VIACELL INC
Form 10-Q
May 10, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2007

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

Commission File Number 0-51110
VIACELL, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**04-3244816**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
245 First Street, Cambridge, MA	**02142**
(Address of Principal Executive Offices)	*(Zip Code)*

(617) 914-3400
(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 þ No o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).
Yes o No þ

As of May 6, 2007, 38,757,042 shares of the Company s common stock, $0.01 par value, were outstanding.

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ViaCell, Inc.
Quarterly Report on Form 10-Q
For the Fiscal Quarter Ended March 31, 2007

NOTE ABOUT REFERENCES TO VIACELL

Throughout this report, the words we, our, us , the Company , and ViaCell refer to ViaCell, Inc. and its subsidiaries.

NOTE ABOUT TRADEMARKS

ViaCell® and ViaCord® are registered trademarks of ViaCell, Inc. ViaCyte℠ is a service mark of ViaCell, Inc. Cell Sentinel™ is a trademark of Pall Corporation. Motherhood Maternity®, A Pea in the Pod®, Mimi Maternity®, and Destination Maternity™ are trademarks of Mothers Work, Inc.

NOTE ABOUT FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements, including statements about our current projections as to future financial performance, our expectations as to the potential and anticipated results of our research and development programs, and our views as to the possible outcome of pending litigation related to our intellectual property portfolio and other disputes. We have based these forward-looking statements on our current expectations about such future events. While we believe these expectations are reasonable, forward-looking statements are inherently subject to risks and uncertainties, many of which are beyond our control. Our actual results may differ materially from those suggested by these forward-looking statements for various reasons, including those discussed in this report in Part II, Item 1A Risk Factors. Given these risks and uncertainties, you are cautioned not to place substantial weight on forward-looking statements. The forward-looking statements included in this report are made only as of the date of this report. We do not undertake any obligation to update or revise any of these statements.

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PART I FINANCIAL INFORMATION
Item 1 Financial Statements
ViaCell, Inc.
Condensed Consolidated Balance Sheets
(amounts in thousands except share and per share data)
(unaudited)

	March 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,610	$ 18,039
Short-term investments	32,808	33,206
Accounts receivable, less allowances of $1,998 and $1,787 at March 31, 2007 and December 31, 2006, respectively	12,471	12,616
Prepaid expenses and other current assets	2,059	2,008
Total current assets	61,948	65,869
Property and equipment, net	8,234	8,376
Goodwill	3,621	3,621
Intangible assets, net	2,571	2,621
Restricted cash	1,795	1,795
Total assets	$ 78,169	$ 82,282
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt obligations	$ 62	$ 55
Accounts payable	1,642	960
Accrued expenses	8,804	9,550
Deferred revenue	7,785	7,300
Total current liabilities	18,293	17,865
Deferred revenue	16,089	14,666
Deferred rent	3,217	3,252
Contingent purchase price	8,155	8,155
Long-term debt obligations, net of current portion	22	27
Total liabilities	45,776	43,965
Commitments and contingencies (Note 5)		
Stockholders equity:		
Preferred stock, $0.01 par value; authorized 5,000,000 shares at March 31, 2007 and December 31, 2006, none outstanding		
Common stock, $0.01 par value; authorized 100,000,000 shares at March 31, 2007 and December 31, 2006; issued and outstanding 38,747,919 and 38,525,036 shares at March 31, 2007 and December 31, 2006, respectively	387	385
Additional paid-in capital	232,962	232,215

Accumulated deficit	(201,174)	(194,490)
Accumulated other comprehensive income	218	207
Total stockholders equity	32,393	38,317
Total liabilities and stockholders equity	$ 78,169	$ 82,282

