August 15, 2005

By: /s/ Mark E. Saad
Mark E. Saad
Chief Financial Officer

Dated: August 15, 2005