CERUS CORP
Form 10-Q
August 16, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10 - Q

(Mark One)

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

For the quarterly period ended June 30, 2010

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 0-21937

CERUS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**68-0262011**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

2550 Stanwell Drive

Concord, California 94520

(Address of principal executive offices, including Zip Code)

(925) 288-6000

(Registrant s telephone number, including area code)

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 x 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 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 the definitions of large accelerated filer , accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

As of July 13, 2010, there were 38.9 million shares of the registrant s common stock outstanding.

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CERUS CORPORATION

QUARTERLY REPORT ON FORM 10-Q

THREE AND SIX MONTHS ENDED JUNE 30, 2010

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PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CERUS CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2010 (Unaudited)	December 31, 2009 (see Note 1)
Assets		
Current assets:		
Cash and cash equivalents	$ 14,139	$ 17,287
Short-term investments	1,725	2,644
Accounts receivable, net of allowance of $7 and $66 at June 30, 2010 and December 31, 2009, respectively	3,467	3,625
Inventories	6,267	7,707
Prepaid expenses and other current assets	1,303	1,096
Total current assets	26,901	32,359
Non-current assets:		
Property and equipment, net	1,691	1,217
Restricted cash	339	332
Other assets	961	583
Total assets	$ 29,892	$ 34,491
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 3,513	$ 4,423
Accrued liabilities	4,147	5,286
Accrued restructuring		113
Deferred revenue	212	345
Current portion of long-term debt	797	
Current portion of capital lease obligations	9	9
Warrant liability	4,352	2,737
Total current liabilities	13,030	12,913
Non-current liabilities		
Long-term debt	4,036	
Long-term portion of capital lease obligations	11	15
Other non-current liabilities	737	115
Total liabilities	17,814	13,043
Stockholders equity		
Preferred stock	9,496	9,496
Common stock	39	39
Additional paid-in capital	422,890	421,897

Accumulated other comprehensive income	144	58
Accumulated deficit	(420,491)	(410,042)
Total stockholders equity	$ 12,078	$ 21,448
Total liabilities and stockholders equity	$ 29,892	$ 34,491

See notes to condensed consolidated financial statements.

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CERUS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

UNAUDITED

(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Revenue:				
Product revenue	$ 5,690	$ 3,871	$ 11,190	$ 6,956
Government grants and cooperative agreement	245	335	467	738
Total revenue	5,935	4,206	11,657	7,694
Cost of product revenue	2,934	2,520	6,092	4,614
Gross profit	3,001	1,686	5,565	3,080
Operating expenses:				
Research and development	1,244	1,625	2,494	3,637
Selling, general and administrative	5,304	5,409	10,575	11,510
Restructuring		129		841
Total operating expenses	6,548	7,163	13,069	15,988
Loss from operations	(3,547)	(5,477)	(7,504)	(12,908)
Non-operating income (expense):				
Warrant liability revaluation	(653)		(1,615)	
Foreign exchange gain (loss)	(975)	(730)	(1,073)	(839)
Other income (expense), net	(252)	(5)	(257)	138
Total non-operating income (expense)	(1,880)	(735)	(2,945)	(701)
Net loss	$ (5,427)	$ (6,212)	$ (10,449)	$ (13,609)
Per share information:				
Net loss per share basic and diluted	$ (0.14)	$ (0.19)	$ (0.27)	$ (0.42)
Weighted average common shares outstanding basic and diluted	38,940	32,650	38,880	32,620

See notes to condensed consolidated financial statements.

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CERUS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

(in thousands)

	Six Months Ended June 30,	
	2010	**2009**
Operating activities:		
Net loss	$ (10,449)	$ (13,609)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	369	370
Stock-based compensation	798	1,046
Revaluation of warrant liability	1,615	
Other-than-temporary loss on marketable securities	35	
Non-cash interest expense	51	
Loss on sale of fixed assets	39	109
Changes in operating assets and liabilities:		
Accounts receivable	158	1,019
Inventories	1,440	1,354
Other assets	(208)	96
Accounts payable and accrued expenses	(1,447)	(668)
Accrued restructuring	(113)	361
Deferred revenue	(133)	214
Net cash used in operating activities	(7,845)	(9,708)
Investing activities:		
Purchases of furniture, equipment and leasehold improvements	(797)	(100)
Purchases and refunds of long-term investments and other assets	(469)	214
Maturities of marketable securities	970	7,038
Net cash (used in) provided by investing activities	(296)	7,152
Financing activities:		
Net proceeds from issuance of common stock, and exercise of stock options	196	43
Payments on capital lease obligations and notes	(55)	
Proceeds from note payable, net of discount	4,852	
Net cash provided by financing activities	4,993	43
Net decrease in cash and cash equivalents	(3,148)	(2,513)
Cash and cash equivalents, beginning of period	17,287	10,303
Cash and cash equivalents, end of period	$ 14,139	$ 7,790
Supplemental disclosures:		
Cash paid for interest	$ 154	$ 1

See notes to condensed consolidated financial statements.

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CERUS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

Note 1. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include those of Cerus Corporation and its subsidiary, Cerus Europe B.V. (collectively referred to hereinafter as Cerus or the Company) after elimination of all intercompany accounts and transactions. These condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, considered necessary for a fair presentation have been made, including normal recurring adjustments and reclassifications. Operating results for the six-month period ended June 30, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010, or for any future period.

These condensed consolidated financial statements and notes should be read in conjunction with our audited financial statements and notes thereto for the year ended December 31, 2009, included in our 2009 Annual Report on Form 10-K. The accompanying balance sheet as of December 31, 2009, has been derived from our audited financial statements as of that date.

Use of Estimates

The preparation of financial statements requires management to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates, which are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from those estimates under different assumptions or conditions.

Revenue

The Company recognizes revenue in accordance with the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, Topic 605-25, Revenue Recognition - Arrangements with Multiple Deliverables, as applicable. Revenue is recognized when (i) persuasive evidence of an agreement with the funding party exists; (ii) services have been rendered or product has been delivered; (iii) pricing is fixed or determinable; and (iv) collection is probable.

The Company s main sources of revenues through June 30, 2010 were product revenue from sales of the INTERCEPT Blood System, research and development activities and agreements, United States government grants and awards, and commercialization agreements.

Revenue related to product sales is generally recognized when the Company fulfills its obligations for each element of an agreement. For all INTERCEPT Blood System sales, the Company uses a binding purchase order and signed sales contract as evidence of written agreement. The Company sells INTERCEPT Blood System directly to blood banks, hospitals, universities, government agencies, as well as to distributors in certain regions. Generally, the Company s contracts with its customers do not provide for open return rights, except within a reasonable time after receipt of goods in the case of defective or non-conforming product. Deliverables and the units of accounting vary according to the provisions of the purchase order or sales contract. For revenue arrangements with multiple elements, the Company evaluates whether the delivered elements have standalone value to the customer, whether the fair value of the undelivered elements is reliably determinable, and whether the delivery of the remaining elements is probable and within the Company s control. When all of these conditions are met, the Company recognizes the revenue on the delivered elements. If these conditions are not met, the Company defers revenue until such time as all of the conditions have been met or all of the elements have been delivered. Consideration received is allocated to elements that are identified as discrete units of accounting based on the relative fair value method. At June 30, 2010 and December 31, 2009, the Company had $0.2 million and $0.3 million, respectively, of short-term deferred revenue on its condensed consolidated balance sheets. Freight costs charged to customers are recorded as a component of revenue under FASB ASC Topic 605, Accounting for Shipping and Handling Fees and Costs. Value-added-taxes, or VAT, that the Company invoices to its customers and remits to governments, are recorded on a net basis, and are excluded from product revenue.

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Research and Development Expenses

The Company receives certain United States government grants that support the Company s efforts in defined research projects. These grants generally provide for reimbursement of approved costs incurred as defined in the various grants. Revenue associated with these grants is recognized as costs under each grant are incurred. In accordance with FASB ASC Topic 730, Accounting for Research and Development Expenses, research and development expenses are charged to expense when incurred. Research and development expenses include salaries and related expenses for scientific personnel, payments to consultants, supplies and chemicals used in in-house laboratories, costs of research and development facilities, depreciation of equipment and external contract research expenses, including clinical trials, preclinical safety studies, other laboratory studies, process development and product manufacturing for research use.