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ViaCell, Inc.
Condensed Consolidated Statements of Operations
(amounts in thousands except per share data)
(unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Processing and storage revenues	$ 14,362	$ 11,937
Grant revenues	95	144
Total revenues	14,457	12,081
Operating expenses:		
Cost of processing and storage revenues	2,639	2,328
Research and development	3,278	3,466
Sales and marketing	11,121	7,922
General and administrative	4,800	4,638
Restructuring		(181)
Total operating expenses	21,838	18,173
Loss from operations	(7,381)	(6,092)
Interest income (expense):		
Interest income	698	724
Interest expense	(1)	(26)
Total interest income, net	697	698
Loss from operations before cumulative effect of change in accounting principle	(6,684)	(5,394)
Cumulative effect of change in accounting principle		283
Net loss	$ (6,684)	$ (5,111)
Net loss per share:		
Basic and diluted net loss per common share before cumulative effect of change in accounting principle	$ (0.17)	$ (0.14)
Cumulative effect of change in accounting principle		0.01
Basic and diluted net loss per common share	$ (0.17)	$ (0.13)
Weighted average shares used in basic and diluted net loss per share computation	38,669	38,295

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ViaCell, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(in thousands)
(unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Net loss	$ (6,684)	$ (5,111)
Foreign currency translation adjustment	11	10
Comprehensive loss	$ (6,673)	$ (5,101)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ViaCell, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Cash flows from operating activities:		
Net loss	$ (6,684)	$ (5,111)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	577	559
Cumulative effect of change in accounting principle		(283)
Stock-based compensation	613	711
Reserve for bad debt	331	266
Tenant improvement allowance		62
Changes in assets and liabilities:		
Accounts receivable	(186)	747
Prepaid expenses and other current assets	(52)	(906)
Accounts payable	681	(51)
Accrued expenses	(759)	1,209
Deferred revenue	1,908	1,292
Deferred rent	(89)	(235)
Net cash used in operating activities	(3,660)	(1,740)
Cash flows from investing activities:		
Purchases of property and equipment	(306)	(400)
Proceeds from maturities of investments	17,128	8,887
Purchases of investments	(16,730)	(8,055)
Net cash provided by investing activities	92	432
Cash flows from financing activities:		
Proceeds from exercise of stock options	136	22
Repayments on credit facilities		(437)
Payments of capital lease principal	(10)	(16)
Net cash provided by (used in) financing activities	126	(431)
Effect of change in exchange rates on cash	13	30
Net decrease in cash and cash equivalents	(3,429)	(1,709)
Cash and cash equivalents, beginning of period	18,039	33,138
Cash and cash equivalents, end of period	$ 14,610	$ 31,429

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ViaCell, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements

1. Organization and Nature of Business

ViaCell is a biotechnology company dedicated to enabling the widespread application of human cells as medicine. The Company has a reproductive health business that generates revenues from sales of ViaCord, a service offering through which expectant families can preserve their baby s umbilical cord blood for possible future medical use. Stem cells from umbilical cord blood are a treatment option today for over 40 diseases, including certain blood cancers and genetic diseases. The Company is also working to leverage its commercial infrastructure and product development capabilities by developing ViaCyte sm, a product candidate being studied for its potential to broaden reproductive choices for women through the cryopreservation of human unfertilized eggs. The Company s other research and development efforts are focused on investigating the potential for new therapeutic uses of umbilical cord blood-derived stem cells and on technology for expanding populations of these cells. The Company is concentrating these efforts in the areas of cancer, cardiac disease, and diabetes.

ViaCell was incorporated in the State of Delaware on September 2, 1994. The Company s corporate headquarters and main research facility are located in Cambridge, Massachusetts. The Company has a processing and storage facility in Hebron, Kentucky.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements as of March 31, 2007 and for the three months ended March 31, 2007 and 2006, and related notes, are unaudited but in management s opinion include all adjustments, consisting only of normal recurring adjustments, that the Company considers necessary for fair statement of the interim periods presented. The Company has prepared its unaudited, condensed consolidated financial statements following the requirements of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under these rules, the Company has condensed or omitted certain footnotes and other financial information that are normally required by accounting principles generally accepted in the U.S. (GAAP). The Company s accounting policies are described in the Notes to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006 and updated, as necessary, in this Form 10-Q. Results for the three months ended March 31, 2007 are not necessarily indicative of results for the entire fiscal year or future periods. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated. The year-end condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R Share-Based Payment (SFAS 123R) using the modified prospective method, which results in the provisions of SFAS 123R only being applied to the condensed consolidated financial statements on a going-forward basis (that is, the prior period results have not been restated). Under the fair value recognition provisions of SFAS 123R, stock-based compensation expense is measured using the Black-Scholes option pricing model at the grant date based on the value of the award and is recognized as expense on a straight-line basis over the requisite service period. The Company had previously followed Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, which resulted in the accounting for employee stock options at their intrinsic value in the condensed consolidated financial statements. Employee stock-based compensation expense was $0.6 million and $0.7 million for the three months ended March 31, 2007 and March 31, 2006, respectively.

