

UNITED STATES
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, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 001-34375

CYTORI THERAPEUTICS, INC.

(Exact name of Registrant as Specified in Its Charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

33-0827593

(I.R.S. Employer Identification No.)

3020 CALLAN ROAD, SAN DIEGO, CALIFORNIA

(Address of principal executive offices)

92121

(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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of July 31, 2014, there were 79,541,775 shares of the registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements**

CYTORI THERAPEUTICS, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(UNAUDITED)

	<u>As of June 30,</u> <u>2014</u>	<u>As of December 31,</u> <u>2013</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 12,760,000	\$ 15,506,000
Accounts receivable, net of reserves of \$1,162,000 and \$1,445,000 in 2014 and 2013, respectively	2,004,000	4,152,000
Inventories, net	4,488,000	3,694,000
Other current assets	1,288,000	1,225,000
Total current assets	20,540,000	24,577,000
Property and equipment, net	1,290,000	1,054,000
Restricted cash and cash equivalents	350,000	350,000
Other assets	2,567,000	2,812,000
Intangibles, net	9,581,000	9,345,000
Goodwill	3,922,000	3,922,000
Total assets	\$ 38,250,000	\$ 42,060,000
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 6,527,000	\$ 6,077,000
Current portion of long-term obligations, net of discount	7,342,000	3,191,000
Termination fee obligation	—	400,000
Puregraft divestiture obligation	215,000	547,000
Joint Venture purchase obligation	2,647,000	4,691,000
Total current liabilities	16,731,000	14,906,000
Deferred revenues	212,000	212,000
Long-term deferred rent and other	613,000	710,000
Long-term obligations, net of discount, less current portion	19,501,000	23,100,000
Total liabilities	37,057,000	38,928,000
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized; -0- shares issued and outstanding in 2014 and 2013	—	—
Common stock, \$0.001 par value; 145,000,000 shares authorized; 79,541,775 and 71,305,375 shares issued and outstanding in 2014 and 2013, respectively	79,000	71,000
Additional paid-in capital	323,848,000	303,710,000
Accumulated other comprehensive income	399,000	256,000
Accumulated deficit	(323,133,000)	(300,905,000)
Total stockholders' equity	1,193,000	3,132,000
Total liabilities and stockholders' equity	\$ 38,250,000	\$ 42,060,000

SEE NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

CYTORI THERAPEUTICS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(UNAUDITED)

	For the Three Months		For the Six Months	
	Ended June 30,		Ended June 30,	
	2014	2013	2014	2013
Product revenues	\$ 935,000	\$ 1,408,000	\$ 1,965,000	\$ 2,800,000
Cost of product revenues	766,000	608,000	1,187,000	1,365,000
Gross profit	169,000	800,000	778,000	1,435,000
Development revenues:				
Development, related party	—	—	—	638,000
Development revenue	—	—	—	1,179,000
Government contracts and other	356,000	859,000	759,000	1,408,000
	356,000	859,000	759,000	3,225,000
Operating expenses:				
Research and development	4,674,000	4,150,000	8,966,000	7,869,000
Sales and marketing	1,934,000	2,410,000	3,861,000	4,667,000
General and administrative	4,602,000	4,046,000	8,942,000	7,892,000
Change in fair value of warrant liability	—	(84,000)	—	(418,000)
Change in fair value of option liability	—	(2,500,000)	—	(2,250,000)
Total operating expenses	11,210,000	8,022,000	21,769,000	17,760,000
Operating loss	(10,685,000)	(6,363,000)	(20,232,000)	(13,100,000)
Other income (expense):				
Loss on asset disposal	(1,000)	(257,000)	(1,000)	(257,000)
Gain on previously held equity interest in Joint Venture	—	4,892,000	—	4,892,000
Loss on debt extinguishment	—	(708,000)	—	(708,000)
Interest income	1,000	1,000	3,000	1,000
Interest expense	(1,085,000)	(652,000)	(2,026,000)	(1,361,000)
Other income (expense), net	(58,000)	(124,000)	28,000	(296,000)
Equity loss from investment in joint venture	—	—	—	(48,000)
Total other income (expense)	(1,143,000)	3,152,000	(1,996,000)	2,223,000
Net loss	\$ (11,828,000)	\$ (3,211,000)	\$ (22,228,000)	\$ (10,877,000)
Other comprehensive income (loss) – foreign currency translation adjustments	193,000	76,000	143,000	(34,000)
Net comprehensive loss	\$ (11,635,000)	\$ (3,135,000)	\$ (22,085,000)	\$ (10,911,000)
Basic and diluted net loss per common share	\$ (0.15)	\$ (0.05)	\$ (0.29)	\$ (0.16)
Basic and diluted weighted average common shares	76,682,643	67,200,588	75,399,647	67,096,348

SEE NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

CYTORI THERAPEUTICS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Six Months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net loss	\$ (22,228,000)	\$ (10,877,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	344,000	660,000
Amortization of deferred financing costs and debt discount	562,000	330,000
Joint Venture acquisition obligation accretion	145,000	51,000
Provision for doubtful accounts	836,000	188,000
Provision for expired enzyme	209,000	—
Change in fair value of warrant liability	—	(418,000)
Change in fair value of option liability	—	(2,250,000)
Share-based compensation expense	1,448,000	1,838,000
Equity loss from investment in Joint Venture	—	48,000
Loss on asset disposal	—	257,000
Gain on previously held equity interest in Joint Venture	—	(4,892,000)
Loss on debt extinguishment	—	708,000
Increases (decreases) in cash caused by changes in operating assets and liabilities:		
Accounts receivable	1,386,000	862,000
Inventories	(526,000)	(816,000)
Other current assets	(59,000)	(27,000)
Other assets	(281,000)	(587,000)
Accounts payable and accrued expenses	124,000	(279,000)
Deferred revenues, related party	—	(638,000)
Deferred revenues	—	(1,200,000)
Long-term deferred rent	(97,000)	28,000
Net cash used in operating activities	<u>(18,137,000)</u>	<u>(17,014,000)</u>
Cash flows from investing activities:		
Purchases of property and equipment	(467,000)	(432,000)
Expenditures for intellectual property	(255,000)	—
License agreement termination fee	(400,000)	(400,000)
Cash acquired in purchase of Joint Venture	—	5,000
Net cash used in investing activities	<u>(1,122,000)</u>	<u>(827,000)</u>
Cash flows from financing activities:		
Principal payments on long-term obligations	—	(22,292,000)
Proceeds from long-term obligations	—	27,000,000
Debt issuance costs and loan fees	—	(1,744,000)
Joint Venture purchase payments	(2,189,000)	(70,000)
Proceeds from exercise of employee stock options and warrants	33,000	115,000
Proceeds from sale of common stock	19,075,000	3,001,000
Costs from sale of common stock	(410,000)	(184,000)
Net cash provided by financing activities	<u>16,509,000</u>	<u>5,826,000</u>
Effect of exchange rate changes on cash and cash equivalents	<u>4,000</u>	<u>(81,000)</u>
Net decrease in cash and cash equivalents	(2,746,000)	(12,096,000)
Cash and cash equivalents at beginning of period	<u>15,506,000</u>	<u>25,717,000</u>
Cash and cash equivalents at end of period	<u>\$ 12,760,000</u>	<u>\$ 13,621,000</u>
Supplemental disclosure of cash flows information:		
Cash paid during period for:		
Interest	\$ 1,318,000	\$ 1,151,000
Supplemental schedule of non-cash investing and financing activities:		
Fair value of warrants allocated to additional paid-in capital	—	949,000
Fair value of intangible assets acquired	—	9,394,000
Fair value of tangible assets acquired	—	260,000
Joint Venture purchase obligation	—	4,709,000
Fair value of previously held equity interest at acquisition date	—	4,929,000

SEE NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS



CYTORI THERAPEUTICS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
June 30, 2014
(UNAUDITED)

1. Basis of Presentation

Our accompanying unaudited consolidated condensed financial statements as of June 30, 2014 and for the three and six months ended June 30, 2014 and 2013 have been prepared in accordance with accounting principles generally accepted in the United States of America 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 of America for annual financial statements. Our consolidated condensed balance sheet at June 30, 2014 has been derived from the audited financial statements at December 31, 2013, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America 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., and our subsidiaries (the Company) have been included. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These financial statements should be read in conjunction with the consolidated financial statements and notes therein included in our annual report on Form 10-K for the year ended December 31, 2013.

2. Use of Estimates

The preparation of Consolidated Condensed Financial Statements in conformity with U.S. generally accepted accounting principles 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. Our most significant estimates and critical accounting policies involve recognizing revenue, determining the assumptions used in measuring share-based compensation expense and valuing allowances for doubtful accounts and inventories.

Actual results could differ from these estimates. Management's estimates and assumptions are reviewed regularly, and the effects of revisions are reflected in the Consolidated Condensed Financial Statements in the periods they are determined to be necessary.

3. Capital Availability

We incurred net losses of \$11,828,000 and \$22,228,000 for the three and six months ended June 30, 2014 and \$3,211,000 and \$10,877,000 for the three and six months ended June 30, 2013, respectively. We have an accumulated deficit of \$323,133,000 as of June 30, 2014. Additionally, we have used net cash of \$18,137,000 and \$17,014,000 to fund our operating activities for the six months ended June 30, 2014 and 2013, respectively. To date, these operating losses have been funded primarily from outside sources of invested capital.

We have been placing, and will continue to place, significant effort into raising additional capital that will provide adequate capital resources to allow us to continue to fund our future operations. Based on our cash and cash equivalents on hand of \$12,760,000 at June 30, 2014 and our minimum liquidity requirements of the Loan Agreement that require us to make principal and interest payments of \$868,000 per month beginning in August 2014 and maintain at least three months of cash on hand, we must raise additional capital in August 2014 to avoid an event of default by August 31, 2014. If we are unable to raise additional capital as planned, we will not have sufficient cash on hand to avoid an event of default under the Loan Agreement, which, absent a waiver or modification of the loan terms, would allow the lender to cause the loan amount of \$28,670,000 to be immediately due and payable. Our financing plans include pursuing additional cash through strategic corporate partnerships and engaging in future sales of equity, as well as obtaining a modification of the terms of the Loan Agreement. While we have an established history of raising capital through these platforms, and we are currently involved in negotiations with multiple parties, there is no guarantee that adequate funds will be available when needed from additional debt or equity financing, development and commercialization partnerships or from other sources, or on terms acceptable to us. There is also no guarantee that our lender would agree to a modification of the Loan Agreement, or on terms that are acceptable to us. If our efforts to obtain sufficient additional funds are not successful, in addition to the lender's ability to cause the loan amount to be immediately due and payable, we would also be required to delay, scale back, or eliminate some or all of our research or product development, manufacturing operations, administrative operations, including our employee base, and clinical or regulatory activities, which could negatively affect our ability to achieve certain corporate goals.

The Company continues to seek additional capital through product revenues, strategic transactions, including extension opportunities under the awarded BARDA contract, and from other financing alternatives.

4. Transactions with Olympus Corporation

Acquisition of Olympus' Interest in the Joint Venture

In 2005, we entered into a joint venture and other related agreements (the "Joint Venture Agreements") with Olympus. The Joint Venture was owned equally by Olympus and us. We had previously accounted for our interests in the Joint Venture using the equity method of accounting, since we could not exert significant influence over the Joint Venture's operations.

On May 8, 2013, Cytori and Olympus agreed to terminate the Olympus-Cytori Joint Venture (the "Termination Agreement"), and Cytori acquired the remaining 50% equity interest in the Joint Venture from Olympus. The termination of the relationship and purchase of the Olympus' equity shares of the Joint Venture allows Cytori to regain full control of the manufacturing rights for the Celution ® system. The purpose of the acquisition is to gain more flexibility on the manufacturing process and associated costs, enable higher margins, and speed the transition to the critical next-generation systems. In connection with the Termination Agreement, the assets acquired, liabilities assumed, and the Company's previously held equity interest were recorded at fair value. For valuation purposes Cytori determined the acquisition date (the date on which Cytori effectively gained full control of the equity interest previously held by Olympus) to be May 27, 2013. The remeasurement of the previously held equity interest at the acquisition date resulted in a net gain of \$4,892,000 that was recorded in the accompanying consolidated condensed statements of operations.

As consideration for the Termination Agreement, Cytori can choose from alternative payment options as defined in the Termination Agreement. The payment options call for a minimum of \$4,500,000 up to a maximum of \$16,000,000 to be paid by Cytori to Olympus in installments over periods ranging from one year to six years depending on the option selected by the Company. Installment payments will be calculated quarterly based on 5% of Cytori's gross sales receipts for all products sold. If Cytori receives an aggregate \$35,000,000 in cash through strategic or financing arrangements during the first year of the Termination Agreement, Cytori will pay \$4,500,000 upon request of Olympus as full and complete consideration under the Agreement.

The fair value of the Joint Venture, including the identified intangible assets acquired, consideration transferred, and Cytori's previously held equity interest, was estimated from a market participant perspective, using valuation techniques based on the income approach for measuring fair value. Specifically, an excess earnings methodology was employed using primarily Level 3 fair value inputs. The intangible assets acquired consisted primarily of contractual license rights that had previously enabled the Joint Venture to conduct development and manufacturing activities pertaining to certain aspects of Cytori's Celution ® technology. The useful life of the identifiable intangible assets was estimated based on the assumed future economic benefit expected to be received from the assets. Inputs used in the valuation included various market participant assumptions in order to project potential future cash flows, discounted at a rate commensurate with the risk involved.

	<u>Useful Life (in years)</u>	<u>Estimated Fair Value</u>
Intangible assets:		
Developed technology	7	\$ 9,394,000

The following table summarizes the fair value of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

	<u>Estimated Fair Value</u>
Current assets	\$ 236
Property and equipment	260
Intangible assets	<u>9,394</u>
Total assets acquired	9,890
Accrued and other current liabilities	<u>(33)</u>
Total fair value of the Joint Venture	<u>\$ 9,857</u>

Acquisition-related transaction costs are not included as components of consideration transferred but have been accounted for as expenses in the period in which the costs are incurred.