The Company s use of estimates in recording accrued liabilities for research and development activities (described previously in this Note under the heading Use of Estimates) affects the amounts of research and development expenses recorded and revenue recorded from development funding and government grants and collaborative agreements. Actual results may differ from those estimates under different assumptions or conditions.

Cash, Cash Equivalents and Short-Term Investments

The Company considers all highly liquid investments with an original maturity of 90 days or less from the date of purchase to be cash equivalents. Cash equivalents consist principally of short-term money market instruments.

In accordance with FASB ASC Topic 320, Accounting for Certain Investments in Debt and Equity Securities, the Company has classified all debt securities as available-for-sale at the time of purchase and reevaluates such designation as of each balance sheet date. Available-for-sale securities are carried at estimated fair value based on quoted market prices. The Company reports the amortization of any premium and accretion of any discount resulting from the purchase of debt securities as a component of other income (expense), net. The Company s available-for-sale securities consist primarily of United States government agency securities and corporate debt securities.

Unrealized gains and losses at June 30, 2010 and December 31, 2009, are reported in accumulated other comprehensive income (loss) on the Company s condensed consolidated balance sheets. The Company reviews all of its marketable securities on a regular basis to evaluate whether any security has experienced an other-than-temporary decline in fair value. During the three and six months ended June 30, 2010, the Company recorded other-than-temporary impairment losses of $0.04 million. During three and six months ended June 30, 2009, the Company did not recognize any losses associated with investments experiencing an other-than-temporary decline in fair value. See Note 2 regarding the inputs used to determine the fair value of the Company s investments. The cost of securities sold is based on the specific identification method.

As of June 30, 2010, the Company also maintained a certificate of deposit for approximately $0.2 million with a domestic bank. The Company holds this certificate of deposit for any potential decommissioning resulting from the Company s possession of radioactive material. The certificate of deposit is held to satisfy the financial surety requirements of the California Department of Health Services and is recorded as restricted cash on its condensed consolidated balance sheets at June 30, 2010 and December 31, 2009.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents, short-term investments and accounts receivable.

Substantially all of the Company s cash, cash equivalents and short-term investments are maintained pursuant to the Company s investment policy at a major financial institution of high credit standing. The Company monitors the financial credit worthiness of the issuers of its investments and limits the concentration in individual securities and type of investments that exist within its investment portfolio. Generally, all of the Company s remaining investments carry high credit quality ratings, in accordance with its investment policy. At June 30, 2010, the Company does not believe there is significant financial risk from non-performance by the issuers of the Company s cash equivalents and short-term investments.

Concentrations of credit risk with respect to trade receivables exist to the full extent of amounts presented in the condensed consolidated financial statements. On a regular basis, including at the time of sale, the Company performs credit evaluations of its customers. Generally, the Company does not require collateral from its customers to secure accounts receivable. To the extent that the Company determines specific invoices or customer accounts may be uncollectible, the Company reserves against the accounts receivable on its balance sheet and records a charge on its statement of operations. The Company had recorded allowances for potentially uncollectible accounts receivable of approximately $0.01 million and $0.1 million at June 30, 2010 and December 31, 2009, respectively. Actual collection losses may differ from management s

estimate, and such differences could be material to the Company s financial position and results of operations.

The Company had four customers each accounting for more than 10% of the Company s outstanding trade receivables and aggregating approximately 63% and 73% of outstanding trade receivables at June 30, 2010 and December 31, 2009, respectively. To date, the Company has not experienced collection difficulties from these customers.

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Inventories

At June 30, 2010 and December 31, 2009, inventory consisted of finished goods of INTERCEPT disposable kits, components thereof, UVA illumination devices, and certain replacement parts for the illumination devices. The Company s supply chain for certain of these components, held as work-in-process on its condensed consolidated balance sheet, can take in excess of one year for production to be complete before the work-in-process is utilized in finished disposable kits. Inventory is recorded at the lower of cost, determined on a first in, first-out basis, or market value. Platelet and plasma system disposable kits generally have two-year lives from date of manufacture. The Company frequently reviews the composition of inventory in order to identify obsolete, slow-moving or otherwise unsalable items. To the extent unsalable items are observed and there is no alternative use, the Company will record a write-down to net realizable value in the period that the impairment is first recognized. At June 30, 2010 and December 31, 2009, the Company had $0.2 million and $0.3 million, respectively, reserved for potential obsolete or expiring product.

Property and Equipment, net

Property and equipment is comprised of furniture, equipment, information technology hardware and software and is recorded at cost. At the time the property and equipment is ready for its intended use, it is depreciated on a straight-line basis over the estimated useful lives of the assets (generally three to five years). Leasehold improvements are amortized on a straight-line basis over the shorter of the lease term or the estimated useful lives of the improvements.

The Company evaluates its long-lived assets for impairment in accordance with ASC Topic 360, Accounting for the Impairment or Disposal of Long-Lived Assets . The Company continually monitors events and changes in circumstances that could indicate carrying amounts of its long-lived assets may not be recoverable. When such events or changes in circumstances occur, the Company assesses recoverability by determining whether the carrying value of such assets will be recovered through the undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, the Company recognizes an impairment loss based on the excess of the carrying amount over the fair value of the assets. The Company did not recognize impairment charges related to its long-lived assets during the three and six months ended June 30, 2010 or 2009.

Long-Term Investment in Related Party

At June 30, 2010 and December 31, 2009, the Company held an approximate 13% interest in the voting securities of BioOne Corporation, or BioOne, and accounted for its investment in BioOne under the cost method. At December 31, 2009, the Company evaluated several criteria to determine whether facts and circumstances supported the carrying value of its investment in BioOne. These criteria included, but were not limited to: third-party investor interest and participation in recent equity offerings at current pricing, business outlook of BioOne and available financial information. As a result of its evaluation of the criteria used to support its position in BioOne, the Company determined that there were no factors to support any carrying value of its investment in BioOne. As a result, at December 31, 2009, the Company completely impaired its investment in BioOne and as such recorded its investment at zero at June 30, 2010 and December 31, 2009.

Foreign Currency Remeasurement

The functional currency of the Company s foreign subsidiary is the United States Dollar. Monetary assets and liabilities denominated in foreign currencies are remeasured in United States Dollars using the exchange rates at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are remeasured in United States Dollars using historical exchange rates. Revenues and expenses are remeasured using average exchange rates prevailing during the period. Remeasurements are recorded in the Company s consolidated statements of operations. The Company recorded foreign currency losses of $1.0 million and $0.7 million during the three months ended June 30, 2010, and 2009, respectively. The Company recorded foreign currency losses of $1.1 million and $0.8 million during the six months ended June 30, 2010, and 2009, respectively.

Stock-Based Compensation

The Company maintains an equity incentive plan to provide long-term incentives for employees, contractors, members of the Board of Directors, and Scientific Advisory Board. The plan allows for the issuance of non-statutory and incentive stock options, restricted stock, restricted stock units, stock appreciation rights, other stock-related awards, and performance awards which may be settled in cash, stock, or other property. The Company also maintains an active employee stock purchase plan within the meaning of Section 423(b) of the Internal Revenue Code.

The Company accounts for stock-based compensation in accordance with ASC Topic 718, Compensation Stock Compensation. Under the fair value recognition provisions, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized

as expense on a straight-line basis over the requisite service period, which is the vesting period. To the extent that stock options contain performance criteria for vesting, stock-based compensation is recognized once the performance criteria are probable of being met.

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For its non-employee stock-based awards the Company accounts for these in accordance with ASC Topic 505-50, Equity Based Payment to Non-Employees and considers the measurement date at which the fair value of the stock-based award is measured is equal to the earlier of 1) the date at which a commitment for performance by the counter party to earn the equity instrument is reached or 2) the date at which the counter party s performance is complete. The Company recognizes stock-based compensation expense for the fair value of the vested portion of the non-employee awards in its consolidated statements of operations.

See Note 10 for further information regarding our stock-based compensation assumptions and expenses.