The Company recognized the full impact of its share-based payment plan in the condensed consolidated financial statements for the three months ended March 31, 2007 and March 31, 2006 under SFAS 123R and did not capitalize any such costs on the condensed consolidated balance sheets, as the costs that qualified for capitalization were not material. Expense recognized in connection with the adoption of SFAS 123R increased the Company s net loss for the three months ended March 31, 2007 and March 31, 2006 by $0.6 million and $0.7 million, respectively, and increased basic and diluted net loss per share by $0.02 for both the three months ended March 31, 2007 and March 31, 2006. There was no impact in the three months ended March 31, 2007 and March 31, 2006 on the Company s cash flows from operating, investing or financing activities in connection with recognition of stock-based compensation expense under SFAS 123R.

The following table presents stock-based compensation expense included in the Company s unaudited condensed consolidated statements of operations (in thousands):

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Cost of processing and storage revenues	$ 14	$ 15
Research and development	50	104
Sales and marketing	80	57
General and administrative	469	535
Total stock-based compensation expense	$ 613	$ 711

The fair value of stock options as of their respective grant dates was estimated using the Black-Scholes option-pricing model.

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Presented below is the Company s stock option activity for the three months ended March 31, 2007 and March 31, 2006, respectively:

	Three Months Ended March 31, 2007		Three Months Ended March 31, 2006	
	Number of Options Outstanding	Weighted Average Exercise Price	Number of Options Outstanding	Weighted Average Exercise Price
Outstanding at beginning of period	3,991,327	$3.02	3,930,694	$2.77
Granted	415,145	4.79	240,625	5.21
Exercised	(35,446)	3.84	(35,051)	0.65
Canceled	(33,037)	5.44	(17,072)	6.17
Outstanding at end of period	4,337,989	3.16	4,119,196	2.91
Exercisable at end of period	2,465,551		2,178,044	
Weighted average fair value of options granted		2.28		2.93

Net Loss Per Common Share

Basic net loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of common and potentially dilutive shares of common stock outstanding during the period. Potentially dilutive shares of common stock consist of shares of common stock issuable upon the exercise of stock options and warrants. Potentially dilutive shares of common stock are excluded from the calculation if their effect is anti-dilutive.

The following sets forth the computation of basic and diluted net loss per share (in thousands, except per share data):

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Basic and diluted net loss per share:		
Net loss	$ (6,684)	$ (5,111)
Weighted average number of common shares outstanding	38,669	38,295
Basic and diluted net loss per share	$ (0.17)	$ (0.13)

The following reflects the weighted average of potentially dilutive securities that were excluded from the calculation of basic and diluted net loss per share because their effect was antidilutive:

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Stock Options	4,031,549	3,958,946
Warrants	1,262,777	1,837,291

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In-Process Research and Development Expense

As part of the Company s acquisition of Kourion Therapeutics in September 2003, the Company is obligated to make up to four future payments (milestone payments) of $3.0 million each to former shareholders of Kourion Therapeutics if certain product development goals are achieved within specified timeframes. These milestone payments are payable in cash or stock, valued at its fair market value at the time of issuance, at the election of each former Kourion shareholder. On December 31, 2006, the first of these milestone payments expired and was not paid since the related development goal was not met within the required timeframe. As of March 31, 2007, the Company has $8.2 million in contingent purchase price classified as long-term liabilities on its condensed consolidated balance sheet associated with the remaining outstanding milestone payments, which was originally recorded as an offset to the amount of negative goodwill associated with the acquisition of Kourion Therapeutics. Of the remaining $9.0 million of potential milestone payments, an additional $3.0 million will expire and never be paid if certain development goals are not met by June 30, 2007. The Company currently expects that these development goals will not be met and that its long-term liabilities will therefore be reduced to $6.0 million as of June 30, 2007 to reflect the two remaining milestone payments that will remain outstanding. Should this occur, the reduction in long-term liabilities is expected to result in a credit to in-process research and development expense of $2.2 million in the quarter ended June 30, 2007.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159), which permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 will be effective for the first fiscal year that begins after November 15, 2007. The Company has not yet completed its evaluation of the impact of adoption of SFAS 159 on its financial condition or results of operations.