There was no revenue or earnings from the Joint Venture included in our consolidated results subsequent to the date of acquisition. Had the acquisition occurred on January 1, 2013, consolidated revenue would not have been affected, but our consolidated net loss would have been reduced by \$48,000, the amount of our year to date equity loss from investment in Joint Venture.

The Company calculated the fair value of the purchase consideration on the acquisition date to be \$4,928,000. This was determined using a weighted probability assessment of the payment options available to Cytori. Present value risk-adjusted discount rates applied to the purchase consideration ranged from 9.75% to 12.75%. The fair value calculation of the purchase consideration resulted in a discount of \$1,072,000, which will be amortized to interest expense over a weighted average expected term of 1.8 years. On a quarterly basis, the Company will reassess the probabilities of the various payment options and expected term. Changes in the expected term and the remaining discount amount as a result of the reassessment will be recognized prospectively as an adjustment to interest expense. Upon final settlement of the purchase obligation, any difference between the amount paid and the carrying amount of the purchase obligation will be recorded as a gain or loss on extinguishment of the liability. As a result of this reassessment as of March 31, 2014 the Company believed it would settle the obligation for a total of \$4.5 million (less any installment payments already made), which would have resulted in a gain of \$0.6 million upon settlement.

As of May 8, 2014, the Company's obligation to Olympus had not been settled, and accordingly, the obligation increased by \$1.5 million under an alternative payment option. This option calls for \$6.0 million in total payments to be made by May 8, 2015. Since we have made payments totaling \$2.6 million through June 30, our remaining payment obligation under this option is now \$3.4 million.

As a result of our quarterly reassessment, we have recorded additional interest expense of \$145,000 during the quarter ended June 30, 2014 and have a remaining unrecognized future discount amount of approximately \$700,000 as of June 30, 2014.

Put/Calls and Guarantees

Prior to the termination of the Joint Venture, the Shareholders' Agreement between Cytori and Olympus provided that in certain specified circumstances of our insolvency or if we experienced a change in control, Olympus would have the rights to (i) repurchase our interests in the Joint Venture at the fair value of such interests or (ii) sell its own interests in the Joint Venture to Cytori (the "Put") at the higher of (a) \$22,000,000 or (b) the Put's fair value.

At December 31, 2012, the estimated fair value of the Put was \$2,250,000. The Put, as a previously existing contractual relationship between Olympus and Cytori, was cancelled as a result of the Joint Venture termination in May 2013 and therefore its related fair value decreased to zero as a result of the termination. Fluctuations in the Put value were recorded in the consolidated condensed statements of operations as a component of change in fair value of option liabilities.

5. Partnership Agreement with Lorem Vascular

On October 29, 2013, we entered into a partnership with Lorem Vascular Pty. Ltd ("Lorem Vascular"), to commercialize Cytori Cell Therapy for the cardiovascular, renal and diabetes markets, in China, Hong Kong, Malaysia, Singapore and Australia (the "License/Supply Agreement"), and a Common Stock Purchase Agreement. On January 30, 2014 we entered into the Amended and Restated License/Supply Agreement with Lorem Vascular (the "Restated Agreement") which restated the License/Supply Agreement in its entirety and expanded the licensed field to all uses excepting alopecia (hair loss). Under the Restated Agreement, Lorem Vascular committed to pay up to \$500 million in license fees in the form of revenue milestones. In addition, Lorem is required to pay us 30% of their gross profits in China, Hong Kong and Malaysia for the term of the agreement. In addition, Lorem Vascular has agreed to purchase the Cytori Celution® System and consumables under the Restated Agreement. Pursuant to the related Common Stock Purchase Agreement, Cytori sold Lorem Vascular 8 million shares of Cytori common stock at \$3.00 per share for a total of \$24 million. The Equity purchased was closed in two installments, the first half in November 2013, and the second half in January 2014.

In addition, Lorem Vascular had initially committed to purchase approximately \$7 million in Celution® devices and consumables, with an approximately \$2 million order already completed, and an approximately \$5 million order to be placed following regulatory approval in China. Lorem and Cytori have implemented a regulatory plan for China and anticipate approval in 2014.

6. Long-term Debt

On June 28, 2013 we entered into the Loan Agreement with the Lenders, pursuant to which the Lenders funded an aggregate principal amount of \$27.0 million (Term Loans), subject to the terms and conditions set forth in the loan agreement. The Term Loans accrue interest at a fixed rate of 9.75% per annum. Pursuant to the Loan Agreement, we are required to make interest only payments through July 1, 2014 and thereafter we are required to make payments of principal and accrued interest in equal monthly installments sufficient to amortize the Term Loans through July 1, 2017, the maturity date. All unpaid principal and interest with respect to the Term Loans is due and payable in full on July 1, 2017. At maturity of the Term Loans, or earlier repayment in full following voluntary prepayment or upon acceleration, the Company is required to make a final payment fee in an aggregate amount equal to \$1,620,000. In connection with the Term Loans, on June 28, 2013, we issued to the Lenders warrants to purchase up to an aggregate of 596,553 shares of our common stock at an exercise price of \$2.26 per share. These warrants are immediately exercisable and will expire on June 28, 2020.

In connection with the Loan Agreement, we prepaid all outstanding amounts under the prior loan agreement, at which time the Company's obligations under the prior loan agreement immediately terminated. The Company paid to the prior agent and the prior lenders approximately \$18,866,000, consisting of the then outstanding principal balance due of approximately \$17,325,000, accrued but unpaid interest of approximately \$119,000, a final payment fee (net of fees waived or refunded by the Lenders under the new loan agreement) of approximately \$1,078,000, a prepayment fee (net of fees waived or refunded by the Lenders under the new loan agreement) of approximately \$312,000 and other customary lender fees and expenses.

The net proceeds of the Term Loans, after payment of lender fees and expenses and prepaying all the outstanding amounts relating to the prior loan agreement, were approximately \$7.8 million.

For the continuing Lenders, we accounted for this amendment as a debt modification. Accordingly, related fees of \$1,942,000 were recorded as debt discount, and along with the unamortized debt discount will be amortized as an adjustment of interest expense using the effective interest method. For one existing lender that did not participate in the Term Loans, the payoff of their loan was accounted for as debt extinguishment. Accordingly, a loss on debt extinguishment of \$708,000 was recorded, which includes that lender's portion of unamortized fees and discounts along with prepayment and final payment fees.

We allocated the aggregate proceeds of the Term Loans between the warrants and the debt obligations based on their relative fair values. The fair value of the warrants issued to the Lenders was calculated utilizing the Black-Scholes option pricing model. We are amortizing the resulting additional discount of \$949,000 to interest expense over the term of the loan using the effective interest method. The overall effective interest rate for the Term Loans is 13.92%. The Term Loans are collateralized by the tangible assets of the company, including a security interest in substantially all of its existing and after-acquired assets.

7. Revenue Recognition

Product Sales

We recognize revenue from product sales when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the price to the customer is fixed or determinable and (iv) collection of the resulting accounts receivable is reasonably assured. We recognize revenue for sales to new customers as cash is received as the risk of non-payment results in the conclusion that collection is not reasonably assured.

For all sales, we use a binding purchase order or a signed agreement as evidence of an arrangement. If the other revenue recognition criteria are met, revenue for these product sales is recognized upon delivery to the customer, as all risks and rewards of ownership have been substantively transferred to the customer at that point. For sales to customers who arrange for and manage the shipping process, we recognize revenue upon shipment from our facilities. Shipping and handling costs that are billed to our customers are classified as revenue. The customer's obligation to pay and the payment terms are set at the time of delivery and are not dependent on the subsequent use or resale of our products. For sales where all revenue recognition criteria are not met, revenue is deferred and related inventory remains on our books.

For sales that include multiple deliverables, such as sales of our StemSource® Cell Bank (“cell bank”), we account for products or services (“deliverables”) separately rather than as a combined unit. StemSource® Cell Banks typically consist of a complex array of equipment, proprietary knowledge, license rights, and services, including one or more StemSource® devices, a cryogenic freezer, measuring and monitoring equipment, and a database patient tracking system. In addition, we typically provide consulting, installation, and training services. Web hosting, technical support and maintenance services are generally provided for a period of up to one year subsequent to the date of sale. FASB authoritative guidance requires an evaluation of these deliverables to determine the appropriate “units of accounting” for purposes of revenue recognition. Each cell bank is customized to provide the best solution for the customer. Depending on customers’ needs, all or combination of the following units of accounting will apply to cell bank transactions:

- initial consulting services;
- license rights and standard operating procedures;
- equipment and supplies;
- installation services;
- training services;
- database hosting services;
- technical support services; and
- maintenance services.

FASB authoritative guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence (“VSOE”); (b) third-party evidence (“TPE”); or (c) management estimates. This guidance requires arrangement consideration to be allocated at the inception of the arrangement to all deliverables using the relative selling price method. For our cell bank sales, we establish relative selling prices for all deliverables based on vendor-specific quotes for comparable services when available. In the absence of VSOE, we use competitors’ products or services considered largely interchangeable with our own or management’s best estimate. Revenue allocated to each unit of accounting is calculated and recognized based on the relative selling price of each deliverable. Future services such as web hosting and ongoing maintenance are deferred and recognized into income as the services are provided, generally over one year following the installation of the equipment.

Concentration of Significant Customers

Five distributors comprised 71% of our revenue recognized for the six months ended June 30, 2014. Three distributors accounted for 78% of total outstanding accounts receivable as of June 30, 2014.

Two distributors comprised 38% of our revenue recognized for the six months ended June 30, 2013. Two direct customers and two distributors accounted for 58% of total outstanding accounts receivable as of June 30, 2013.

Product revenues, classified by geographic location, are as follows:

	Six months ended			
	June 30, 2014		June 30, 2013	
	Product Revenues	% of Total	Product Revenues	% of Total
North America	\$ 264,000	14%	\$ 583,000	21%
Japan	1,263,000	64%	1,487,000	53%
Europe	438,000	22%	625,000	22%
Other countries	—	—	105,000	4%
Total product revenues	\$ 1,965,000	100%	\$ 2,800,000	100%

Research and Development

We earn revenue for performing tasks under research and development agreements with both commercial enterprises, such as Olympus and Senko, and governmental agencies like the U.S. Department of Health and Human Service’s Biomedical Advanced Research and Development Authority (BARDA). Revenue earned under development agreements with commercial enterprises is classified as development revenues. Revenues derived from reimbursement of direct out-of-pocket expenses for research costs associated with government contracts are recorded as government contract and other within development revenues. Government contract revenue is recorded at the gross amount of the reimbursement. The costs associated with these reimbursements are reflected as a component of research and development expense in our statements of operations.

In the third quarter of 2012, we were awarded a contract to develop a new countermeasure for thermal burns valued at up to \$106 million with BARDA. The initial base period included \$4.7 million over two years and covered preclinical research and continued development of Cytori’s Celution® system to improve cell processing. The additional contract options, if fully executed, cover clinical development through FDA approval under a device-based PMA regulatory pathway. This is a cost reimbursement contract and related government contract revenue was recorded at the gross amount of reimbursement starting in the fourth quarter of 2012. In July 2014, we received from BARDA preliminary notice of intent to exercise ‘Option 1’ under the master contract. The notice of intent followed an In-Process Review meeting with BARDA in June, in which they confirmed that Cytori had completed the objectives of the base contract to the government’s satisfaction. We are currently in negotiations with BARDA to finalize additions to the Statement of Work which would extend the contract through September 2016.

We received funds from Olympus and Olympus-Cytori, Inc. during 2005 and 2006. We recorded upfront fees totaling \$28,311,000 as deferred revenues, related party. In exchange for these proceeds, we agreed to (a) provide Olympus-Cytori, Inc. an exclusive and perpetual license to our Celution® System device technology and certain related intellectual property, and (b) provide future development contributions related to commercializing the Celution® System platform. The license and development services were not separable and as a result the recognition of this deferred amount as revenue required achievement of service related milestones, under a proportional performance methodology. Revenue was recognized as the above mentioned R&D milestones were completed. Of the amounts received and deferred, we recognized the last remaining development revenue of \$638,000 during the three months ended March 31, 2013 as a result of the United States Court of Appeals upholding the FDA's previous determination that our cell processing devices were not substantially equivalent to the cited predicate devices. The recognition of revenue associated with this event reflects the completion of our efforts expended to use commercially reasonable efforts to obtain device regulatory approvals in the United States as it pertains to the 510(k) pathway. As of June 30, 2014, there are no deferred amounts under this contract.

Refer to Note 14 for discussion about arrangement with Senko.

8. Inventories

Inventories are carried at the lower of cost or market, determined on the first-in, first-out (FIFO) method.

Inventories consisted of the following:

	<u>June 30, 2014</u>	<u>December 31, 2013</u>
Raw materials	\$ 1,466,000	\$ 1,315,000
Work in process	772,000	232,000
Finished goods	2,250,000	2,147,000
	<u>\$ 4,488,000</u>	<u>\$ 3,694,000</u>

9. Share-Based Compensation

Stock Options

During the second quarter of 2014 we issued to our executive officers and certain non-executive employees options to purchase an aggregate of 1,565,000 shares of our common stock with four-year vesting. The grant date fair value of the awards granted to our officers and employees was \$1.61 per share for options with an exercise price of \$2.38 (which was the fair market value of our common stock on the date of grant). The resulting share-based compensation expense of \$2,525,000, net of estimated forfeitures will be recognized over the respective vesting periods.

During the first quarter of 2014, we issued to our directors options to purchase an aggregate of 96,180 shares of our common stock, with two-year vesting. The grant date fair value of the awards granted to our officers was \$1.75 per share for options with an exercise price of \$2.57 (which was the fair market value of our common stock on the date of grant). The resulting share-based compensation expense of \$168,000, net of estimated forfeitures, will be recognized as expense over the respective vesting periods.

During the first quarter of 2013, we issued to our directors and executive officers options to purchase an aggregate of 1,897,000 shares of our common stock, with four-year vesting for our officers and two-year vesting for our directors. The grant date fair value of the awards granted to our officers was \$1.80 per share for options with an exercise price of \$2.74 (which was the fair market value of our common stock on the date of grant) and \$1.49 per share for options with an exercise price of \$5.00, respectively. The grant date fair value of the awards granted to our directors was \$1.84 per share for options with an exercise price of \$2.80 (which was the fair market value of our common stock on the date of grant). The resulting share-based compensation expense of \$3,235,000, net of estimated forfeitures, will be recognized as expense over the respective vesting periods.