Warrant Liability

In August 2009, the Company issued warrants to purchase an aggregate of 2.4 million shares of common stock of the Company in connection with a registered direct offering. The outstanding warrants are classified as a liability, and as such, the fair value of the warrants is recorded on the condensed consolidated balance sheet at inception of such classification and adjusted to fair value at each financial reporting date. The changes in fair value of the warrants are recorded in the condensed consolidated statements of operations. The fair value of the warrants is estimated using the binomial-lattice option-pricing model. During the three and six months ended June 30, 2010, the Company recorded non-cash charges of $0.7 million and $1.6 million, respectively, associated with changes in the fair value of the warrants from December 31, 2009. The warrants will continue to be reported as a liability until such time as the instruments are exercised or are otherwise modified to remove the provisions which require this treatment, at which time the warrants are adjusted to fair value and reclassified from liabilities to stockholders equity. If the warrants are reclassified as permanent equity, the fair value of the warrants would be recorded in stockholders equity and no further adjustment would be made in subsequent periods.

See Note 9 for further information regarding our warrant liability valuation.

Other Comprehensive Income (Loss)

The components of comprehensive income (loss) include net income (loss) and other comprehensive income (loss). The Company s only component of other comprehensive income (loss) for the three and six months ended June 30, 2010 and 2009 consisted of unrealized gains or losses from the Company s available-for-sales short-term investments. Other comprehensive income (loss) is reported as a separate component of stockholders equity.

Income Taxes

The Company accounts for income taxes in accordance with Accounting for Income Taxes, ASC Topic 740. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. ASC Topic 740 requires derecognition of tax positions that do not have a greater than 50% likelihood of being recognized upon review by a taxing authority having full knowledge of all relevant information. Use of a valuation allowance as described in ASC 740 is not an appropriate substitute for the derecognition of a tax position. The Company did not have any recorded liabilities for unrecognized tax benefits at June 30, 2010 or December 31, 2009. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in its income tax expense. To date, the Company has not recognized any interest and penalties in its condensed consolidated statements of operations, nor has its accrued for or made payments for interest and penalties. The Company continues to carry a full valuation allowance on all of its deferred tax assets. The tax years 2005 through 2009 remain subject to examination by the taxing jurisdictions to which the Company is subject.

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Net Loss Per Share Basic and Diluted

Basic and diluted loss per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period.

The following table sets forth the reconciliation of the denominator used in the computation of basic and diluted net loss per common share (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Numerator:				
Net loss	$ (5,427)	$ (6,212)	$ (10,449)	$ (13,609)
Denominator:				
Basic and diluted weighted average number of common shares outstanding	38,940	32,650	38,880	32,620
Net loss per common share basic and diluted	$ (0.14)	$ (0.19)	$ (0.27)	$ (0.42)

The table below presents stock options, convertible preferred stock and restricted stock units that are excluded from the diluted net loss per common share due to their anti-dilutive effect (shares in thousands):

	2010	2009
Antidilutive securities weighted average shares	6,358	6,894

Guarantee and Indemnification Arrangements

The Company recognizes the fair value for guarantee and indemnification arrangements issued or modified by the Company after December 31, 2002, if these arrangements are within the scope of FASB Pre-codification, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others . In addition, the Company monitors the conditions that are subject to the guarantees and indemnifications, as required under previously existing generally accepted accounting principles, in order to identify if a loss has occurred. If the Company determines it is probable that a loss has occurred, then any such estimable loss would be recognized under those guarantees and indemnifications. Some of the agreements of the Company contain provisions that indemnify the counter party from damages and costs resulting from claims that the Company s technology infringes the intellectual property rights of a third party or claims that the sale or use of the Company s products have caused personal injury or other damage or loss. The Company has not received any such requests for indemnification under these provisions and has not been required to make material payments pursuant to these provisions.

The Company generally provides for a one-year warranty on certain of its INTERCEPT blood-safety products covering defects in materials and workmanship. The Company accrues costs associated with warranty obligations when claims become probable and estimable. There have been very few warranty costs incurred through June 30, 2010. Accordingly, at June 30, 2010, the Company has not accrued for any potential future warranty costs.

Fair Value of Financial Instruments

The Company applies the provisions of ASC Topic 820-10-65-4, Fair Value Measurements, relating to its financial assets and liabilities. The carrying amounts of accounts receivables, accounts payable, and other accrued liabilities approximate their fair value due to the relative short-term maturities. Based on the borrowing rates currently available to the Company for loans with similar terms, the Company believes the fair value of long-term debt approximates their carrying amounts. The carrying amounts and fair value of the Company s short term investments and warrant liability are described in Note 2. Financial Instruments to these condensed consolidated financial statements.

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New Accounting Pronouncements

Revenue Recognition

In October 2009, the FASB issued updated revenue recognition guidance under ASC Topic 605 relating to revenue arrangements with multiple deliverables. Under the revised guidance, companies with revenue arrangements that have multiple deliverables must assess whether or not multiple deliverables exist under the revised guidance, how the deliverables should be separated and how the consideration should be allocated to the elements. In addition, the revised guidance requires an entity to allocate revenue in an arrangement using the best estimated selling price (BESP) of deliverables if a vendor does not have vendor specific objective evidence of selling price or third-party evidence (TPE) of selling price. Each unit must have standalone value to the customer, similar to previous guidance. The revised guidance is effective for the Company beginning January 1, 2011.

Variable Interest Entities

In June 2009, the FASB issued amended standards for determining whether to consolidate a variable interest entity. These new standards amend the evaluation criteria to identify the primary beneficiary of a variable interest entity and require ongoing reassessment of whether an enterprise is the primary beneficiary of the variable interest entity. The provisions of the new standards are effective for annual reporting periods beginning after November 15, 2009 and interim periods within those fiscal years. These standards were effective for the Company beginning January 1, 2010. The adoption of the new standards did not have an impact on the Company s condensed consolidated financial statements.

Note 2. Financial Instruments

The Company measures and records certain financial assets at fair value on a recurring basis, including its available-for-sale short-term investments. The Company s available-for-sale short-term investments consist of fixed income corporate bonds and United States government agency securities. The Company classifies investments with original maturities of three months or less at the date of purchase, as cash equivalents. Cash equivalents consist of corporate commercial paper and money market funds, for which the carrying amount is a reasonable estimate of fair value. Similarly, the Company measures and records certain financial liabilities at fair value.

At June 30, 2010, the fair values of certain of the Company s financial assets and liabilities were determined using the following inputs (in thousands):

Fixed income available-for-sale-securities	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds[1]	$ 8,832	$ 8,832	$	$
Corporate bonds[2]	312		312	
United States government agency securities[2]	1,413		1,413	
	$ 10,557	$ 8,832	$ 1,725	$
Liabilities				
Warrant Liability[3]	$ 4,352	$	$	$ 4,352

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At December 31, 2009, the fair values of certain of the Company s financial assets were determined using the following inputs (in thousands):

Fixed income available-for-sale-securities	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds[1]	$ 11,059	$ 11,059	$	$
Corporate bonds[2]	657		657	
United States government agency securities[2]	1,987		1,987	
	$ 13,703	$ 11,059	$ 2,644	$
Liabilities				
Warrant Liability[3]	$ 2,737	$	$	$ 2,737

(1) Included in cash and cash equivalents on the Company s condensed consolidated balance sheet.
(2) Included in short-term investments on the Company s condensed consolidated balance sheet.
(3) Included in current liabilities on the Company s condensed consolidated balance sheet.

The Company classifies investments within Level 1 if quote prices are available in active markets. The Company classifies items in Level 2 if the investments are valued using observable inputs to quoted market prices, benchmark yields, reported trades, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. These investments include: United States government agencies and corporate bonds. Investments are held by a custodian who obtains investment prices from a third party pricing provider that uses standard inputs to models which vary by asset class. The Company did not hold financial assets which were recorded at fair value in the Level 3 category, which defines that one or more significant inputs or significant value drivers are unobservable, as of June 30, 2010 and December 31, 2009. The Company s warrant liability is recorded at fair value and classified in the Level 3 category. For further discussion, see Note 9.

Note 3. Cash, Cash Equivalents and Short-Term Investments

The following is a summary of cash, cash equivalents and short-term investments (in thousands):

	June 30, 2010		
	Carrying Value	Unrealized Gain	Fair Value
Cash and cash equivalents:			
Cash	$ 5,307	$	$ 5,307
Money Market funds	8,832		8,832
Total cash and cash equivalents	$ 14,139	$	$ 14,139
Short-term investments			
Corporate debt securities	$ 258	$ 54	$ 312
United States government agency securities	1,323	90	1,413
Total short-term investments	$ 1,581	$ 144	$ 1,725
	$ 15,720	$ 144	$ 15,864

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	Carrying Value	December 31, 2009 Unrealized Gain	Fair Value
Cash and cash equivalents:			
Cash	$ 6,228	$	$ 6,228
Money Market funds	11,059		11,059
Total cash and cash equivalents	$ 17,287	$	$ 17,287
Short-term investments			
Corporate debt securities	$ 629	$ 28	$ 657
United States government agency securities	1,957	30	1,987
Total short-term investments	$ 2,586	$ 58	$ 2,644
	$ 19,873	$ 58	$ 19,931

	June 30, 2010	December 31, 2009
Due in one year or less	$ 8,832	$ 11,059
Due greater than one year and less than three years	1,725	2,644
Total	$ 10,557	$ 13,703

Realized gains and losses from the sale of available-for-sale investments and from other-than-temporary declines in market value are recorded in Interest income (expense) and other, net. The Company did not have any sales of available-for-sale investments during the six months ended June 30, 2010 and 2009. During the six months ended June 30, 2010, the Company recorded other-than temporary impairment losses of $0.04 million. During the six months ended June 30, 2009, the Company did not recognize any losses associated with investments experiencing an other-than-temporary decline in fair market value.

Note 4. Inventories

Inventories consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Work in progress	$ 3,375	$ 3,638
Finished goods	2,892	4,069
	$ 6,267	$ 7,707

The Company s inventories at June 30, 2010 and December 31, 2009 consisted of finished goods of INTERCEPT disposable kits, components thereof, UVA illumination devices, and certain replacement parts for the illumination devices. The Company is responsible for supplying its manufacturer, Fenwal, Inc., with certain components for assembly into finished INTERCEPT disposable kits. The Company accounts for these components as work-in-process until such time as the components are used in the production of finished INTERCEPT disposable kits. The Company s work-in-process components are manufactured over a protracted length of time before being incorporated into the finished disposable kits. As a result, work-in-process costs accumulate for a period of time which can exceed one year.

Note 5. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Accrued compensation and related	$ 1,178	$ 942
Accrued inventory	976	2,366
Accrued contract and other accrued expenses	1,993	1,978
	$ 4,147	$ 5,286

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Note 6. Restructuring

In March 2009, pursuant to the Board of Directors approval, the Company began implementing a plan to focus resources on commercializing the INTERCEPT Blood System in Europe, to consolidate facilities, and to reduce its cost structure. Effected employees received severance consideration and continuation of benefits, as well as transition assistance. All one-time termination benefits have been paid as of June 30, 2010. No additional costs are expected to be incurred by the Company under this restructuring plan.

A summary of the Company s restructuring costs is as follows (in thousands):

	Balance at December 31, 2009	Restructuring Charge	Cash Payments	Balance at June 30, 2010
One-time termination benefits	$ 113	$	$ 113	$

Note 7. Commitments and Contingencies

Operating Leases

The Company leases its office facilities and certain equipment under non-cancelable operating leases with initial terms in excess of one year that require the Company to pay operating costs, property taxes, insurance and maintenance. These facility leases generally contain renewal options and provisions adjusting the lease payments if those renewal options are exercised. The Company s facility leases qualify as operating leases under FASB ASC Topic 840, Leases and as such, are not included on its condensed consolidated balance sheets.

In addition to the operating leases themselves, certain of the Company s leases provided for lease incentives and landlord-financed leasehold improvements. At June 30, 2010, the Company had financed $0.3 million of leasehold improvements. The Company pays for the financed leasehold improvements as a component of rent and is required to pay interest and reimburse its landlords over the remaining life of the respective leases.

Royalties

The Company is obligated to pay royalties on certain INTERCEPT product sales based on a percentage of net sales generated. The royalty rates vary by product, with a rate of 10% of net sales for the platelet system, 3% for the plasma system, 5% for the red blood cell system, and 6.5% for illuminators. These royalties are recorded as part of cost of product revenue.

Purchase Commitments

The Company is party to agreements with certain providers of INTERCEPT blood safety system components which the Company purchases and provides to Fenwal at no cost. Certain of these agreements require minimum purchase commitments from the Company.

Note 8. Long-term Note Payable

Long-term note payable at June 30, 2010 consisted of the following (in thousands):

	Principal	Unamortized Discount	Total
Current portion of note payable	$ 884	$ 87	$ 797
Long term portion of note payable	4,116	80	4,036
Long-term note payable.	$ 5,000	$ 167	$ 4,833

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On March 31, 2010, the Company entered into a growth capital facility agreement and immediately issued a senior secured long-term note payable for $5.0 million. The note issued under the agreement is secured by all of the Company s assets, except intellectual property. The note carries a fixed interest rate of 12.04%, with interest only payments for the first nine months and then equal principal and interest payments for an additional 30 months. In connection with issuing the note, the Company paid an upfront facility fee of $0.1 million and incurred closing costs of $0.1 million. The combined facility fee and closing costs have been recorded as a discount to the note payable and will be amortized as a component of interest expense using the effective interest method over the term of the note (discount is based on implied interest rate of 13.84%). In addition, the Company agreed to pay a $0.4 million closing fee upon maturity of the note. The closing fee will be accreted to interest expense using the effective interest method over the life of the note.

Under the growth capital facility, subject to certain conditions including compliance with covenants, the Company may borrow an additional $5.0 million under an additional note payable between September 30, 2010 and December 31, 2010. The terms of the additional $5.0 million note would be identical to the first note issued under the growth capital facility except the Company would not incur any additional upfront facility fees.

The Company is required to maintain compliance with certain customary and routine financial covenants. Additionally, the note requires the Company to generate minimum revenues at certain pre-established levels. As of June 30, 2010 and through August 13, 2010, the Company was in compliance with financial covenants set forth in the growth capital facility. Non-compliance with the covenants may result in the principal of the note becoming due and payable.

Note 9. Stockholders Equity

Series B Preferred Stock

Fenwal holds 3,327 shares of the Company s Series B preferred stock. The Series B preferred stock has no voting rights, except with respect to the authorization of any class or series of stock having preference or priority over the Series B preferred stock as to voting, liquidation or conversion or with respect to the determination of fair market value of non-publicly traded shares received by the holder of Series B stock in the event of a liquidation, or except as required by Delaware law. Fenwal may convert each share of Series B preferred stock into 100 shares of the Company s common stock at any time. If all shares of Series B preferred stock were converted to common stock, 332,700 shares of common stock would be issued, which represents approximately 1% of the outstanding common stock of the Company at June 30, 2010. The Company has the right to redeem the Series B preferred stock prior to conversion for a payment of $9.5 million.

Common Stock and Warrant Liability

In August 2009, the Company received net proceeds of approximately $12.1 million after deducting placement agent s fees and stock issuance costs of approximately $1.1 million, from a registered direct offering of 6.0 million units. Each unit sold consisted of one share of common stock and a warrant to purchase 4/10 of a share of common stock. Each unit was sold for $2.20, resulting in the issuance of 6.0 million shares of common stock and warrants to purchase 2.4 million shares of common stock, exercisable at an exercise price of $2.90 per share. The warrants contain certain provisions that, under certain circumstances which may be out of the Company s control, could require the Company to pay cash to settle the exercise of the warrants or may require the Company to redeem the warrants.

The offering was made pursuant to the Company s shelf registration statement on Form S-3. These warrants became exercisable on February 25, 2010 and are exercisable for a period of five years from the issuance date. The warrants are classified as a liability pursuant to Accounting for Derivative Instruments and Hedging Activities and Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity Topics of FASB ASC. Therefore, the fair value of the warrants is recorded on the condensed consolidated balance sheet as a liability and will be adjusted to fair value at each financial reporting date thereafter until the earlier of exercise or expiration. At December 31, 2009, the fair value of the warrants was determined to be approximately $2.7 million using the binomial-lattice option valuation model applying the following assumptions: (i) a risk-free rate of 2.69%, (ii) an expected term of 4.65 years, (iii) no dividend yield and (iv) a volatility of 82%. At June 30, 2010, the fair value of the warrants was determined to be approximately $4.4 million using the binomial-lattice option valuation model applying the following assumptions: (i) a risk-free rate of 0.01%, (ii) an expected term of 4.15 years, (iii) no dividend yield and (iv) a volatility of 73%. Because the fair value of the warrants had increased from the December 31, 2009 valuation, during the six months ended June 30, 2010, the Company recorded a $1.6 million charge to its condensed consolidated statements of operations.