During the first quarter of 2013, we issued a grant to our non-executive employees options to purchase an aggregate of 552,350 shares of our common stock, with four-year vesting. The grant date fair values of the awards were \$1.92 per share and \$1.64 per share, respectively, due to the awards being granted on two different dates. The resulting share-based compensation expense of \$974,000, net of estimated forfeitures, will be recognized as expense over the respective vesting periods.

Restricted Stock Awards

During the second quarter of 2014, we issued to our directors 31,508 shares of restricted stock. The stock award vests on January 2, 2015 and the resulting share-based compensation expense of \$76,000 will be recognized as expense over the vesting period.

During the first quarter of 2014, we issued to our directors 63,300 shares of restricted stock. The stock award vests on January 2, 2015 and the resulting share-based compensation expense of \$162,700 will be recognized as expense over the vesting period.

Performance-Based Restricted Stock Awards

In January 2012, we granted 276,375 performance-based restricted stock awards under the 2004 Equity Incentive Plan. The awards provided certain employees until December 31, 2012 to achieve certain performance goals established by the Compensation Committee. In January 2013, the Compensation Committee modified the awards to allow a portion of the awards to continue vesting based on partial achievement of the performance goals. As a result of this modification, 86,229 shares with fair value of \$2.74 per share will continue vesting under the modified terms of the grant that would have been cancelled under the original terms. Since we had not recognized any expense relating to these shares through December 31, 2012, additional compensation expense \$236,000 resulting from this modification was recognized from the modification date through the vesting date of January 2014. We recognized \$9,800 of compensation expense related to performance-based awards during the six months ended June 30, 2014.

10. Loss per Share

Basic per share data is computed by dividing net income or loss applicable 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 or loss applicable 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 shares that would have been outstanding as calculated using the treasury stock method. Potential common shares were related entirely to outstanding but unexercised options and warrants for all periods presented.

We have excluded all potentially dilutive securities, including unvested performance-based restricted stock, from the calculation of diluted loss per share attributable to common stockholders for the three and six months ended June 30, 2014 and 2013, as their inclusion would be antidilutive. Potentially dilutive common shares excluded from the calculations of diluted loss per share were 22,507,907 for the three and six month periods ended June 30, 2014 and 19,536,812 for the three and six month periods ended June 30, 2013, respectively.

11. Accumulated Other Comprehensive Loss

During the first quarter of 2013, we determined that the functional currency of our Japanese subsidiary changed from the US Dollar to the Japanese Yen due to significant changes in economic facts and circumstances of our Japan subsidiary. As a result of this change, a portion of the foreign exchange gain or loss will be classified as foreign currency translation adjustments within other comprehensive income or loss. Our comprehensive loss includes net loss and foreign currency translation adjustments. See the unaudited consolidated condensed statements of operations and comprehensive loss for the effect of foreign currency translation adjustments.

12. Commitments and Contingencies

We have entered into agreements with various research organizations for pre-clinical and clinical development studies, which have provisions for cancellation. Under the terms of these agreements, the vendors provide a variety of services including conducting research, recruiting and enrolling patients, monitoring studies and data analysis. Payments under these agreements typically include fees for services and reimbursement of expenses. The timing of payments due under these agreements was estimated based on current schedules of pre-clinical and clinical studies in progress. As of June 30, 2014, we have pre-clinical research study obligations of \$23,000 (all of which are expected to be complete within a year) and clinical research study obligations of \$7,605,000 (\$5,755,000 of which are expected to be complete within a year). Should the timing of the pre-clinical and clinical trials change, the timing of the payment of these obligations would also change.

During 2008, we entered into a supply agreement with a minimum purchase requirements clause. As of June 30, 2014, we have minimum purchase obligations of \$850,000 (all of which are expected to be paid within a year).

We have entered into several lease agreements for our headquarters office location as well as international office locations. As of June 30, 2014, we have remaining lease obligations of \$6,333,000 (\$1,905,000 of which are expected to be completed within a year).

We are subject to various claims and contingencies related to legal proceedings. Due to their nature, such legal proceedings involve inherent uncertainties including, but not limited to, court rulings, negotiations between affected parties and governmental actions. Management assesses the probability of loss for such contingencies and accrues a liability and/or discloses the relevant circumstances, as appropriate. Management believes that any liability to us that may arise as a result of currently pending legal proceedings will not have a material adverse effect on our financial condition, liquidity, or results of operations as a whole.

Refer to note 6 for a discussion of our commitments and contingencies related to our long-term obligations.

Refer to note 4 for a discussion of our commitments and contingencies related to our transactions with Olympus.

Refer to note 14 for a discussion of our commitments and contingencies related to our arrangements with Senko.

13. Sale and Exclusive License/Supply Agreement with Bimini Technologies LLC

On July 30, 2013, we entered into a Sale and Exclusive License/Supply Agreement with Bimini Technologies LLC (“Bimini”), pursuant to which we sold to Bimini substantially all of the assets (other than certain retained rights and licenses) of our Puregraft® product line, a series of standalone fat transplantation products that were developed to improve the predictability of outcomes for autologous fat grafting and aesthetic body contouring. The aggregate value of the consideration paid by Bimini at the execution of the agreement was \$5.0 million.

In connection with the sale, Bimini granted to the Company an exclusive, perpetual, royalty bearing license to market and sell the Puregraft products for use in combination with adipose derived regenerative cells, and non-exclusive rights for use in connection with the Company’s licensed cell and tissue banks (in addition to certain Company retained ownership rights in the technology). The Company will supply Puregraft products to Bimini on an interim basis until the Company transfers the manufacturing of the Puregraft products to Bimini. After the transfer, Bimini will supply the Puregraft products to the Company.

Pursuant to the sale agreement, the Company has also granted to Bimini the global, exclusive, perpetual, irrevocable royalty bearing license to purchase from Cytori, use and sell the Celution® System products for Alopecia (hair loss). Cytori will supply Celution devices and consumable sets to Bimini, and Bimini will be responsible for all costs associated with commercial development in the Alopecia market.

The agreement includes certain obligations to be performed by the Company on the behalf of Bimini, which includes transferring the manufacturing of Puregraft products to an agreed upon third party on or before December 31, 2014 and training. The Company recorded a gain on the Puregraft divestiture of \$4.5 million in 2013, and has a remaining obligation of approximately \$215,000 in future transfer and training obligations, as of June 30, 2014. Bimini is obligated to make certain additional milestone payments to the Company (in an aggregate amount of up to \$10.0 million), contingent upon the achievement of certain milestones relating to Bimini’s gross profits from sales of the Puregraft products.

14. Thin Film Japan Distribution Agreement

In 2004, the Company 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 and are responsible for the completion of the initial regulatory application to the Ministry of Health, Labor and Welfare (“MHLW”) and commercialization of the Thin Film product line in Japan. The Distribution Agreement with Senko commences upon “commercialization.” Essentially, commercialization occurs when one or more Thin Film product registrations are completed with the MHLW. At the inception of this arrangement, we received a \$1,500,000 license fee which was recorded as deferred revenues in 2004. Half of the license fee was refundable if the parties agree commercialization is not achievable and a proportional amount was refundable if we terminate the arrangement, other than for material breach by Senko, before three years post-commercialization. We have also received \$1,250,000 in milestone payments from Senko.

In February 2013, we entered into a mutual termination and release agreement with Senko, whereby the Distribution Agreement and all Senko rights, licenses and privileges granted under the Distribution Agreement terminated and reverted to the Company. As a result of this Termination Agreement, we are obligated to pay Senko \$1,200,000 in six quarterly installment payments of \$200,000 each through May 2014 (all of which has been paid). At the time of the Termination Agreement, we had a balance of \$2,379,000 in deferred revenues on our balance sheet relating to the payments received from Senko in the past pursuant to the Distribution Agreement. At the time of the Termination Agreement we accrued \$1,200,000 of the termination fee, and recognized the remaining \$1,179,000 in development revenues which reflects the Company’s efforts towards commercialization under the agreement. As of June 30, 2014, we have no remaining termination fee obligation.

15. Fair Value Measurements

Fair value measurements are market-based measurements, not entity-specific measurements. Therefore, fair value measurements are determined based on the assumptions that market participants would use in pricing the asset or liability. We follow a three-level hierarchy to prioritize the inputs used in the valuation techniques to derive fair values. The basis for fair value measurements for each level within the hierarchy is described below:

- Level 1: Quoted prices in active markets for identical assets or liabilities.
- Level 2: Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable in active markets.
- Level 3: Valuations derived from valuation techniques in which one or more significant inputs are unobservable in active markets.

	Balance as of June 30, 2014	Basis of Fair Value Measurements		
		Level 1	Level 2	Level 3
Assets:				
Cash equivalents	\$ 4,644,000	\$ 4,644,000	\$ —	\$ —

	Balance as of December 31, 2013	Basis of Fair Value Measurements		
		Level 1	Level 2	Level 3
Assets:				
Cash equivalents	\$ 4,644,000	\$ 4,644,000	\$ —	\$ —

We use quoted market prices to determine the fair value of our cash equivalents, which consist of money market funds that are classified in Level 1 of the fair value hierarchy.

16. Fair Value

Financial Instruments

We disclose fair value information about all financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate fair value. The disclosures of estimated fair value of financial instruments at June 30, 2014 and December 31, 2013, were determined using available market information and appropriate valuation methods. Considerable judgment is necessary to interpret market data and develop estimated fair value. The use of different market assumptions or estimation methods may have a material effect on the estimated fair value amounts.

The carrying amounts for cash and cash equivalents, accounts receivable, inventories, other current assets, accounts payable, accrued expenses and other liabilities approximate fair value due to the short-term nature of these instruments.

We utilize quoted market prices to estimate the fair value of our fixed rate debt, when available. If quoted market prices are not available, we calculate the fair value of our fixed rate debt based on a currently available market rate assuming the loans are outstanding through maturity and considering the collateral. In determining the current market rate for fixed rate debt, a market spread is added to the quoted yields on federal government treasury securities with similar terms to the debt.

At June 30, 2014 and December 31, 2013, the aggregate fair value and the carrying value of the Company's fixed rate long-term debt were as follows:

	June 30, 2014		December 31, 2013	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Fixed rate long-term debt	\$ 26,712,000	\$ 26,803,000	\$ 26,207,000	\$ 26,241,000

Carrying value is net of debt discount of \$1,817,000 and \$2,379,000 as of June 30, 2014 and December 31, 2013, respectively.

The fair value of debt is classified as Level 3 in the fair value hierarchy as some of the inputs to our valuation model are either not observable quoted prices or are not derived principally from or corroborated by observable market data by correlation or other means. These inputs include the monthly payments and term of the loan, the stated interest rate, the estimated market interest rate for similar debt, and the amount and timing of the final payment fee.

17. Stockholders' Equity

Common Stock

In December 2012, we entered into an underwriting agreement with Lazard Capital Markets, LLC (underwriter), relating to the issuance and sale of 7,020,000 shares of our common stock. The price to the public in this offering was \$2.85 per share and the underwriter purchased the shares from us at a price of \$2.69 per share. The transaction was completed on December 19, 2012 raising approximately \$20,007,000 in gross proceeds before deducting underwriting discounts and commissions and other offering expenses payable by us. Under the terms of the underwriting agreement, we granted the underwriter an option, exercisable for 30 days, to purchase up to an additional 1,053,000 shares.

In January 2013, the underwriter exercised this option and as a result we sold an additional 1,053,000 shares raising approximately \$3,001,000 in gross proceeds before deducting underwriting discounts and commissions and other offering expenses payable by us.

In October 2013, we entered into a Common Stock Purchase Agreement with Lorem Vascular for the purchase of 8,000,000 shares at \$3.00 per share. The transaction occurred in two separate closings of 4,000,000 shares each. The first closing occurred in November 2013, and the second closing occurred in January 2014. As of December 31, 2013, we received \$15,000,000 of the gross proceeds, \$12,000,000 for the first closing and \$3,000,000 towards the second closing. The balance of \$9,000,000 in gross proceeds required to complete the second closing were received in January 2014.

In May 2014, we and 47 holders of warrants to purchase a total of 3,156,238 shares of the Company's common stock, \$0.001 par value per share, issued in a private offering in May 2009, agreed to extend the expiration date of the warrants from May 14, 2014 to May 14, 2015 and increase the exercise price of the warrants from \$2.62 per share to \$3.50 per share pursuant to an Amendment to Warrant to Purchase Common Stock. One holder of warrants did not agree to the Amendment, and their warrants, covering 38,500 shares of Common Stock, expired unexercised on May 14, 2014 in accordance with the original terms.

In May 2014, we entered into subscription agreements with certain institutional investors pursuant to which sold a total of 4,048,584 units, with each unit consisting of one share of common stock and one warrant to purchase one share of common stock at a purchase price of \$2.47 per unit, in a registered direct offering. Each warrant will have an exercise price of \$3.00 per share, will be exercisable immediately after issuance and will expire five years from the date of issuance. The transaction was completed on June 4, 2014 raising approximately \$10,000,000 in gross proceeds before deducting any offering expenses or fees payable by us. Under the terms of our Placement Agent Agreement, we granted WBB Securities, LLC warrants to purchase 202,429 shares of common stock. The placement agent warrants will have the same terms as the warrants issued to the purchasers in the offering, except that such warrants will have an exercise price of \$3.09.

Other Related Party Transactions

During the six months ended June 30, 2013, we incurred approximately \$45,000, in royalty costs in connection with our sales of our Celution® 800/CRS System products to the European and Asia-Pacific reconstructive surgery market, pursuant to our License and Royalty Agreement and the Amended License/Commercial Agreement with the Olympus-Cytori, Inc. joint venture. There were no comparable royalty costs during the six months ended June 30, 2014.

Additionally, refer to note 4 for a discussion of related party transactions with Olympus.