Note 10. Stock-Based Compensation

The Company maintains an equity compensation plan to provide long-term incentives for employees, contractors, and members of its Board of Directors and Scientific Advisory Boards. The Company also maintains an Employee Stock Purchase Plan which is intended to qualify as an

employee stock purchase plan within the meaning of Section 423(b) of the Internal Revenue Code. Under the Purchase Plan, the Company s Board of Directors may authorize participation by eligible employees, including officers, in periodic offerings.

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The Company has granted restricted stock units to the Chief Executive Officer, Senior Vice Presidents, and Vice Presidents in accordance with the Bonus Plan for Senior Management of Cerus Corporation. Subject to each grantee s continued employment, shares underlying the grants vest in three annual installments and are issuable at the end of the three-year vesting term.

The Company currently uses the Black-Scholes option pricing model to determine the fair value of stock options and employee stock purchase plan shares. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price, as well as assumptions regarding a number of complex and subjective variables. The variables used to calculate the fair value of stock-based payment awards using the Black-Scholes option pricing model include the expected term of the grants, the Company s expected stock price volatility, actual and projected employee stock option exercise behaviors, including forfeitures, the risk-free interest rate and expected dividends.

The Company does not recognize stock-based compensation on stock options that contain performance conditions, until such time as the performance criteria are probable of being achieved. As such, the Company had not recorded any such stock based compensation for the 50,000 performance-based stock options granted.

Total stock-based compensation recognized on the Company s condensed consolidated statements of operations for the three and six months ended June 30, 2010, and 2009, was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Research and development	$ 99	$ 105	$ 162	$ 274
Selling, general and administrative	374	366	636	772
	$ 473	$ 471	$ 798	$ 1,046

Activity under the Company s equity incentive plans is set forth below (in thousands except per share amounts):

	Number of Options Outstanding	Weighted Average Exercise Price per Share ($)
Balances at December 31, 2009	6,565	$ 7.38
Granted	99	1.92
Cancelled	(286)	15.34
Exercised	(134)	1.27
Balances at June 30, 2010	6,244	$ 7.07

Note 11. Comprehensive Loss

Comprehensive loss comprises net loss and other comprehensive loss. Other comprehensive loss for all periods presented comprises unrealized holding gains on our available-for-sale securities, which are excluded from net loss and included as a component of stockholders equity. Comprehensive loss and its components are as follows (in thousands):

	Three Months Ended June 30,	Six Months Ended June 30,

	2010	2009	2009	2009
Net loss:				
As reported	$ (5,427)	$ (6,212)	$ (10,449)	$ (13,609)
Other comprehensive loss:				
Net unrealized gain/(loss) on available-for-sale securities	39	(28)	86	(165)
Comprehensive loss	$ (5,388)	$ (6,240)	$ (10,363)	$ (13,774)

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Note 12. Development and License Agreements

Agreements with Baxter and Fenwal

In connection with the transfer of commercialization rights to the Company in February 2006, Baxter International Inc., or Baxter agreed to supply, at the Company s expense, certain transition services, including regulatory, technical and related administrative support through December 31, 2006. During that 2006 transition period, the Company recorded receivables of $2.8 million from Baxter and payables of $4.7 million to Baxter, associated with those transition services. The Company and Baxter disputed the amounts owed and due since 2006. As such, since 2006, the Company recorded the transition service receivables and payables on its condensed consolidated balance sheets. In December 2009, the Company and Baxter entered into a settlement agreement with both parties waiving all rights and obligations associated with the 2006 transition services. In consideration for agreeing to the settlement, the Company agreed to pay Baxter $0.5 million which was recorded as a payable on its December 31, 2009 consolidated balance sheet. The $0.5 million payable was paid by the Company during the first quarter of 2010.

As a result of Baxter s sale of its transfusion therapies division in 2007 to Fenwal, the Company has certain agreements with Fenwal which require the Company to pay royalties on future INTERCEPT Blood System product sales at royalty rates that vary by product: 10% of product sales for the platelet system, 3% for the plasma system and 5% for the red blood cell system. During the three months ended June 30, 2010 and June 30, 2009, the Company made royalty payments to Fenwal of $0.4 million and $0.3 million, respectively. During the six months ended June 30, 2010 and June 30, 2009, the Company made royalty payments of $0.8 million and $0.6 million, respectively. At December 31, 2009 and June 30, 2010, the Company owed royalties to Fenwal of $0.8 million and $0.8 million, respectively.

In December 2008, the Company extended its agreement with Fenwal to manufacture finished disposable kits for the platelet and plasma systems through December 31, 2013. Under the amended manufacturing agreement, the Company pays Fenwal a set price per kit, which is established annually plus a fixed surcharge per kit. In addition, volume driven manufacturing overhead is be paid or refunded if actual manufacturing volumes are lower or higher than the annually estimated production volumes. The Company made payments to Fenwal of $1.3 million and $0.7 million relating to the manufacturing of the Company products during the three months ended June 30, 2010 and June 30, 2009, respectively, and $4.7 million and $2.6 million during the six months ended June 30, 2010 and June 30, 2009, respectively. At December 31, 2009 and June 30, 2010, the Company owed Fenwal of $3.7 million and $2.0 million, respectively, for INTERCEPT disposable kits manufactured.

Agreements with BioOne

BioOne was formed in 2004 to develop technologies to improve the safety of blood products in Asia, and is funded by equity investments from Japanese venture capital firms, other corporations and individual investors. At June 30, 2010, the Company held 13% of the voting rights in BioOne. See Note 1 for additional information regarding the Company s investment in BioOne.

Platelet Agreement

In September 2004, Baxter and the Company entered into an agreement with BioOne for commercialization of the INTERCEPT Blood System for platelets in parts of Asia. Under the terms of the agreement, BioOne is responsible, at its expense, for seeking regulatory approvals and will have exclusive rights to market and distribute the INTERCEPT Blood System for platelets in Japan, China, Taiwan, South Korea, Thailand, Vietnam and Singapore, following their receipt of regulatory approval in each of those countries. The agreement provides for contingent milestone payments and royalties on future product sales, which generally would be shared equally by Fenwal (Baxter s assignee) and the Company. The Company did not recognize any revenue under this agreement during the either the six months ended June 30, 2010 or 2009.

Plasma Agreement

A definitive agreement with BioOne for the plasma system was signed by Baxter and the Company in September 2005 for the commercialization of the INTERCEPT Blood System for plasma in parts of Asia. Under the terms of the agreement, BioOne is responsible, at its expense, for seeking regulatory approvals and will have exclusive rights to market and distribute the INTERCEPT Blood System for plasma in Japan, China, Taiwan, South Korea, Thailand, Vietnam and Singapore, following their receipt of regulatory approval in each of those countries. The agreement provides for contingent milestone payments and royalties on future product sales, which generally would be shared equally by Fenwal (Baxter s assignee) and the Company. The Company did not recognize any revenue under this agreement during the six months ended June 30, 2010 or 2009.

Note 13. Segment Information and Geographic Information

At June 30, 2010 and 2009, the Company operated only one segment, blood safety. The Company s chief executive officer is the chief operating decision maker who evaluates performance based on the net revenues and operating income (loss) of the blood safety segment.

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During the six months ended June 30, 2010 and 2009, the Company had the following significant customers, listed as a percentage of product revenue:

Customer	2010	2009
Establishment Francais du Sang	22%	19%
Movaco, S.A.	20%	28%
Delrus Inc	16%	*
Service Du Sang	13%	*
Grifols Italia S.P.A.	*	10%

* Represents amounts less than 10%

During the six months ended June 30, 2010 and 2009, the Company also recognized government grants and cooperative agreement revenue which represented 4% and 10% of total revenue, respectively.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis should be read in conjunction with our condensed consolidated financial statements and the accompanying notes included in this report and the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2009. Operating results for the three and six months ended June 30, 2010 are not necessarily indicative of results that may occur in future periods.

This report contains forward-looking statements that involve risks and uncertainties. The forward-looking statements are contained principally in the sections entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors. These statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. Examples of forward-looking statements include, but are not limited to, statements about our estimates regarding the sufficiency of our cash resources, our ability to commercialize and achieve market acceptance of the INTERCEPT Blood Systems, the successful completion of our research, development and clinical programs our ability to manage costs associated with pre-clinical and clinical development for the INTERCEPT Blood Systems, our ability to obtain and maintain regulatory approvals of the INTERCEPT Blood Systems, and our ability to protect our intellectual property and operate our business without infringing upon the intellectual property rights of others. In some cases, you can identify forward-looking statements by terms such as anticipate, will, believe, estimate, expect, plan, and similar expressions intended to identify such forward-looking statements. Forward-looking statements reflect our current views with respect to future events, are based on assumptions, and are subject to risks and uncertainties. There can be no assurance that these statements will prove to be correct. We discuss many of these risks in this Quarterly Report on Form 10-Q in greater detail in the section entitled Risk Factors under Part II, Item 1A below. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our estimates and assumptions only as of the date of this Quarterly Report on Form 10-Q. You should read this Quarterly Report on Form 10-Q and the documents that we incorporate by reference in and have filed as exhibits to this Quarterly Report on Form 10-Q, completely and with the understanding that our actual future results may be materially different from what we expect. Except as required by law, we assume no obligation to update any forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in any forward-looking statements, even if new information becomes available in the future.

Overview

Since our inception in 1991, we have devoted substantially all of our efforts and resources to the research, development, clinical testing and commercialization of blood safety systems and, from 2001 until late 2007, immunotherapies for cancer and infectious disease. Our INTERCEPT platelet system, or the platelet system, and our INTERCEPT plasma system, or the plasma system, have received CE marks and are being marketed in Europe, Russia, the Middle East and selected countries in other regions around the world. We are pursuing regulatory approvals for the platelet and plasma systems in the United States and other countries. The INTERCEPT red blood cell system, or the red blood cell system, is in clinical development.

Our near-term capital requirements are dependent on various factors, including operating costs and working capital investments associated with commercializing the INTERCEPT Blood System, costs associated with planning and conducting studies and clinical development of our

platelet and red blood cell systems, timing and magnitude of payments under awards from the United States government, and costs related to creating, maintaining and defending our intellectual property. Our long-term capital requirements will also be dependent on competitive developments and regulatory factors. Until we are able to generate a sufficient amount of product revenue and generate positive net cash flows from operations, meeting our long-term capital requirements is in large part subject to access to public and private equity and debt capital markets, as well as to additional collaborative arrangements with partners or government grants, augmented by cash generated from operations and interest income earned on the investment of our cash balances and short-term investments. We believe that cash received from product sales and our available cash balances will be sufficient to meet our capital requirements for at least the next twelve months. If our assumptions prove to be incorrect, we could consume our available capital resources sooner than we currently expect.

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We expect to prioritize continued commercialization of the platelet and plasma systems in Europe, the Community of Independent States, or CIS countries, the Middle East and in selected countries in other regions around the world over pursuit of development and commercialization of the red blood cell system, or regulatory approval of the platelet or plasma systems in the United States.

We have borrowed and in the future may borrow capital from institutional and commercial banking sources. Potential borrowings may include restrictive covenants, including covenants that restrict the operation of our business, liens on assets, high effective interest rates and repayment provisions that reduce cash resources and limit future access to capital markets. To the extent we raise additional capital by issuing equity securities, our stockholders may experience substantial dilution. To the extent that we raise additional funds through collaboration or partnering arrangements, we may be required to relinquish some of our rights to our technologies or rights to market and sell our products in certain geographies, or grant licenses on terms that are not favorable to us. The credit markets and the financial services industry have continued to experience turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government. We do not know whether capital will be available if and when needed, or that, if available, we will be able to obtain additional capital on reasonable terms. If we are unable to raise additional capital we will need to curtail planned development and may need to curtail commercialization activities.

We recognize growing, but still relatively modest, product revenues from the sale of our platelet and plasma systems in Europe, the CIS countries, the Middle East, and certain other countries around the world. We must conduct significant research, development, preclinical and clinical evaluation, commercialization and regulatory compliance activities for our products that, together with anticipated selling, general and administrative expenses, are expected to result in substantial losses at least until after our platelet and plasma systems gain widespread commercial acceptance in Europe, Russia, the Middle East, and selected countries in other regions around the world. Our ability to achieve a profitable level of operations in the future will depend on our ability to successfully commercialize and achieve market acceptance of our blood safety products. We may never achieve a profitable level of operations. Subject to the availability of adequate funding from partners, government grants, and/or capital markets, we also anticipate continuing our expenditures in support of preclinical and clinical trials and device development of our red blood cell system over the next several years.

We pay royalties to Fenwal on product sales, at rates of 10% of net sales for the platelet system, 3% for the plasma system, 5% for the red blood cell system, and 6.5% on sales of UVA illuminators. In December 2008, we amended and extended our supply agreement with Fenwal for the manufacture of INTERCEPT finished disposable kits for the platelet and plasma systems through December 31, 2013. Under the amended manufacturing agreement, we pay Fenwal a set price per kit, which is established annually, plus a fixed surcharge per kit. In addition, volume driven manufacturing overhead will be paid or refunded if actual manufacturing volumes are lower or higher than the annually estimated production volumes. Under the amended manufacturing agreement, we are responsible for providing certain disposable kit components to Fenwal at no cost to Fenwal. This required us to enter into supply arrangements with certain other manufacturers for those components, some of which contain minimum purchase commitments. As a result, our supply chain for certain of these components, held as work-in-process on our condensed consolidated balance sheet, can take over one year to complete production before being utilized in finished disposable kits.

We have worldwide commercialization rights for the INTERCEPT blood systems, except in certain parts of Asia. BioOne is responsible for commercializing the platelet and plasma systems, including regulatory efforts, in those certain parts of Asia. At June 30, 2010, we owned approximately 13% of the equity interest in BioOne. We evaluate the carrying value of our investment in BioOne using a variety of criteria, including, but are not limited to: third-party investor interest and participation in recent equity offerings at current pricing, business outlook of BioOne and available financial information. As a result of BioOne s position relative to these criteria, at December 31, 2009, we have completely written down our investment in BioOne and recorded the carrying value of our equity interest in BioOne at zero.

In November 2007, we spun-off our immunotherapy business to Anza Therapeutics, Inc., or Anza, for preferred stock representing an equity interest of approximately 20% of Anza s preferred equity. We accounted for the immunotherapy business as a discontinued operation and restated our consolidated financial statements for 2007 and prior periods to reflect that accounting treatment. We were informed in February 2009 that Anza had ceased operations. In July 2009, we entered into a three-way license agreement with Anza and Aduro BioTech, or Aduro, and separate agreements with each of Anza and Aduro BioTech (collectively, the Assignment Agreements). In November 2009, Anza transferred all of its intellectual property to Aduro, pursuant to the terms of the Assignment Agreements. In exchange for agreeing to the transfer and for relinquishing our shares in Anza and releasing any claims against Anza, we received $0.8 million in cash, preferred shares representing 10% of Aduro s capital and a 1% royalty on any future sales resulting from the transferred technology. Because Aduro s technology and efforts are in the very early stage of research and development, we have no basis to assign value to the equity we have received in Aduro or that such equity will have monetary value at such time as we are allowed to sell it or that we will receive any royalties from Aduro.

Through June 30, 2010, in addition to the product revenues from sales of our platelet and plasma systems, we have recognized revenue from grants and cooperative agreements with the Armed Forces.

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Critical Accounting Policies and Management Estimates

The preparation of financial statements requires us to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, inventory valuation, accrued liabilities, stock-based compensation assumptions, and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates under different assumptions or conditions.

We believe the following critical accounting policies require us to make significant judgments and estimates used in the preparation of our financial statements:

Revenue Revenue is recognized when (i) persuasive evidence of an agreement with the funding party exists; (ii) services have been rendered or product has been delivered; (iii) pricing is fixed or determinable; and (iv) collection is probable.

Revenue related to product sales is generally recognized when we fulfill our obligations for each element of an agreement. For all sales of our INTERCEPT Blood System products, we use a binding purchase order and signed sales contract as evidence of a written agreement. We sell INTERCEPT Blood System for platelets and plasma directly to blood banks, hospitals, universities, government agencies, as well as to distributors in certain regions. Generally, our contracts with customers do not provide for open return rights, except within a reasonable time after receipt of goods in the case of non-conforming product. Deliverables and the units of accounting vary according to the provisions of each purchase order or sales contract. For revenue arrangements with multiple elements we evaluate whether the delivered elements have standalone value to the customer, whether the fair value of the undelivered elements is reliably determinable, and whether the delivery of the remaining elements is probable and within our control. When all of these conditions are met, we recognize the revenue on the delivered elements. If these conditions are not met, we defer revenue until such time as all of the conditions have been met or all of the elements have been delivered. Consideration received is allocated to elements that are identified as discrete units of accounting based on the relative fair market value method. Freight costs charged to customers are recorded as a component of revenue and value-added-taxes, or VAT, that we invoice to our customers and remit to governments are recorded on a net basis, which excludes such VAT from product revenue.