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

Our Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) includes the following sections:

- Overview that discusses our operating results and some of the trends that affect our business.
- Results of Operations that includes a more detailed discussion of our revenue and expenses.
- Liquidity and Capital Resources which discusses key aspects of our statements of cash flows, changes in our financial position and our financial commitments.
- Significant changes since our most recent Annual Report on Form 10-K in the Critical Accounting Policies and Significant Estimates that we believe are important to understanding the assumptions and judgments underlying our financial statements.

You should read this MD&A in conjunction with the financial statements and related notes in Item 1 and our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report contains certain statements that may be deemed “forward-looking statements” within the meaning of U.S. securities laws. All statements, other than statements of historical fact, that address activities, events or developments that we intend, expect, project, believe or anticipate and similar expressions or future conditional verbs such as will, should, would, could 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.

These statements include, without limitation, statements about our anticipated expenditures, including those related to clinical research studies and general and administrative expenses; the potential size of the market for our products, future development and/or expansion of our products and therapies in our markets, our ability to generate product revenues or effectively manage our gross profit margins; our ability to obtain regulatory clearance; expectations as to our future performance; our potential need for additional financing and the anticipated amount and availability thereof; and the potential enhancement of our cash position through development, marketing, and licensing arrangements. Our actual results will likely differ, perhaps materially, from those anticipated in these forward-looking statements as a result of various factors, including: our need and ability to raise additional cash, our joint ventures, risks associated with laws or regulatory requirements applicable to us, market conditions, product performance, potential litigation, and competition within the regenerative medicine field, to name a few. The forward-looking statements included in this report are subject to a number of additional material risks and uncertainties, including but not limited to the risks described under the heading “Risk Factors” in Item 1A of Part II below, which we encourage you to read 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

We are a cell therapy company dedicated to the development of novel treatments primarily for cardiovascular disease as well as for a range of soft tissue injuries. In the U.S. our goal is to bring Cytori Cell Therapy to market for treatment of heart failure due to ischemic heart disease through Cytori-sponsored clinical development efforts and to develop a treatment for thermal burns combined with radiation injury under a contract from BARDA, a division of the U.S. Department of Health and Human Services.

Cytori Cell Therapy is a proprietary formulation of stem and regenerative cells derived from a patient’s own adipose (fat) tissue (ADRCs). Adipose tissue is a rich and accessible source of stem and other regenerative cells. To access these cells from a patient at the time of a surgical procedure, we have designed and developed a sophisticated tissue processing system, the Celution® System, which automates the complex process of digesting fat tissue, releasing the ADRCs, and concentrating them into an optimized and proprietary formulation in a sterile environment. The system is comprised of a central device and single-use, per-procedure consumable cartridges. The business model is based on the sale of the device and generating recurring revenue from the cartridges that are utilized in each procedure.

In addition to our targeted therapeutic development, we have continued to commercialize the Celution® System under select medical device clearances to research customers developing new therapeutic applications for Cytori Cell Therapy in Europe, Japan, and other regions. The early sales of systems, consumables and ancillary products contributes margins that partially offset our operating expenses and play an important strategic role in fostering familiarity within the medical community with our technology. These sales have also facilitated the discovery of new applications for Cytori Cell Therapy by customers conducting investigator-initiated and funded research.

Development Pipeline

The primary therapeutic areas currently within our development pipeline are cardiovascular disease, specifically heart failure due to ischemic heart disease, the treatment of thermal burns, and orthopedics and sports medicine indications.

In the U.S., we are conducting our ATHENA and ATHENA II trials, both prospective, double blind, placebo-controlled, multi-center trials designed to enroll up to 45 patients with ischemic heart disease at a lower and higher cell dose, respectively. The trial will measure several endpoints, including peak oxygen consumption (VO₂ max). Additional endpoints include perfusion defect, left ventricle end-systolic and diastolic volume and ejection fraction at six and 12 months, NYHA functional class and health-related quality of life. In August 2014, we announced that enrollment in both ATHENA trials had been placed on hold based on a safety review of reported cerebrovascular events. As a result, it will not be possible to complete enrollment of the ATHENA trial by year end 2014 as previously anticipated. The symptoms, which occurred in three patients, appear to be related in part to the medical co-morbidities in the treated population and the complex nature of the procedures involved in the trial. We are currently working closely with the Investigator, Data Monitoring Committee and the FDA to refine the protocol to mitigate these risks, and we will require their approval prior to continuing further enrollment in the trials. Updated information on enrollment projections will be announced pending final accepted protocol revisions.

In addition to the ATHENA trial, Cytori has been selected by the Cardiovascular Cell Therapy Research Network (CCTRN) to supply adipose-derived regenerative cells (ADRCs) in a sponsored U.S. phase I clinical trial evaluating safety and feasibility of using ADRCs in patients with Left Ventricular Assist Devices (LVADs). The trial, named CELLVAD-ADRC, will be funded by the CCTRN, who will oversee trial design, implementation and enrollment. Furthermore, we are continuing to follow patients enrolled in the ADVANCE heart attack trial. ADVANCE is our European clinical trial for acute myocardial infarction (heart attack) which was discontinued in September 30, 2013 to focus our internal and financial resources on the U.S. ATHENA trial. All evidence to date from the ADVANCE trial supports the current, known safety profile for Cytori's Cell Therapy. The outcomes will be fully analyzed in conjunction with the existing safety and feasibility data from the APOLLO acute myocardial infarction trial.

We have completed two European pilot trials (PRECISE and APOLLO) investigating Cytori's Cell Therapy for cardiovascular disease. The PRECISE trial studied patients with chronic myocardial ischemia and supports the safety profile and feasibility of Cytori's Cell Therapy as well as an improvement in cardiac functional capacity as measured by VO₂ max. Long term follow up data from the PRECISE trial was published in the American Heart Journal in April 2014 supporting the safety profile, feasibility and indications of a favorable benefit to risk profile. Results from the APOLLO trial for acute heart attack demonstrated the safety and feasibility of Cytori Cell Therapy in this population but the size of the pilot trial was not sufficient to comment definitively on efficacy.

In addition to our cardiovascular disease therapeutic pipeline, Cytori is also developing its cell therapy platform for the treatment of thermal burns combined with radiation injury, sports medicine and orthopedics. In the third quarter of 2012, we were awarded a contract to develop a new countermeasure for thermal burns valued at up to \$106 million with the U.S. Department of Health and Human Service's Biomedical Advanced Research and Development Authority (BARDA), including a base period of \$4.7 million over two years and three contract options. In July 2014, we received from BARDA preliminary notice of intent to exercise 'Option 1' under the master contract. The notice of intent followed an In-Process Review meeting with BARDA in June in which they confirmed that Cytori had completed the objectives of the base contract to the government's satisfaction. We are currently in negotiations with BARDA to finalize additions to the Statement of Work which would extend the contract through September 2016.

We also received FDA approval in late 2013 to conduct a safety and feasibility clinical trial in patients with acute hamstring tears in order to evaluate the effect of Cytori Cell Therapy on healing in muscle injury.

Results of OperationsProduct revenues

Product revenues consisted of revenues primarily from our Celution® and Puregraft® Systems and StemSource® Cell Banks.

The following table summarizes the components for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Product revenues - third party	\$ 935,000	\$ 1,408,000	\$ 1,965,000	\$ 2,800,000

We experienced a decrease in product revenue during the three and six months ended June 30, 2014 as compared to the same periods in 2013, due principally to the product mix comprising revenue for each period, anticipated timing associated with larger system related sales and our new revenue recognition policy in 2014 for new customers.

A significant contributor to Cytori's product revenue historically and throughout 2013 has been sales in Japan. In September 2012 we obtained Class I Device Clearance for Celution® and a number of our other products in Japan. This clearance is expected to facilitate sales growth in Japan and it is anticipated that demand will come mostly from researchers at academic hospitals seeking to perform investigator-initiated and funded studies using Cytori's Cell Therapy.

The future: We expect to continue to generate product revenues from a mix of Celution® and StemSource® System and consumables sales. We will sell the products to a diverse group of distributors and partners in Europe, Asia and the U.S., who may apply the products towards reconstructive surgery, soft tissue repair, research, and cell and tissue banking as approved in each country. Additionally, as a result of Class I Device Clearance for Celution® and a number of our other products in Japan, we anticipate to sell these products to researchers at academic hospitals seeking to perform investigator-initiated and funded studies using Cytori's Cell Therapy. As a result of sale of our Puregraft® product line discussed in note 13 of the Consolidated Financial Statements, we do not expect significant revenues from that product line in the foreseeable future.

Cost of product revenues

Cost of product revenues relate primarily to Celution® System products and StemSource® Cell Banks and includes material, manufacturing labor, and overhead costs. The following table summarizes the components of our cost of revenues for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Cost of product revenues	\$ 746,000	\$ 585,000	\$ 1,148,000	\$ 1,323,000
Share-based compensation	20,000	23,000	39,000	42,000
Total cost of product revenues	\$ 766,000	\$ 608,000	\$ 1,187,000	\$ 1,365,000
Total cost of product revenues as % of product revenues	81.9%	43.2%	60.4%	48.8%

Cost of product revenues as a percentage of product revenues was 81.9% and 60.4% for the three and six months ended June 30, 2014 and 43.2% and 48.8% for the three and six months ended June 30, 2013, respectively. Fluctuation in this percentage is to be expected due to the product mix, distributor and direct sales mix, and allocation of overhead.

The future. We expect to continue to see variation in our gross profit margin as the timing and product mix comprising revenues fluctuates.

Development revenues

The following table summarizes the components of our development revenues for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Development (Olympus)	\$ —	\$ —	\$ —	\$ 638,000
Development (Senko)	—	—	—	1,179,000
Government contract (BARDA)	356,000	843,000	759,000	1,389,000
Other	—	16,000	—	19,000
Total development revenues	\$ 356,000	\$ 859,000	\$ 759,000	\$ 3,225,000

We recognize deferred revenues, related party, as development revenue when certain performance obligations are met (i.e., using a proportional performance approach). Of the amounts received and deferred, we recognized the remaining development revenue of \$638,000 during the three months ended March 31, 2013 as a result of the United States Court of Appeals upholding the FDA's previous determination that our cell processing devices were not substantially equivalent to the cited predicate devices. The recognition of revenue associated with this event reflects the completion of our efforts expended to use commercially reasonable efforts to obtain device regulatory approvals in the United States as it pertains to the 510(k) pathway.

In February 2013, we entered into a mutual termination and release agreement with Senko, whereby the Distribution Agreement and all Senko rights, licenses and privileges granted under the Distribution Agreement terminated and reverted to the Company. As a result of this Termination Agreement, we are obligated to pay Senko \$1,200,000 in six quarterly installment payments of \$200,000 each through May 2014. At the time of the Termination Agreement, we had a balance of \$2,379,000 in deferred revenues on our balance sheet relating to the payments received from Senko in the past pursuant to the Distribution Agreement. At the time of the Termination Agreement, we accrued \$1,200,000 of the termination fee, and recognized the remaining \$1,179,000 in development revenues which reflects the Company's efforts towards commercialization under the agreement.

In the third quarter of 2012, we were awarded a contract to develop a new countermeasure for thermal burns valued at up to \$106 million with BARDA. The initial base period includes \$4.7 million over two years and covers preclinical research and continued development of Cytori's Celution® system to improve cell processing. The additional contract options, if fully executed, could cover clinical development through FDA approval under a device-based PMA regulatory pathway. This is a cost reimbursement contract and related government contract revenue was recorded at the gross amount of reimbursement starting in the fourth quarter of 2012. To receive funds under this arrangement, we are required to (i) demonstrate that we incurred "qualifying expenses," as defined in the contract agreement between BARDA and us, (ii) maintain a system of controls, whereby we can accurately track and report all expenditures related solely to develop a new countermeasure for thermal burns, and (iii) file appropriate forms and follow appropriate protocols established by BARDA. During the three months and six months ended June 30, 2014, we incurred \$330,000 and \$705,000 in qualified expenditures. We recognized a total of \$356,000 and \$759,000 in revenues for the three and six months ended June 30, 2014, respectively, which included allowable fees as well as cost reimbursements. During the three months and six months ended June 30, 2013, we incurred \$784,000 and \$1,292,000 in qualified expenditures. We recognized a total of \$843,000 and \$1,389,000 in revenues for the three and six months ended June 30, 2013, respectively, which included allowable fees as well as cost reimbursements.

The future: We have received preliminary written notice of intent to exercise "Option 1" of our contract with BARDA. Based on this notification, Cytori and BARDA are in negotiations on the specifics for the additions to the Statement of Work to be executed in the Option 1 period which would extend the contract through September 2016. It is anticipated that this process will be completed in August 2014.

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, pre-clinical studies and clinical studies.

The following table summarizes the components of our research and development expenses for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
General research and development	\$ 4,530,000	\$ 3,995,000	\$ 8,700,000	\$ 7,572,000
Share-based compensation	144,000	155,000	266,000	297,000
Total research and development expenses	<u>\$ 4,674,000</u>	<u>\$ 4,150,000</u>	<u>\$ 8,966,000</u>	<u>\$ 7,869,000</u>

Research and development expenses relate to the development of a technology platform that involves using adipose tissue as a source of autologous regenerative cells for therapeutic applications. These expenses, in conjunction with continued development efforts related to our Celution® System, result primarily from the broad expansion of our research and development efforts enabled by the funding we received from Olympus in 2005 and 2006 and from other investors during the last few years.

The increase in research and development expenses for the three and six months ended June 30, 2014 as compared to the same periods in 2013 is due to increases in salary and related benefits expense (excluding share-based compensation) of \$89,000 and \$17,000, an increase in professional services expenses of \$638,000 and \$993,000, an increase in clinical study expense of \$65,000 and \$242,000, an increase in research supplies expense of \$31,000 and \$204,000, which was offset by a decrease in insurance expense of \$91,000 and \$48,000, a decrease in advertising and promotion expense of \$28,000 and \$39,000, and a decrease of all other costs of approximately, \$180,000 and \$272,000, respectively.

The future: We expect research and development expenditures to increase in 2014 as we continue our clinical trial activities, our development work under our BARDA contract, and as we seek additional regulatory clearances and potentially seek to initiate additional trials or patient registries during 2014.

Sales and marketing expenses

Sales and marketing expenses include costs of sales and marketing personnel, tradeshow, physician training, and promotional activities and materials. The following table summarizes the components of our sales and marketing expenses for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months e nded June 30,	
	2014	2013	2014	2013
Sales and marketing	\$ 1,784,000	\$ 2,189,000	\$ 3,596,000	\$ 4,285,000
Share-based compensation	150,000	221,000	265,000	382,000
Total sales and marketing expenses	<u>\$ 1,934,000</u>	<u>\$ 2,410,000</u>	<u>\$ 3,861,000</u>	<u>\$ 4,667,000</u>

The decrease in sales and marketing expense during the three and six months ended June 30, 2014 as compared to the same periods in 2013 was mainly attributed to the decrease in salary and related benefits expense (excluding share-based compensation) of \$94,000 and \$374,000, decrease in travel and entertainment expenses of \$15,000 and \$0, decrease in professional services expense of \$205,000 and \$175,000, decrease in advertising and promotion expense of \$48,000 and \$97,000, and a decrease in all other costs of approximately, \$114,000 and \$160,000, respectively.

The future: We expect sales and marketing expenditures to remain relatively stable in the remainder of 2014.

General and administrative expenses

General and administrative expenses include costs for administrative personnel, legal and other professional expenses, and general corporate expenses. The following table summarizes the general and administrative expenses for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
General and administrative	\$ 4,154,000	\$ 3,480,000	\$ 8,064,000	\$ 6,775,000
Share-based compensation	448,000	566,000	878,000	1,117,000
Total general and administrative expenses	<u>\$ 4,602,000</u>	<u>\$ 4,046,000</u>	<u>\$ 8,942,000</u>	<u>\$ 7,892,000</u>

For the three and six months ended June 30, 2014 as compared to the same periods in 2013, general and administrative expenses increased primarily due to an increase in professional services expenses of \$531,000 and \$1,004,000 and a non-cash accounts receivable charge of \$371,000 and \$836,000 related to past-due accounts, respectively, which were offset by a decrease in travel and entertainment of \$62,000 and \$115,000, a decrease in advertising and promotion of \$30,000 and \$78,000 and a decrease in all other costs of \$254,000 and \$597,000.

The future: We expect general and administrative expenses to remain relatively stable through the remainder of 2014.

Share-based compensation expenses

Share-based compensation expenses include charges related to options and restricted stock awards issued to employees, directors and non-employees along with charges related to the employee stock purchases under the Employee Stock Purchase Plan (ESPP). We measure stock-based compensation expense based on the grant-date fair value of any awards granted to our employees. Such expense is recognized over the period of time that employees provide service to us and earn all rights to the awards.

The following table summarizes the components of our share-based compensation expenses for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Cost of product revenues	\$ 20,000	\$ 23,000	\$ 39,000	\$ 42,000
Research and development-related	144,000	155,000	266,000	297,000
Sales and marketing-related	150,000	221,000	265,000	382,000
General and administrative-related	448,000	566,000	878,000	1,117,000
Total share-based compensation	<u>\$ 762,000</u>	<u>\$ 965,000</u>	<u>\$ 1,448,000</u>	<u>\$ 1,838,000</u>

Most of the share-based compensation expenses for the three and six months ended June 30, 2014 and 2013 related to the vesting of stock option and restricted stock awards to employees.

See Notes to the Consolidated Financial Statements included elsewhere herein for disclosure and discussion of share based compensation.

The future. We expect to continue to grant options and stock awards (which will result in an expense) to our employees, directors, and, as appropriate, to non-employee service providers. In addition, previously-granted options will continue to vest in accordance with their original terms. As of June 30, 2014, the total compensation cost related to non-vested stock options and stock awards not yet recognized for all our plans is approximately \$6,226,000, which is expected to be recognized as a result of vesting under service conditions over a weighted average period of 1.93 years.

Change in fair value of warrant liability

The following is a table summarizing the change in fair value of our warrant liability for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Change in fair value of warrant liability	—	\$ (84,000)	\$ —	\$ (418,000)

Changes in fair value of our warrant liability were primarily due to fluctuations in the valuation inputs, such as stock price, volatility, remaining life and others.

The future: No future changes in the fair value of the warrant liability will be recognized as the warrants expired in August 2013.

Change in fair value of option liability

The following is a table summarizing the change in fair value of our put option liability for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Change in fair value of put option liability	\$ —	\$ (2,500,000)	\$ —	\$ (2,250,000)

Changes in fair value of our put option liability were due to changes in assumptions used in estimating the value of the Put, such as bankruptcy threshold for Cytori, fair value of the Olympus-Cytori, Inc. Joint Venture, volatility and others.

The future: The Put was cancelled as a result of the Joint Venture termination and we will not be recognizing any changes in fair value of put option liability in the future.

Loss on asset disposal

The following table summarizes our loss on asset disposal for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Loss on asset disposal	\$ (1,000)	\$ (257,000)	\$ (1,000)	\$ (257,000)

During the quarter ended June 30, 2013, we identified Celution® One equipment that that was initially purchased from the Joint Venture with the purpose of being used in our clinical studies. This equipment was manufactured using a configuration that can no longer be used in our studies. The related net book value of \$257,000 was recorded as loss on asset disposal.

Financing items

The following table summarizes interest income, interest expense, and other income and expense for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Loss on debt extinguishment	\$ —	\$ (708,000)	\$ —	\$ (708,000)
Loss on asset disposal	(1,000)	(257,000)	(1,000)	(257,000)
Interest income	1,000	1,000	3,000	1,000
Interest expense	(1,085,000)	(652,000)	(2,026,000)	(1,361,000)
Other income (expense), net	(58,000)	(124,000)	28,000	(296,000)
Total	\$ (1,143,000)	\$ (1,740,000)	\$ (1,996,000)	\$ (2,621,000)

- In connection with the Loan and Security Agreement entered into on June 28, 2013 (the “Loan Agreement”) with Oxford Finance LLC and Silicon Valley Bank (the “Lenders”), a loss on debt extinguishment was recorded that relates to the payoff of the prior loan obligation. See Notes to Consolidated Condensed Financial Statements for further information.
- Interest expense increased for the three months ended June 30, 2014 as compared to the same period in 2013, due to cash interest and non-cash amortization of debt issuance costs and debt discount for our \$27.0 million term loan.
- The changes in other income (expense) during the three months ended June 30, 2014 as compared to the same period in 2013 resulted primarily from changes in foreign currency exchange rates.

The future: Interest income earned in 2014 will be dependent on our levels of funds available for investment as well as general economic conditions. Subject to our future financing activities, we expect interest expense in 2014 to increase slightly as we continue to pay interest on the \$27.0 million term loan that was amended in June 2013.

Gain on previously held equity interest and equity loss from investment in Joint Venture

The following table summarizes our gain on previously held equity interest and equity loss from investment in Joint Venture for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Gain on previously held equity interest	\$ —	\$ 4,892,000	\$ —	\$ 4,892,000
Equity loss in investment	—	—	—	(48,000)
Total	\$ —	\$ 4,892,000	\$ —	\$ 4,844,000

Gain on previously held equity interest represents the effect of remeasuring our equity interest in connection with the May 2013 acquisition of the remaining interest in the Olympus-Cytori Joint Venture. See Notes to the Consolidated Condensed Financial Statements included elsewhere herein for disclosure and discussion of our Transactions with Olympus.

The equity losses relate entirely to our previously existing 50% equity interest in the Joint Venture, which prior to the termination of the Joint Venture, was accounted for using the equity method of accounting.

The future: Pursuant to the May 2013 acquisition of the remaining interest in the Olympus-Cytori Joint Venture we will not recognize any additional losses from the activities of the Joint Venture.

Liquidity and Capital Resources

Short-term and long-term liquidity

The following is a summary of our key liquidity measures at June 30, 2014 and December 31, 2013:

	As of June 30, 2014	As of December 31, 2013
Cash and cash equivalents	\$ 12,760,000	\$ 15,506,000
Current assets	\$ 20,540,000	\$ 24,577,000
Current liabilities	16,731,000	14,906,000
Working capital	\$ 3,809,000	\$ 9,671,000

We incurred net losses of \$11,828,000 and \$22,228,000 for the three and six months ended June 30, 2014 and \$3,211,000 and \$10,877,000 for the three and six months ended June 30, 2013, respectively. We have an accumulated deficit of \$323,133,000 as of June 30, 2014. Additionally, we have used net cash of \$18,137,000 and \$17,014,000 to fund our operating activities for the six months ended June 30, 2014 and 2013, respectively. To date, these operating losses have been funded primarily from outside sources of invested capital and gross profits.

We have been placing, and will continue to place, significant effort into raising additional capital that will provide adequate capital resources to allow us to continue to fund our future operations. Based on our cash and cash equivalents on hand of \$12,760,000 at June 30, 2014 and our minimum liquidity requirements of the Loan Agreement that require us to make principal and interest payments of \$868,000 per month beginning in August 2014 and maintain at least three months of cash on hand, we must raise additional capital in August 2014 to avoid an event of default by August 31, 2014. If we are unable to raise additional capital as planned, we will not have sufficient cash on hand to avoid an event of default under the Loan Agreement, which, absent a waiver or modification of the loan terms, would allow the lender to cause the loan amount of \$28,670,000 to be immediately due and payable. Our financing plans include pursuing additional cash through strategic corporate partnerships and engaging in future sales of equity, as well as obtaining a modification of the terms of the Loan Agreement. While we have an established history of raising capital through these platforms, and we are currently involved in negotiations with multiple parties, there is no guarantee that adequate funds will be available when needed from additional debt or equity financing, development and commercialization partnerships or from other sources, or on terms acceptable to us. There is also no guarantee that our lender would agree to a modification of the Loan Agreement, or on terms that are acceptable to us. If our efforts to obtain sufficient additional funds are not successful, in addition to the lender's ability to cause the loan amount to be immediately due and payable, we would also be required to delay, scale back, or eliminate some or all of our research or product development, manufacturing operations, administrative operations, including our employee base, and clinical or regulatory activities, which could negatively affect our ability to achieve certain corporate goals.

The Company continues to seek additional capital through product revenues, strategic transactions, including extension opportunities under the awarded BARDA contract, and from other financing alternatives.

The following summarizes our contractual obligations and other commitments at June 30, 2014, and the effect such obligations could have on our liquidity and cash flow in future periods:

Contractual Obligations	Payments due by period				
	Total	Less than 1 year	1 – 3 years	3 – 5 years	More than 5 years
Long-term obligations	\$ 28,661,000	\$ 8,164,000	\$ 20,497,000	\$ —	\$ —
Interest commitment on long-term obligations	4,254,000	2,278,000	1,976,000	—	—
Operating lease obligations	6,333,000	1,905,000	3,784,000	644,000	—
Minimum purchase requirements	850,000	850,000	—	—	—
Pre-clinical research study obligations	23,000	23,000	—	—	—
Clinical research study obligations	7,605,000	5,755,000	1,650,000	200,000	—
Puregraft divestiture obligation	215,000	215,000	—	—	—
Joint Venture purchase obligation*	2,647,000	2,647,000	—	—	—
Total	\$ 50,588,000	\$ 21,837,000	\$ 27,907,000	\$ 844,000	\$ —

* The Company has various payment options which could result in the acceleration or deferral of the Joint Venture purchase obligation. See Notes to the Consolidated Condensed Financial Statements included elsewhere herein for disclosure and discussion of our acquisition of Olympus' interest in the Joint Venture.

Cash (used in) provided by operating, investing, and financing activities for the six months ended June 30, 2014 and 2013 is summarized as follows:

	For the six months ended June 30,	
	2014	2013
Net cash used in operating activities	\$ (18,137,000)	\$ (17,014,000)
Net cash used in investing activities	(1,122,000)	(827,000)
Net cash provided by financing activities	16,509,000	5,826,000
Effect of exchange rate changes on cash and cash equivalents	4,000	(81,000)
Net decrease in cash and cash equivalents	<u>(2,746,000)</u>	<u>(12,096,000)</u>

Operating activities

Operating activities, inclusive of research and development, sales and marketing, and general and administrative efforts, offset in part by product sales, generated an operating loss of \$20,232,000 for the six months ended June 30, 2014. The operating cash impact of this loss was \$18,137,000, after adjusting for the non-cash share-based compensation and other adjustments for material non-cash activities, such as depreciation, amortization, change in fair value of option and warrant liabilities, and changes in working capital due to timing of product shipments (accounts receivable) and payment of liabilities.

Operating activities, inclusive of research and development, sales and marketing, and general and administrative efforts, offset in part by product sales, generated an operating loss of \$13,100,000 for the six months ended June 30, 2013. The operating cash impact of this loss was \$17,014,000, after adjusting for the recognition of non-cash development revenues of \$1,817,000, non-cash share-based compensation and other adjustments for material non-cash activities, such as depreciation, amortization, change in fair value of option and warrant liabilities, and changes in working capital due to timing of product shipments (accounts receivable) and payment of liabilities.

Investing activities

Net cash used in investing activities for the six months ended June 30, 2014 resulted from cash outflows for payment of a license termination fee of \$400,000, expenditures for intellectual property of \$255,000 and for purchases of property and equipment of \$467,000.

Net cash used in investing activities for the six months ended June 30, 2013 resulted from cash outflows for payment of a license termination fee of \$400,000 and for purchases of property and equipment \$432,000.

Financing Activities

The net cash provided by financing activities for the six months ended June 30, 2014 related primarily to a sale of 4,048,584 units, consisting of one share of common stock and one warrant to purchase one share of common stock, for approximately \$10,000,000 in gross proceeds in connection with a registered direct offering to certain institutional investors. We received \$9,000,000 in January 2014 pursuant to our Common Stock Purchase Agreement with Lorem Vascular that was executed in October of 2013. Also, during the six months ended June 30, 2014, we paid \$2,189,000 payment towards our Joint Venture purchase obligation.