Revenue related to the cost reimbursement provisions under development contracts is recognized as the costs on the projects are incurred. We receive certain United States government grants and contracts that support research in defined research projects. These grants generally provide for reimbursement of approved costs incurred as defined in the various grants. Revenue associated with these grants is recognized as costs under each grant are incurred.

Inventory We own work-in-process inventory for certain components of INTERCEPT disposable kits, finished INTERCEPT disposable kits, illuminators, and certain replacement parts for our illuminators. Our supply chain for certain of these components, held as work-in-process on our condensed consolidated balance sheet, can take over one year to complete production before being utilized in finished disposable kits. Under our manufacturing agreement with Fenwal, our carrying value of INTERCEPT disposable kits is dependent on an annually set price. In addition, at the end of each year, volume driven manufacturing overhead is either paid or refunded by or to us if manufacturing volumes are higher or lower than the anticipated manufacturing volumes at the time the price is established. As a result, at each interim period, manufacturing overhead can fluctuate and requires us to use judgment in accruing the manufacturing overhead. In addition, we use judgment in determining whether the manufacturing overhead is a cost of our inventory and recoverable when product is sold. We use significant judgment and evaluate manufacturing variances incurred during periods of abnormally low production by considering a variety of factors including the reasons for low production volumes, anticipated future production levels that correlate to and offset volumes experienced during abnormally low production cycles, and contractual requirements. We record manufacturing variances incurred during periods of abnormally low production volumes as a component of cost of product revenue when production volumes are abnormally low.

Inventory is recorded at the lower of cost, determined on a first in, first-out basis, or market value. Our platelet and plasma system disposable kits generally have a two-year shelf life from the date of manufacture. Illuminators and replacement parts do not have regulated expiration dates. We use significant judgment to analyze and determine if the composition of our inventory is obsolete, slow-moving, or unsalable and frequently review such determinations. Our limited history selling the INTERCEPT Blood System limits the amount of historical data we have to perform this analysis. Generally, we write-down specifically identified obsolete, slow-moving, or known unsalable inventory that has no alternative use, using a number of factors including product expiration dates, open and unfulfilled orders, and sales forecasts.

Accrued expenses - We record accrued liabilities for expenses related to certain contract research activities and development services, including those related to clinical trials, preclinical safety studies and external laboratory studies, as well as transition services and development activities being performed by third parties. Some of those accrued liabilities are based on estimates because billings for these activities may not occur on a timely basis consistent with the performance of the services. Specifically, accruals for clinical trials require us to make estimates

surrounding costs associated with patients at various stages of the clinical trial, pass through costs to clinical sites, contract research organization costs including fees, database development, and reporting costs, among others.

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Stock-based compensation We issue stock-based awards to our employees, members of our Board of Directors, our Scientific Advisory Board and certain contractors as strategic, long-term incentives. We recorded stock-based compensation expense for employee awards in accordance with ASC 505-50, Equity Based Payments to Non-Employees . We use the Black-Scholes option pricing model to determine the grant-date fair value of a stock award. We continue to apply the provisions of Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunctions with Selling, Goods or Services, for our non-employee stock-based awards. Under the provisions, the measurement date at which the fair value of the stock-based award is measured is equal to the earlier of (i) the date at which a commitment for performance by the grantee to earn the equity instrument is reached or (ii) the date at which the grantee s performance is complete. We recognize stock-based compensation expense for the fair value of the vested portion of the non-employee awards in our condensed consolidated statements of operations.

The Black-Scholes option pricing model calculates the grant-date fair value using certain variables. These variables are impacted by our stock price, award exercise behaviors, the risk free interest rate and our expected dividends and many of these variables require us to use significant judgment.

Expected Term. We estimate the expected term of options granted using a variety of factors. Where possible, we estimate the expected term of options granted by analyzing employee exercise and post-vesting termination behavior. To make this estimation, we analyze the population of options granted by discrete homogeneous groups. For those homogeneous groups where we are unable to obtain sufficient information to estimate the expected term in this manner, we estimate the expected term of the options granted by taking the average of the vesting term and the contractual term of the option. The expected term of employee stock purchase plan shares is the term of each offering period.

Estimated Forfeiture Rate. We estimate the forfeiture rate of options at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. We estimate the historic pre-vesting forfeiture rates by groups that possess a degree of homogeneity regarding average time to vest and expected term. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods.

Estimated Volatility. We estimate the volatility of our common stock by using historical volatility of our common stock. We have used significant judgment in making these estimates and we will continue to monitor the availability of actively traded options on our common stock. If we determine that sufficient actively traded options on our common stock exist, we may consider a combination of historical and implied volatility, or solely implied volatility.

Risk-Free Interest Rate. We base the risk-free interest rate that we use in the option pricing model on United States Treasury zero-coupon issues with remaining terms similar to the expected term on the options.

Expected Dividend. We do not anticipate paying any cash dividends in the foreseeable future and therefore use an expected dividend yield of zero in the option pricing model.

If factors change and we utilize different assumptions in determining the grant-date fair value of stock-based compensation expense in the future, or if we utilize a different option pricing model in the future, then those results may differ significantly from what we have recorded in the current period and could materially affect our operating results. There is significant risk that the Black-Scholes option pricing model and the judgment we have used in ascertaining the variables will yield results that differ materially from the actual values realized upon the exercise, expiration, termination or forfeitures of the awards in the future. Historical results were utilized in deriving our variables, which may not be indicative of the future.

Income Taxes Since our inception, we have accumulated significant net operating losses and research and development credits that may be used in future periods to offset future taxable income. We currently estimate that we may not be able to utilize all of our deferred tax assets. In addition, we may not generate future taxable income prior to the expiration of our net operating loss carry forwards and research and development credits. Timing and significance of any estimated future taxable income is highly subjective and is beyond the control of management due to uncertainties in market conditions, economic environments in which we operate, and timing of regulatory approval of our products. We do not recognize tax positions that have a lower than 50% likelihood of being recognized upon review by a taxing authority having full knowledge of all relevant information. Use of a valuation allowance is not an appropriate substitute for the derecognition of a tax position. We did not have any recorded liabilities for unrecognized tax benefits at June 30, 2010 or 2009. We recognize interest accrued and penalties related to unrecognized tax benefits in our income tax expense. To date, we have not recognized any interest and penalties in our statements of operations, nor have we accrued for or made payments for interest and penalties. We continue to carry a full valuation allowance on all of our deferred tax assets. Although we believe it more likely than not that a taxing authority would agree with our current tax positions, there can be no assurance that the tax positions we have taken will be substantiated by a taxing authority if reviewed.

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Results of Operations

Three and Six -Month Periods Ended June 30, 2010 and 2009

Revenue

(in thousands, except percentage)	Three months ended June 30, 2010	2009	Change		Six months ended June 30, 2010	2009	Change	
Product revenue	$ 5,690	$ 3,871	$ 1,819	47 %	$ 11,190	$ 6,956	$ 4,234	61 %
Government grants and cooperative agreement	245	335	(90)	(27)%	467	738	(271)	(37)%
Total revenue	$ 5,935	$ 4,206	$ 1,729	41%	$ 11,657	$ 7,694	$ 3,963	52%

Product revenue increased $1.8 million to $5.7 million during the three months ended June 30, 2010, compared to $3.9 million during the comparable period in the prior year. The increase in product revenue was primarily a result of an increase in disposable kit sales to customers. Product revenue increased $4.2 million to $11.2 million during the six months ended June 30, 2010, compared to $7.0 million during the comparable period in the prior year. The increase in product revenue was primarily a result of an increase in disposable kit sales to customers, and was also driven by an increase in illuminator sales compared to 2009. Sales of disposable platelet and plasma system kits directly to existing customers continued to grow due to increased market penetration and customer adoption of the INTERCEPT Blood System in Europe and the Middle East. We expect that product revenues for both the platelet and plasma systems will continue to increase in future periods as the INTERCEPT Blood System gains market acceptance in geographies where commercialization efforts are underway. These quarterly results may not be indicative of INTERCEPT Blood System revenue in the future.