The net cash provided by financing activities for the six months ended June 30, 2013 related primarily to a sale of 1,053,000 shares for approximately \$3,001,000 in gross proceeds in connection with the underwriter exercising the option to purchase additional shares relating to our December 2012 public offering partially offset by principal payments of \$22,292,000 primarily relating to our \$25.0 million loan. Additionally, in June 2013, we entered into the Loan Agreement with the Lenders pursuant to which the Lenders funded aggregate principal amount of \$27,000,000 offset by \$1,744,000 debt issuance costs and loan fees. Also, during the six months ended June 30, 2013, we paid \$70,000 payment towards our Joint Venture purchase obligation.

Critical Accounting Policies and Significant Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 were 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. Our critical accounting policies and estimates remain consistent with those reported in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

Recent Accounting Pronouncements

The following new accounting standard has been issued, but not adopted by the Company as of June 30, 2014:

In May 2014, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) jointly issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. ASU 2014-09 requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. The effective date of ASU 2014-09 is for annual reporting periods beginning after December 15, 2016. The Company is currently evaluating the impact of adopting ASU 2014-09.

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. There have been no material changes in our market risks during the quarter ended June 30, 2014.

Interest Rate Exposure

We are not subject to market risk due to fluctuations in interest rates on our long-term obligations as they bear a fixed rate of interest. Our exposure relates primarily to short-term investments, including funds classified as cash equivalents. As of June 30, 2014, all excess funds were invested in money market funds and other highly liquid investments, therefore our interest rate exposure is not considered to be material.

Foreign Currency Exchange Rate Exposure

Our exposure to market risk due to fluctuations in foreign currency exchange rates relates primarily to our activities in Europe and Japan. Transaction gains or losses resulting from cash balances and revenues have not been significant in the past and we are not currently 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 three months ended June 30, 2014, 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.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or furnished pursuant to the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) under the Exchange Act, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this Quarterly Report as a result of an unremediated material weakness related to the recognition and measurement of revenue in accordance with U.S. generally accepted accounting principles, as described in further detail below.

Changes in Internal Control over Financial Reporting

As described in Item 9A in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, we identified a material weakness in our internal control over financial reporting related to the recognition and measurement of revenue in accordance with U.S. generally accepted accounting principles. Specifically, our controls did not operate effectively to aggregate and communicate information necessary to (i) verify that the collection of accounts receivable was reasonably assured and (ii) evaluate whether contractual provisions were satisfied in order to recognize revenue. As discussed in the Form 10-K, we implemented a remediation plan to improve our systems of disclosure controls and procedures and internal control over financial reporting. This remediation plan includes (i) reevaluating our processes for the recognition of revenue at our Japan subsidiary, (ii) relocating to our Japan subsidiary a qualified individual with appropriate experience to assist with our review of revenue arrangements in accordance with U.S. generally accepted accounting principles and to help facilitate better communication with our Japan subsidiary, and (iii) enhancing our assessment of collectability over our customers to ensure that adequate evidence of collectability is obtained prior to the recognition of revenue. We expect that our remediation efforts, including design, implementation and testing will continue throughout fiscal year 2014. The material weakness will not be considered remediated until our controls are operational for a period of time, tested, and management concludes that these controls are operating effectively.

Other than as described above, there have been no changes in our internal control over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we have been involved in routine litigation incidental to the conduct of our business. As of June 30, 2014, we were not a party to any material legal proceeding. See Notes to the Consolidated Condensed Financial Statements included elsewhere herein for a discussion of our loss contingencies.

Item Risk Factors

1A.

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, including our unaudited Consolidated Condensed Financial Statements and the related notes and “Management’s Discussion and Analysis of Financial Conditions and Results of Operations”. If any of the risks described below occur, our business, operating results, and financial condition could be adversely affected and the value of our common stock could decline.

We have marked with an asterisk () those risks described below that reflect new risks or substantive changes from the risks described under Part I, Item 1A “Risk Factors” included in our Annual Report on Form 10-K for the year ended December 31, 2013.*

Risks Related to Our Business

We will need to raise more cash in the future

We have almost always had negative cash flows from operations. Our business will continue to result in a substantial requirement for research and development expenses for several years, during which we may not be able to bring in sufficient cash and/or revenues to offset these expenses. We have had, and we will continue to have, an ongoing need to raise additional cash from outside sources to continue funding our operations to profitability. We do not currently believe that our cash balance and the revenues from our operations will be sufficient to fund the development and marketing efforts required to reach profitability without raising additional capital from accessible sources of financing in the future.

We have been placing, and will continue to place, significant effort into raising additional capital that will provide adequate capital resources to allow us to continue to fund our future operations. Based on our cash and cash equivalents on hand of \$12,760,000 at June 30, 2014 and our minimum liquidity requirements of the Loan Agreement that require us to make principal and interest payments of \$868,000 per month beginning in August 2014 and maintain at least three months of cash on hand, we must raise additional capital in August 2014 to avoid an event of default by August 31, 2014. If we are unable to raise additional capital as planned, we will not have sufficient cash on hand to avoid an event of default under the Loan Agreement, which, absent a waiver or modification of the loan terms, would allow the lender to cause the loan amount of \$28,670,000 to be immediately due and payable. Our financing plans include pursuing additional cash through strategic corporate partnerships and engaging in future sales of equity, as well as obtaining a modification of the terms of the Loan Agreement. While we have an established history of raising capital through these platforms, and we are currently involved in negotiations with multiple parties, there is no guarantee that adequate funds will be available when needed from additional debt or equity financing, development and commercialization partnerships or from other sources, or on terms acceptable to us. There is also no guarantee that our lender would agree to a modification of the Loan Agreement, or on terms that are acceptable to us. If our efforts to obtain sufficient additional funds are not successful, in addition to the lender’s ability to cause the loan amount to be immediately due and payable, we would also be required to delay, scale back, or eliminate some or all of our research or product development, manufacturing operations, administrative operations, including our employee base, and clinical or regulatory activities, which could negatively affect our ability to achieve certain corporate goals.

The Company continues to seek additional capital through product revenues, strategic transactions, including extension opportunities under the awarded BARDA contract, and from other financing alternatives.

Our level of indebtedness, and covenant restrictions under such indebtedness, could adversely affect our operations and liquidity.*

On June 28, 2013 we entered into a Loan and Security Agreement (“Loan Agreement”) with Oxford Finance LLC and Silicon Valley Bank (together, the “Lenders”), pursuant to which the Lenders funded an aggregate principal amount of \$27.0 million (“Term Loan”), subject to the terms and conditions set forth in the loan agreement. The Term Loan accrues interest at a fixed rate of 9.75% per annum. Pursuant to the Loan Agreement, we are required to make interest only payments through July 1, 2014 and thereafter we are required to make payments of principal and accrued interest in equal monthly installments sufficient to amortize the Term Loan through July 1, 2017, the maturity date. All unpaid principal and interest with respect to the Term Loan is due and payable in full on July 1, 2017. Pursuant to the Loan Agreement, we will be required to make principal and interest payments of \$868,000 per month beginning in August 2014.

Our indebtedness could adversely affect our operations and liquidity, by, among other things:

- causing us to use a larger portion of our cash flow to fund interest and principal payments, reducing the availability of cash to fund working capital and capital expenditures and other business activities;
- making it more difficult for us to take advantage of significant business opportunities, such as acquisition opportunities, and to react to changes in market or industry conditions; and
- limiting our ability to borrow additional monies in the future to fund working capital, capital expenditures and other general corporate purposes.

The Loan Agreement requires us to maintain at least three months of cash on hand and includes certain reporting and other covenants, that, among other things, restrict our ability to: (i) dispose of assets, (ii) change the business we conduct, (iii) make acquisitions, (iv) engage in mergers or consolidations, (v) incur additional indebtedness, (vi) create liens on assets, (vii) maintain any collateral account, (viii) pay dividends, (ix) make investments, loans or advances, (x) engage in certain transactions with affiliates, and (xi) prepay certain other indebtedness or amend other financing arrangements. If we fail to comply with any of these covenants or restrictions, such failure may result in an event of default, which if not cured or waived, could result in the lenders accelerating the maturity of our indebtedness. If the maturity of our indebtedness is accelerated, we may not have sufficient cash resources to satisfy our debt obligations and such acceleration would adversely affect our business and financial condition.

In addition, the indebtedness under our Loan Agreement is secured by a security interest in substantially all of our existing and after-acquired assets, including our intellectual property assets, and therefore, if we are unable to repay such indebtedness, the Lenders could foreclose on these assets, which would adversely affect our ability to operate our business.

Continued turmoil in the economy could harm our business

Negative trends in the general economy, including trends resulting from an actual or perceived recession, tightening credit markets, increased cost of commodities, including oil, actual or threatened military action by the United States and threats of terrorist attacks in the United States and abroad, could cause a reduction of investment in and available funding for companies in certain industries, including ours and our customers. Our ability to raise capital has been and may in the future be adversely affected by downturns in current credit conditions, financial markets and the global economy.

We have never been profitable on an operational basis and expect significant operating losses for the next few years

We have incurred net operating losses in each year since we started business. As our focus on the Celution® System platform and development of therapeutic applications for its cellular output has increased, losses have resulted primarily from expenses associated with research and development activities and general and administrative expenses. While we work continuously to implement cost reduction measures where possible, we nonetheless expect to continue operating in a loss position on a consolidated basis and that recurring operating expenses will be at high levels for the next several years, in order to perform clinical trials, additional pre-clinical research, product development, and marketing. As a result of our historic losses, we have been, and are likely to continue to be, reliant on raising outside capital to fund our operations.

Our business strategy is high-risk

We are focusing our resources and efforts primarily on development of the Celution® System family of products and the therapeutic applications of its cellular output, which requires extensive cash needs for research, development, and commercialization activities. This is a high-risk strategy because there is no assurance that our future products will ever become commercially viable (commercial risk), that we will prevent 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 successfully manage a company in a new area of business (regenerative medicine) and on a different scale than we have operated in the past (operational risk), that we will be able to achieve the desired therapeutic results using stem and regenerative cells (scientific risk), or that our cash resources will be adequate to develop our products until we become profitable, if ever (financial risk). We are using our cash in one of the riskiest industries in the economy (strategic risk). This may make our stock an unsuitable investment for many investors.

The development and manufacture of current and future generation Celution® System devices is important to us

We must continue to develop and manufacture both the current and future generation Celution® System devices. If we are not successful in further development of the current and future generation Celution® System devices, we may not be able to compete successfully in the marketplace (technology risk), and if we experience disruptions and/or delays in our production of these devices as required by the marketplace, our operations and commercialization efforts (clinical, regulatory and/or commercial sales) we would be harmed (manufacturing risk).

Although we have significant experience in manufacturing the current Celution® System platform and its consumables at a commercial level, there can be no guarantee that we will be able to successfully develop and manufacture future generation Celution® Systems in a manner that is cost-effective or commercially viable, or that development and manufacturing capabilities might not take much longer than currently anticipated to be ready for the market.

Although we have been manufacturing the Celution® 800 System and the StemSource® 900-based Cell Bank since 2008, we cannot assure that we will be able to manufacture sufficient numbers of such products to meet future demand, or that we will be able to overcome unforeseen manufacturing difficulties for this sophisticated equipment.

We have a limited operating history; operating results and stock price can be volatile like many life science companies

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 biotech and medical device fields. From time to time, we have tried to update our investors' expectations as to our operating results by periodically announcing financial guidance. However, we have in the past been forced to revise or withdraw such guidance due to lack of visibility and predictability of product demand. Our stock price has a history of significant volatility, which may harm our ability to raise additional capital and may cause an investment in Cytori to be unsuitable for some investors.

We may not be able to correctly estimate or control our future operating expenses, which could lead to cash shortfalls

Our budgeted expense levels are based in part on our expectations concerning future revenues from sales as well our assessment of the future investments needed to expand our commercial organization and support research and development activities. We may be unable to reduce our expenditures in a timely manner to compensate for any unexpected events or a shortfall in revenue. Accordingly, a shortfall in demand for our products or other unexpected events could have an immediate and material impact on our business 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 biotechnology, medical device, and pharmaceutical companies. Many current and potential competitors have substantially greater financial, technological, research and development, marketing, and personnel resources. There is no assurance that our competitors will not succeed in developing alternative 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 products obsolete and non-competitive. In general, we may not be able to prevent others from developing and marketing competitive products similar to ours or which perform similar functions.

Competitors may have greater experience in developing therapies or devices, conducting clinical trials, obtaining regulatory clearances or approvals, manufacturing and commercialization. It is possible that competitors may obtain patent protection, approval, or clearance from the FDA or achieve commercialization earlier than we can, any of which could have a substantial negative effect on our business.

We compete against cell-based therapies derived from alternate sources, such as bone marrow, umbilical cord blood and potentially embryos. Doctors historically are slow to adopt new technologies like ours, regardless of the perceived merits, when older technologies continue to be supported by established providers. Overcoming such inertia often requires very significant marketing expenditures or definitive product performance and/or pricing superiority.

We expect physicians' inertia and skepticism to also be a significant barrier as we attempt to gain market penetration with our future products. We believe we will continue to need to finance lengthy time-consuming clinical studies to provide evidence of the medical benefit of our products and resulting therapies in order to overcome this inertia and skepticism particularly in reconstructive surgery, cell preservation, the cardiovascular area and many other indications.

Many potential applications of our technology are pre-commercialization, which subjects us to development and marketing risks

We are in a relatively early stage of the path to commercialization with many of our products. We believe that our long-term viability and growth will depend in large part on our ability to develop commercial quality cell processing devices and useful procedure-specific consumables, and to establish the safety and efficacy of our therapies through clinical trials and studies. With our Celution® System platform, we are pursuing new approaches for therapies for cardiovascular disease, burns, soft tissue defects, reconstructive surgery, preservation of stem and regenerative cells for potential future use, and other conditions. There is no assurance that our development programs will be successfully completed or that required regulatory clearances or approvals will be obtained on a timely basis, if at all.

There is no proven path for commercializing the Celution[®] System platform in a way to earn a durable profit commensurate with the medical benefit. Although we began to commercialize our reconstructive surgery products in Europe and certain Asian markets, and our cell banking products in Japan, Europe, and certain Asian markets in 2008, additional market opportunities for many of our products and/or services may not materialize for a number of years.