Revenue from government grants and cooperative agreements decreased $0.1 million to $0.2 million for the three months ended June 30, 2010, from $0.3 million for the comparable period in 2009. The decrease was due primarily to a decrease in activities subject to reimbursement under current awards with the United States Department of Defense, or DoD, for research activities for our INTERCEPT Blood System programs. Government grant revenue decreased by $0.3 million to $0.5 million during the six months ended June 30, 2010, compared to $0.7 million during the comparable period in the prior year. The decrease in government grant revenue was primarily due to a decrease in activities subject to reimbursement under current awards with the DoD. As a result of our March 2009 restructuring plan we had fewer employees performing research and development work during 2010 compared to 2009. We anticipate applying for new awards with the DoD to the extent such awards become available. However, we can provide no assurance that should such awards become available, our bids will be accepted by the DoD or at what funding levels.

Cost of Product Revenue

Our cost of product revenue consists of the cost of the INTERCEPT Blood System inventory sold, royalties payable to Fenwal for product sales, certain order fulfillment costs and reserves for obsolete, slow-moving and scrapped inventory. Inventory is accounted for on a first-in, first-out basis.

(in thousands, except percentage)	Three months ended June 30, 2010	2009	Change		Six months ended June 30, 2010	2009	Change	
Cost of product revenue	$ 2,934	$ 2,520	$ 414	16%	$ 6,092	$ 4,614	$ 1,478	32%

Cost of product revenue increased $0.4 million to $2.9 million during the three months ended June 30, 2010, from $2.5 million during the comparable period in the prior year. The increase in cost of revenue was primarily due to higher number of kits sold, partially offset by lower per-unit carrying costs of the inventory sold. Cost of product revenue increased $1.4 million to $6.1 million during the six months ended June 30, 2010, from $4.6 million during the comparable period in the prior year. The increase in cost of revenue was primarily due to a higher number of kits sold, and was also impacted by an increase in illuminator sales. We anticipate our cost of product revenue will increase in the future as a result of increased product sales volume.

Our realized gross margins on product sales were 48% during the three months ended June 30, 2010, up from 35% during the three months ended June 30, 2009. For the six months ending June 30, 2010, our realized gross margins on product sales were 46%, up from 34% for the six

months ended June 30, 2009. The changes in our gross margins are affected by various factors, including manufacturing and supply chain costs, the mix of product sold, and the mix of customers to which product is sold. Generally, we offer our distributors tiered volume discounts of varying magnitudes, depending on their purchase commitments, which depending on sales volumes to those distributors receiving tiered volume discounts, may impact our gross margins.

Research and Development Expenses

Our research and development expenses include salaries and related expenses for our scientific personnel, stock-based compensation, payments to consultants, costs to prepare and conduct preclinical and clinical trials, third-party costs for development activities, certain regulatory costs, costs for licensed technologies, costs associated with our infrastructure, and laboratory chemicals and supplies.

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(in thousands, except percentage)	Three months ended June 30, 2010	2009	Change		Six months ended June 30, 2010	2009	Change	
Research and development	$ 1,244	$ 1,625	$ (381)	(23)%	$ 2,494	$ 3,637	$ (1,143)	(31)%

Research and development expenses decreased $0.4 million to $1.2 million for the three months ended June 30, 2010, from $1.6 million for the comparable period in 2009. Of our total research and development costs incurred, non-cash stock-based compensation represented $0.1 million for each of the three months ended June 30, 2010 and 2009. The decrease in our research and development expenses during the three months ended June 30, 2010, compared to 2009 was the result of reduced research and development activities driven primarily by our March 2009 restructuring plan and the associated reduction in force.

Research and development expenses decreased $1.1 million to $2.5 million for the six months ended June 30, 2010, from $3.6 million for the comparable period in 2009. Of our total research and development expenses incurred, non-cash stock-based compensation represented $0.2 million and $0.3 million for the six months ended June 30, 2010 and June 30, 2009, respectively. The decrease in our research and development expenses during the six months ended June 30, 2010, compared to 2009, was a result of the effect of our March 2009 restructuring and the associated reduction in force.

We anticipate our research and development spending will remain relatively stable over the near term. However, research and development spending may increase to the extent that we are able to find sources of funding to further our red blood cell system development efforts or pursue regulatory approval of the platelet system in the United States. Due to the inherent uncertainties and risks associated with developing biomedical products, including, but not limited to, intense and changing government regulation, uncertainty of future pre-clinical and clinical trial results and uncertainty associated with manufacturing, it is not possible to reasonably estimate the costs to complete these research and development projects. We face numerous risks and uncertainties associated with the successful completion of our research and development projects; see Risk Factors in Part II, Item 1A below.

Selling, General, and Administrative Expenses

Selling, general, and administrative expenses include salaries and related expenses for administrative personnel, stock-based compensations, expenses for our commercialization efforts in Europe, expenses for accounting, tax, and internal control, legal and facility related expenses, and insurance premiums.

(in thousands, except percentage)	Three months ended June 30, 2010	2009	Change		Six months ended June 30, 2010	2009	Change	
Selling, general, and administrative	$ 5,304	$ 5,409	$ (105)	(2)%	$ 10,575	$ 11,510	$ (935)	(8)%

Selling, general, and administrative expenses decreased $0.1 million to $5.3 million for the three months ended June 30, 2010, from $5.4 million for the comparable period in 2009. Of these amounts, non-cash stock-based compensation represented $0.4 million for each of the three months ended June 30, 2010 and 2009. Overall, the decrease in selling, general and administrative expenses from the three months ended June 30, 2010, was primarily due to the decreased personnel costs driven primarily by our March 2009 restructuring plan and the associated reductions in force.

Selling, general, and administrative expenses decreased $0.9 million to $10.6 million for the six months ended June 30, 2010, from $11.5 million for the comparable period in 2009. Of the $10.6 million and $11.5 million of selling, general and administrative expenses recognized during the six months ended June 30, 2010 and 2009, respectively, $0.6 million and $0.8 million was due to non-cash stock-based compensation recognized during the respective periods. Overall, the decrease in selling, general and administrative expenses for the six months ended June 30, 2010, was primarily due to the decreased personnel costs driven primarily by our March 2009 restructuring plan and the associated reductions in force.

We anticipate that we will be focused on maintaining our selling general, and administrative spending at or around the current levels over the coming year, as part of a larger effort to focus our resources, contain operating expenses and conserve cash.

Restructuring

Restructuring costs during three and six months ended June 30, 2009, include one-time termination benefits, facility consolidation and related moving costs.

(in thousands, except percentage)	Three months ended June 30, 2010	2009	Change		Six months ended June 30, 2010	2009	Change	
Restructuring	$	$ 129	$ (129)	(100)%	$	$ 841	$ (841)	(100)%

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During the three months ended March 31, 2009, pursuant to the Board of Directors approval, we began implementing a plan to focus resources on commercializing the INTERCEPT Blood System in Europe, to consolidate facilities, and to reduce our cost structure. During the three and six months ended June 30, 2009, we incurred costs for one-time termination benefits for employee positions that were eliminated under the restructuring plan. We also consolidated facilities and incurred certain other costs associated with the restructuring plan. We continued to implement our restructuring plan and incurred associated costs through the year ended December 31, 2009. All of the costs accrued as one-time termination benefits at March 31, 2009 were paid by June 30, 2010.

Non-Operating Income (Expense)

Non-Operating Income (Expense) consists of mark-to-market adjustments related to the calculated fair value of our outstanding warrants, foreign exchange gain (loss), interest charges incurred on our note payable, interest earned from our short-term investment portfolio, and other non-operating gains and losses.

	Three months ended June 30,				Six months ended June 30,			
(in thousands, except percentage)	**2010**	**2009**	**Change**		**2010**	**2009**	**Change**	
Warrant liability revaluation	$ (653)	$	$ (653)	(100)%	$ (1,615)	$	$ (1,615)	(100)%
Foreign Exchange loss	(975)	(730)	(245)	(34)%	(1,073)	(839)	(234)	(28)%
Other income (expense), net	(252)	(5)	(247)	(4,940)%	(257)	138	(395)	(286)%
Total non-operating income (expense)	$ (1,880)	$ (735)	$ (1,145)	(156)%				