Successful development and market acceptance of our products is subject to developmental risks, including failure of inventive imagination, ineffectiveness, lack of safety, unreliability, failure to receive necessary regulatory clearances or approvals, high commercial cost, preclusion or obsolescence resulting from third parties' proprietary rights or superior or equivalent products, competition from copycat products, and general economic conditions affecting purchasing patterns. There is no assurance that we or our partners will successfully develop and commercialize our products, or that our competitors will not develop competing technologies that are less expensive or superior. Failure to successfully develop and market our products would have a substantial negative effect on our results of operations and financial condition.

If any party to a key collaboration partnership fails to perform material obligations under our agreements, or any other collaboration agreement, or if such agreements are terminated for any reason, our business could significantly suffer

We have entered into collaboration agreements under which we may receive future payments in the form of milestone payments, maintenance fees and royalties. We are dependent on our collaborators to commercialize our products in certain countries in order for us to realize any financial benefits from these collaborations. Our collaborators may not devote the attention and resources to such efforts to be successful. In addition, in the event that a party fails to perform under a key collaboration agreement, or if a key collaboration agreement is terminated, the reduction in anticipated revenues could delay or suspend our product commercialization in certain countries. Specifically, the termination of a key collaboration agreement by one of our collaborators could materially impact our ability to enter into additional collaboration agreements with new collaborators on favorable terms.

If we or our collaborators fail to comply with regulatory requirements applicable to promotion, sale and manufacturing of approved products, regulatory agencies may take action against us or them, which could significantly harm our business

Any approved products, along with the manufacturing processes, post-approval clinical data, labeling, advertising and promotional activities for these products, are subject to continual requirements and review by the FDA, state and foreign regulatory bodies. Regulatory authorities subject a marketed product, its manufacturer and the manufacturing facilities to continual review and periodic inspections. We, our collaborators and our respective contractors, suppliers and vendors, will be subject to ongoing regulatory requirements, including complying with regulations and laws regarding advertising, promotion and sales of products, required submissions of safety and other post-market information and reports, registration requirements, cGMP regulations (including requirements relating to quality control and quality assurance, as well as the corresponding maintenance of records and documentation), and the requirements regarding the distribution of samples to physicians and recordkeeping requirements. Regulatory agencies may change existing requirements or adopt new requirements or policies. We, our collaborators and our respective contractors, suppliers and vendors, may be slow to adapt or may not be able to adapt to these changes or new requirements.

Failure to comply with regulatory requirements may result in any of the following:

- restrictions on our products or manufacturing processes;
- warning letters;
- withdrawal of the products from the market;
- voluntary or mandatory recall;
- fines;
- suspension or withdrawal of regulatory approvals;
- suspension or termination of any of our ongoing clinical trials;
- refusal to permit the import or export of our products;
- refusal to approve pending applications or supplements to approved applications that we submit;
- product seizure;
- injunctions; or
- imposition of civil or criminal penalties.

We must rely on the performance of Lorem Vascular for the commercialization of our products in China, Hong Kong, Singapore, Malaysia and Australia.

Lorem Vascular is the exclusive licensee for our products in China, Hong Kong, Singapore, Malaysia and Australia, and while we will be strongly supportive to their efforts, they are responsible for obtaining regulatory approvals, market development and sales in these countries. Lorem Vascular is also a new company and as such will be required to develop the expertise, personnel and relationships in each of these countries required to successfully market and sell our products. We cannot guarantee that Lorem Vascular will make the investments required to be successful in these countries. We cannot guarantee that the necessary regulatory approvals can be obtained, and we cannot guarantee that our products will be successful in these markets even if advantageous market regulatory approvals are obtained.

Market acceptance of new technology such as ours can be difficult to obtain

New and emerging cell therapy and cell banking technologies, such as those provided by the Celution[®] System family of products, may have difficulty or encounter significant delays in obtaining market acceptance in some or all countries around the world due to the novelty of our cell therapy and cell banking technologies. Therefore, the market adoption of our cell therapy and cell banking technologies may be slow and lengthy with no assurances that significant market adoption will be successful. The lack of market adoption or reduced or minimal market adoption of our cell therapy and cell banking technologies may have a significant impact on our ability to successfully sell our product(s) into a country or region.

Future clinical trial results may differ significantly from our expectations

While we have proceeded incrementally with our clinical trials in an effort to gauge the risks of proceeding with larger and more expensive trials, such as in our PRECISE chronic ischemic trial in Europe, and our ATHENA I and ATHENA II feasibility trial in heart failure due to ischemic heart disease, we cannot guarantee that we will not experience negative results in larger and much more expensive clinical trials than we have conducted to date. Poor results, unanticipated events or other complications in our clinical trials could result in substantial delays in commercialization, substantial negative effects on the perception of our products, and substantial additional costs. These risks are increased by our reliance on third parties in the performance of many of the clinical trial functions, including the clinical investigators, hospitals, and other third party service providers.

Our product candidates may not receive regulatory approvals or their development may be delayed for a variety of reasons, including unsuccessful clinical trials, regulatory requirements or safety concerns

Clinical testing of our products is a long, expensive and uncertain process, and the failure or delay of a clinical trial can occur at any stage. Even if initial results of preclinical and nonclinical studies or clinical trial results are promising, we may obtain different results in subsequent trials or studies that fail to show the desired levels of safety and efficacy, or we may not obtain applicable regulatory approval for a variety of other reasons. Clinical trials for any of our products could be unsuccessful, which would delay or prohibit regulatory approval and commercialization of the product. In the United States and other jurisdictions, regulatory approval can be delayed, limited or not granted for many reasons, including, among others:

- clinical results may not meet prescribed endpoints for the studies or otherwise provide sufficient data to support the efficacy of our products;
- clinical and nonclinical test results may reveal side effects, adverse events or unexpected safety issues associated with the use of our products;
- regulatory review may not find a product safe or effective enough to merit either continued testing or final approval;
- regulatory review may not find that the data from preclinical testing and clinical trials justifies approval;
- regulatory authorities may require that we change our studies or conduct additional studies which may significantly delay or make continued pursuit of approval commercially unattractive;
- a regulatory agency may reject our trial data or disagree with our interpretations of either clinical trial data or applicable regulations;
- the cost of clinical trials required for product approval may be greater than what we originally anticipate, and we may decide to not pursue regulatory approval for such a product;
- a regulatory agency may identify problems or other deficiencies in our existing manufacturing processes or facilities, or the existing processes or facilities of our collaborators, our contract manufacturers or our raw material suppliers;
- a regulatory agency may change its formal or informal approval requirements and policies, act contrary to previous guidance, adopt new regulations or raise new issues or concerns late in the approval process; or
- a product candidate may be approved only for indications that are narrow or under conditions that place the product at a competitive disadvantage, which may limit the sales and marketing activities for such products or otherwise adversely impact the commercial potential of a product.

If a product is not approved in a timely fashion on commercially viable terms, or if development of any product is terminated due to difficulties or delays encountered in the regulatory approval process, it could have a material adverse impact on our business, and we will become more dependent on the development of other proprietary products and/or our ability to successfully acquire other products and technologies. There can be no assurances that any product will receive regulatory approval in a timely manner, or at all.

Certain products will be marketed, and perhaps manufactured, in foreign countries. The process of obtaining regulatory approvals in foreign countries is subject to delay and failure for the reasons set forth above, as well as for reasons that vary from jurisdiction to jurisdiction. The approval process varies among countries and jurisdictions and can involve additional testing. The time required to obtain approval may differ from that required to obtain FDA approval. Foreign regulatory agencies may not provide approvals on a timely basis, if at all. Approval by the FDA does not ensure approval by regulatory authorities in other countries or jurisdictions, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other foreign countries or jurisdictions or by the FDA.

We may not be able to protect our proprietary rights

Our success depends in part on whether we can maintain our existing patents, obtain additional patents, maintain trade secret protection, and operate without infringing on the proprietary rights of third parties.

There can be no assurance that any of our 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 not become the subject of a re-examination, 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 commercial success will also depend, in part, on our ability to avoid infringing on patents issued by others. If we were judicially determined to be infringing on 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.

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.

Successful challenges to our patents through oppositions, reexamination proceedings or interference proceedings could result in a loss of patent rights in the relevant jurisdiction. If we are unsuccessful in actions we bring against the patents of other parties and it is determined that we infringe the patents of third-parties, we may be subject to litigation, or otherwise prevented from commercializing potential products in the relevant jurisdiction, or may be required to obtain licenses to those patents or develop or obtain alternative technologies, any of which could harm our business. Furthermore, if such challenges to our patent rights are not resolved in our favor, we could be delayed or prevented from entering into new collaborations or from commercializing certain products, which could adversely affect our business and results of operations.

On September 16, 2011, President Obama signed into law major patent law reform known as the Leahy-Smith America Invents Act (AIA). Among other things the AIA implements a first inventor to file standard for patent approval, changes the legal standards for patentability under section 102 of the statute, and creates a post grant review system. As a result of the added uncertainty of interpretation of the AIA and the uncertainty of patent law in general, we cannot predict with certainty how much protection, if any, will be given to our patents if we attempt to enforce them and they are challenged in court. Changes to the patent law under the AIA also may provoke third parties to assert claims against us or result in our intellectual property being narrowed in scope or declared to be invalid or unenforceable.

Competitors or third parties may infringe our patents. We may be required to file patent infringement claims, which can be expensive and time-consuming. In addition, in an infringement proceeding, a court may decide that a patent of ours is not valid or is unenforceable, or that the third party's technology does not in fact infringe upon our patents. An adverse determination of any litigation or defense proceedings could put one or more of our patents at risk of being invalidated or interpreted narrowly and could put our related pending patent applications at risk of not issuing. Litigation may fail and, even if successful, may result in substantial costs and be a distraction to our management. We may not be able to prevent misappropriation of our proprietary rights, particularly in countries outside the U.S. where patent rights may be more difficult to enforce. Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential or sensitive information could be compromised by disclosure in the event of litigation. In addition, during the course of litigation there could be public announcements of the results of hearings, motions or other interim proceedings or developments. If securities analysts or investors perceive these results to be negative, it could have a substantial adverse effect on the price of our common stock.

In addition to patents, which alone may not be able to protect the fundamentals of our business, we also rely on unpatented trade secrets and proprietary technological expertise. Some of our intended future cell-related therapeutic products may fit into this category. We rely, in part, on confidentiality agreements with our 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 (or 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 our results of 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. This is particularly relevant to us as most of our current commercial product sales and clinical trials are outside of the United States. Third parties may attempt to oppose the issuance of patents to us in foreign countries by initiating opposition proceedings. Opposition proceedings against any of our patent filings in a foreign country could have an adverse effect on our corresponding patents that are issued or pending in the United States. It may be necessary or useful for us to participate in proceedings to determine the validity of our patents or our competitors' patents that have been issued in countries other than the U.S. This could result in substantial costs, divert our efforts and attention from other aspects of our business, and could have a material adverse effect on our results of operations and financial condition. We currently have pending patent applications in Europe, Australia, Japan, Canada, China, Korea, and Singapore, among others.

We and our medical devices are subject to FDA regulation

As medical devices, the Celution[®] System family of products, and components of the Stemsources[®] cell banks, must receive regulatory clearances or approvals from the FDA and, in many instances, from non-U.S. and state governments prior to their sale. The Celution[®] System family of products is 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 U.S. 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, or 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. Our Celution[®] products under development today and in the foreseeable future 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.

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. 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 our results of operations and financial condition.

To sell in international markets, we will be subject to regulation in foreign countries

In cooperation with our distribution partners, 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 foreign regulatory approvals or clearances, or that we will be able to successfully commercialize current or future products in various 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 our results of operations and financial condition.

Changing, new and/or emerging government regulations may adversely affect us

Government regulations can change without notice. Given the fact that Cytori operates in various international markets, our access to such markets could change with little to no warning due to a change in government regulations that suddenly up-regulate our product(s) and create greater regulatory burden for our cell therapy and cell banking technology products.

Due to the fact that there are new and emerging cell therapy and cell banking regulations that have recently been drafted and/or implemented in various countries around the world, the application and subsequent implementation of these new and emerging regulations have little to no precedence. Therefore, the level of complexity and stringency is not known and may vary from country to country, creating greater uncertainty for the international regulatory process.

Anticipated or unanticipated changes in the way or manner in which the FDA regulates products or classes/groups of products can delay, further burden, or alleviate regulatory pathways that were once available to other products. There are no guarantees that such changes in FDA's approach to the regulatory process will not deleteriously affect some or all of our products or product applications.

We may have difficulty obtaining health insurance reimbursement for our products

New and emerging cell therapy and cell banking technologies, such as those provided by the Celution® System family of products, may have difficulty or encounter significant delays in obtaining health care reimbursement in some or all countries around the world due to the novelty of our cell therapy and cell banking technology and subsequent lack of existing reimbursement schemes/pathways. Therefore, the creation of new reimbursement pathways may be complex and lengthy with no assurances that such reimbursements will be successful. The lack of health insurance reimbursement or reduced or minimal reimbursement pricing may have a significant impact on our ability to successfully sell our cell therapy and cell banking technology product(s) into a county or region, which would negatively impact our operating results.

Our concentration of sales in Japan may have negative effects on our business in the event of any crisis in that region

We have operations in a number of regions around the world, including the United States, Japan, and Europe. Our global operations may be subject to risks that may limit our ability to operate our business. We sell our products globally, which exposes us to a number of risks that can arise from international trade transactions, local business practices and cultural considerations, including:

- political unrest, terrorism and economic or financial instability;
- unexpected changes and uncertainty in regulatory requirements and systems related;
- nationalization programs that may be implemented by foreign governments;
- import-export regulations;
- difficulties in enforcing agreements and collecting receivables;
- difficulties in ensuring compliance with the laws and regulations of multiple jurisdictions;
- changes in labor practices, including wage inflation, labor unrest and unionization policies;
- longer payment cycles by international customers;
- currency exchange fluctuations;
- disruptions of service from utilities or telecommunications providers, including electricity shortages;

- difficulties in staffing foreign branches and subsidiaries and in managing an expatriate workforce, and differing employment practices and labor issues;
- potentially adverse tax consequences;

We also face risks associated with currency exchange and convertibility, inflation and repatriation of earnings as a result of our foreign operations. We are also vulnerable to appreciation or depreciation of foreign currencies against the U.S. dollar. Although we have significant operations in Asia, a substantial portion of transactions are denominated in U.S. dollars. As appreciation against the U.S. dollar increases, it will result in an increase in the cost of our business expenses abroad. Conversely, downward fluctuations in the value of foreign currencies relative to the U.S. dollar may make our products less price competitive than local solutions. From time to time, we may engage in currency hedging activities, but such activities may not be able to limit the risks of currency fluctuations.

Our revenue, results of operations, and cash flows may suffer upon the loss of a significant customer or a significant reduction in the amount of product ordered by any such customer.

Our largest customer accounted for 26% of our revenue during the year ended December 31, 2013. Loss of this significant customer or a significant reduction in the amount of product ordered by this customer could adversely affect our revenue, results of operations, and cash flows.

We must maintain quality assurance certification and manufacturing approvals

The manufacture of our products is, and the manufacture of any future cell-related therapeutic products would be, subject to periodic inspection by regulatory authorities and distribution partners. The manufacture of devices and products 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, or 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 after such occurrences 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 our results of operations and financial condition.

The termination or suspension of the BARDA contract could delay and/or adversely affect our business and our ability to further develop our Celution® System

Cytori was awarded the contract with BARDA in September 2012 with the aim to develop a new countermeasure for a combined injury involving thermal burn and radiation exposure which would be useful following a mass-casualty event. The cost-plus-fixed-fee contract is valued at up to \$106 million, with a guaranteed base period of approximately \$4.7 million which included preclinical research and the acceleration of Cytori's ongoing development of Cytori's ongoing development of the Celution® cell processing System (the Celution® System). Upon satisfactory proof of concept, BARDA may elect to exercise up to three contract options which will extend the contract term to up to five years if all options are exercised. BARDA may suspend or terminate this contract should we fail to achieve key objectives or milestones, or fail to comply with the operating procedures and processes approved by BARDA and its audit agency, the Defense Contract Audit Agency. In July 2014, we received preliminary written notice of intent to exercise "Option 1" of our contract with BARDA. Based on this notification, Cytori and BARDA are in negotiations on the specifics for the additions to the Statement of Work to be executed in the Option 1 period which would extend the contract through September 2016. It is anticipated that this process will be completed in August 2014. There can be no assurance that we will be able to achieve these milestones or continue to comply with these procedures and protocols, or whether we will be able to successfully develop our Celution® System under the contract. If the BARDA contract were terminated or suspended, our business could be adversely affected.

The BARDA contract has certain contracting requirements that allow the U.S. Government to unilaterally control its contracts. If the U.S. Government suspends, cancels, or otherwise terminates our contract with them, we could experience significant revenue shortfalls, and our financial condition and business may be adversely affected

Contracts with U.S. Government agencies typically contain termination provisions unfavorable to the other party, and are subject to audit and modification by the U.S. government at its sole discretion, which will subject us to additional risks. These risks include the ability of the U.S. Government to unilaterally:

- audit or object to our contract-related costs and fees, and require us to reimburse all such costs and fees;
- suspend or prevent us for a set period of time from receiving new contracts or extending our existing contracts based on violations or suspected violations of laws or regulations;
- cancel, terminate or suspend our contracts based on violations or suspected violations of laws or regulations;
- terminate our contracts if in the Government's best interest, including if funds become unavailable to the applicable governmental agency;
- reduce the scope and value of our contracts; and
- change certain terms and conditions in our contracts.

BARDA is able to terminate its contracts with us, either for its best interests or if we default by failing to perform in accordance with or to achieve the milestones set forth in the contract schedules and terms. Termination-for-convenience provisions generally enable us to recover only our costs incurred or committed and settlement expenses on the work completed prior to termination. Changes to, or an unexpected termination of this contract could result in significant revenue shortfalls. If revenue shortfalls occur and are not offset by corresponding reductions in expenses, our business could be adversely affected. We cannot anticipate if, when or to what extent BARDA might revise, alter or terminate its contract with us in the future.

Under our contract with BARDA, our operations, and those of our contractors, are subject to audit by the U.S. Government, a negative outcome to which could adversely affect our financial conditions and business operations

U.S. government agencies, such as the Department of Health and Human Services, or DHHS, and the Defense Contract Audit Agency, or the DCAA, routinely audit and investigate government contractors and recipients of federal grants. These agencies evaluate a contractor's performance under its contracts, cost structure and compliance with applicable laws, regulations and standards.

The DHHS and the DCAA also review the adequacy of, and a contractor's compliance with, its internal control systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems. Any costs found to be improperly allocated to a contract will not be reimbursed, while such costs already reimbursed must generally be repaid. If an audit identifies improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including, but not limited to:

- termination of contracts;
- forfeiture of profits;
- suspension of payments;
- fines; and
- suspension or prohibition from conducting business with the United States government.

Material weakness in our internal control over financial reporting.*

We have identified a material weakness in our internal control over financial reporting as of December 31, 2013, which may adversely affect investor confidence in us and, as a result, the value of our common stock.

We are required, pursuant to Section 404 of the Sarbanes-Oxley Act, to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting. This assessment includes disclosure of any material weaknesses identified by our management in our internal control over financial reporting, as well as a statement that our independent registered public accounting firm has issued an attestation report on the effectiveness of our internal control over financial reporting.

Our management concluded that our internal control over financial reporting was ineffective as of December 31, 2013 because a material weakness existed in our internal control over financial reporting related to the recognition and measurement of revenue in accordance with U.S. generally accepted accounting principles. Specifically, our controls did not operate effectively to aggregate and communicate information necessary to (i) verify that the collection of accounts receivable was reasonably assured and (ii) evaluate whether contractual provisions were satisfied in order to recognize revenue. See Part I, Item 4—Controls and Procedures.

In order to remediate the material weakness in our internal control over financial reporting, we implemented a remediation plan to improve our systems of disclosure controls and procedures and internal control over financial reporting. This remediation plan includes (i) reevaluating our processes for the recognition of revenue at our Japan subsidiary, (ii) relocating to our Japan subsidiary a qualified individual with appropriate experience to assist with our review of revenue arrangements in accordance with U.S. generally accepted accounting principles and to help facilitate better communication with our Japan subsidiary, and (iii) enhancing our assessment of collectability over our customers to ensure that adequate evidence of collectability is obtained prior to the recognition of revenue. We expect that our remediation efforts, including design, implementation and testing will continue throughout fiscal year 2014. The material weakness will not be considered remediated until our controls are operational for a period of time, tested, and management concludes that these controls are operating effectively.

If we are unable to effectively remediate this material weakness in a timely manner, or if we identify one or more additional material weaknesses in the future, investors could lose confidence in the accuracy and completeness of our financial reports, which could have a material adverse effect on the price of our common stock.

We depend on a few key officers

Our performance is substantially dependent on the performance of our executive officers and other key scientific and sales staff, including Marc H. Hedrick, MD, our President and Chief Executive Officer. 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 regenerative cell 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 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 our results of 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.

Risks Related to Ownership of our Common Stock

The market price of our common stock may be volatile and fluctuate significantly, which could result in substantial losses for stockholders and subject us to litigation.

The market price of our common stock may be subject to significant fluctuations. Among the factors that may cause the market price of our common stock to fluctuate are the risks described in this “Risk Factors” section and other factors, including:

- fluctuations in our operating results or the operating results of our competitors;
- changes in estimates of our financial results or recommendations by securities analysts;
- variance in our financial performance from the expectations of securities analysts;
- changes in the estimates of the future size and growth rate of our markets;
- changes in accounting principles or changes in interpretations of existing principles, which could affect our financial results;
- conditions and trends in the markets we serve;
- changes in general economic, industry and market conditions;
- success of competitive products and services;
- changes in market valuations or earnings of our competitors;
- announcements of significant new products, contracts, acquisitions or strategic alliances by us or our competitors;

- the timing and outcome of regulatory reviews and approvals of our products;
- the commencement or outcome of litigation involving our company, our general industry or both;
- changes in our capital structure, such as future issuances of securities or the incurrence of additional debt;
- actual or expected sales of our common stock by the holders of our common stock; and
- the trading volume of our common stock.

In addition, the stock market in general, the NASDAQ Global Market and the market for cell therapy development companies in particular may experience a loss of investor confidence. A loss of investor confidence may result in extreme price and volume fluctuations in our common stock that are unrelated or disproportionate to the operating performance of our business, our financial condition or results of operations. These broad market and industry factors may materially harm the market price of our common stock and expose us to securities class-action litigation. Class-action litigation, even if unsuccessful, could be costly to defend and divert management's attention and resources, which could further materially harm our financial condition and results of operations.

Future sales of our common stock may depress our share price.

As of June 30, 2014, we had 79,541,775 shares of our common stock outstanding. Sales of a number of shares of common stock in the public market, or the expectation of such sales, could cause the market price of our common stock to decline. In addition, our 2004 Equity Incentive Plan provides for annual increases in the number of shares available for issuance under the plan, which may, among other things, result in dilution of the price of our common stock. We may also sell additional common stock in subsequent public offerings, which may adversely affect the market price of our common stock.

We have granted demand registration rights for the resale of certain shares of our common stock to each of Olympus Corporation, Astellas Pharma Inc. and Green Hospital Supply, Inc. pursuant to common stock purchase agreements previously entered into with each of these stockholders. An aggregate of 5,528,571 shares of our common stock are subject to these demand registration rights. If we receive a written request from any of these stockholders to file a registration statement under the Securities Act covering its shares of unregistered common stock, we are required to use reasonable efforts to prepare and file with the SEC within 30 business days of such request a registration statement covering the resale of the shares for an offering to be made on a continuous basis pursuant to Rule 415 under the Securities Act.

Our charter documents contain anti-takeover provisions

Certain provisions of our amended and restated certificate of incorporation and amended and restated bylaws could discourage, delay or prevent a merger, acquisition or other change of control that stockholders may consider favorable. These provisions could also prevent or frustrate attempts by our stockholders to replace or remove members of our Board of Directors. Stockholders who wish to participate in these transactions may not have the opportunity to do so. These provisions:

- authorize our Board of Directors to issue without stockholder approval up to 5,000,000 shares of preferred stock, the rights of which will be determined at the discretion of the Board of Directors;
- require that stockholder actions must be effected at a duly called stockholder meeting and cannot be taken by written consent;
- establish advance notice requirements for stockholder nominations to our Board of Directors or for stockholder proposals that can be acted on at stockholder meetings; and
- limit who may call stockholder meetings.

We are governed by the provisions of Section 203 of the Delaware General Corporation Law, which may, unless certain criteria are met, prohibit large stockholders, in particular those owning 15% or more of the voting rights on our common stock, from merging or combining with us for a prescribed period of time.

We pay no dividends.

We have never paid cash dividends in the past, and currently do not intend to pay any cash dividends in the foreseeable future. Furthermore, our June, 2013 Loan Agreement with the Lenders currently prohibits our issuance of cash dividends. This could make an investment in our company inappropriate for some investors, and may serve to narrow our potential sources of additional capital.

If securities and/or industry analysts fail to continue publishing research about our business, if they change their recommendations adversely or if our results of operations do not meet their expectations, our stock price and trading volume could decline.

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts publish about us or our business. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline. In addition, it is likely that in some future period our operating results will be below the expectations of securities analysts or investors. If one or more of the analysts who cover us downgrade our stock, or if our results of operations do not meet their expectations, our stock price could decline.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

Exhibit No. Description

3.1	Amendment to Amended and Restated Bylaws of Cytori Therapeutics, Inc. (incorporated by reference to our Current Report on Form 8-K filed with the Commission on May 6, 2014).
4.1	Form of Amendment to Warrant to Purchase Common Stock, dated effective May 13, 2014 (incorporated by reference to our Current Report on Form 8-K filed with the Commission on May 15, 2014).
4.2	Form of Warrant to Purchase Common Stock for Investors in the Units (incorporated by reference to our Current Report on Form 8-K filed with the Commission on May 30, 2014).
4.3	Form of Warrant to Purchase Common Stock for Placement Agent of the Units (incorporated by reference to our Current Report on Form 8-K filed with the Commission on May 30, 2014).
10.95	Sales Agreement, dated May 12, 2014, by and between Cytori Therapeutics, Inc. and Cowen and Company, LLC (incorporated by reference to our Current Report on Form 8-K filed with the Commission on May 12, 2014).
10.96	Form of Subscription Agreement by and between Cytori Therapeutics, Inc. and the Investor (as defined therein), dated as of May 29, 2014 (incorporated by reference to our Current Report on Form 8-K filed with the Commission on May 30, 2014).
10.97	Placement Agent Agreement, dated May 29, 2014, between Cytori Therapeutics, Inc. and WBB Securities, LLC (incorporated by reference to our Current Report on Form 8-K filed with the Commission on May 30, 2014).
10.98	Cytori Therapeutics, Inc. 2014 Equity Incentive Plan (incorporated by reference to Appendix A to our definitive proxy statement on Schedule 14A (File No. 001-34375), filed with the Commission on June 12, 2014).
31.1	Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1*	Certifications 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 (filed herewith).
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

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.

CYTORI THERAPEUTICS, INC.

By: /s/ Marc H. Hedrick

Marc H. Hedrick

President & Chief Executive Officer

Principal Financial Officer

Dated: August 11, 2014

**Certification of Principal Executive and Principal 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, Marc H. Hedrick, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) 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
 - (d) 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 (the registrant's fourth fiscal quarter in the case of an annual report) 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 11, 2014

/s/ Marc H. Hedrick

Marc H. Hedrick,

President & Chief Executive Officer

(Principal Executive Officer & Principal Financial Officer)

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, 2014 as filed with the Securities and Exchange Commission on the date hereof, Marc H. Hedrick, as President and Chief Executive Officer and Principal Financial Officer of Cytori Therapeutics, Inc., hereby certifies, 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, as amended.
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.

Dated: August 11, 2014

By: /s/ Marc H. Hedrick

Marc H. Hedrick
President & Chief Executive Officer
Principal Financial Officer