In September 2006, FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157), which defines fair value under GAAP, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. Where applicable, SFAS No. 157 simplifies and codifies related guidance within GAAP and does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not expect the adoption of SFAS No. 157 to have a significant immediate effect on its financial condition or results of operations.

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3. Accrued Expenses

At March 31, 2007 and December 31, 2006, accrued expenses consisted of the following (in thousands):

	March 31, 2007	December 31, 2006
Payroll and payroll-related	$ 1,605	$ 1,904
Management incentive	426	1,047
Professional fees	2,004	1,829
Accrued marketing	1,878	2,079
Deferred rent, current	357	345
Accrued taxes	518	459
Other	2,016	1,887
Accrued expenses	$ 8,804	$ 9,550

4. Income Taxes

On January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48), an interpretation of FASB Statement No. 109 (SFAS 109). FIN 48 establishes a single model to address accounting for uncertain tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before it can be recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement clarification, interest and penalties, accounting in interim periods, disclosure and transition. Upon adoption of FIN 48, the Company recognized no material adjustment in its liability for unrecognized income tax benefits.

As of January 1, 2007, the Company had net deferred tax assets of approximately $61.0 million representing unrecognized tax benefits. The Company has recorded a full valuation allowance against its deferred tax assets. Due to the weight of available evidence, the Company believed it was more likely than not that the deferred tax assets will not be realized. There have been no significant changes to these amounts during the quarter ended March 31, 2007.

In many cases, the Company s uncertain tax positions are related to tax years that remain subject to examination by the relevant tax authorities. Currently, all of the Company s tax years remain open to examination by the major taxing jurisdictions in which the Company has federal and state net operating loss (NOL) carryforwards.

The Company conducts business in the U.S. and Singapore, and previously conducted business in Germany. The Company is subject to examination in the normal course of business by taxing authorities in all of these jurisdictions. As of March 31, 2007, no examinations related to income taxes have occurred.

At December 31, 2006, the Company had federal and state NOL carryforwards of approximately $87.8 million and $93.3 million, respectively, which begin to expire in 2009 and 2007, respectively, and

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federal and state research and development (R&D) credit carryforwards of $3.4 million and $1.6 million, respectively, which begin to expire in 2009 and 2013, respectively. The Company had foreign NOL carryforwards of $14.8 million. These carryforwards expire through 2024 and are subject to review and possible adjustment by the local tax authorities. Under Section 382 of the Internal Revenue Code of 1986, as amended, and similar state and foreign provisions, utilization of the NOL and R&D credit carryforwards may be subject to a substantial annual limitation in the event of ownership changes that have occurred previously or that could occur in the future. These ownership changes may limit the amount of NOL and R&D credit carryforwards that the Company can utilize annually to offset future taxable income and tax, respectively. In general, an ownership change, as defined by Section 382, results from transactions increasing the ownership of certain shareholders or public groups in the stock of a corporation by more than 50 percentage points over a three-year period. Since the Company s formation, the Company has raised capital through the issuance of capital stock on several occasions which, combined with the purchasing shareholders subsequent disposition of those shares, may have resulted in a change of control, as defined by Section 382, or could result in a change of control in the future upon subsequent disposition.

The Company has not currently completed a study to assess whether a change of control has occurred or whether there have been multiple changes of control since its formation due to the significant complexity and cost associated with such a study and that there could be additional changes of control in the future. If the Company has experienced a change of control at any time since Company formation, utilization of its NOL or R&D credit carryfowards would be subject to an annual limitation under Section 382, which is determined by first multiplying the value of the Company s stock at the time of the ownership change by the applicable long-term tax-exempt rate, and then could be subject to additional adjustments, as required. Any limitation may result in expiration of a portion of the Company s NOL or R&D credit carryforwards before utilization. Until the Company completes a study and any limitations are known, no amounts are being presented as an uncertain tax position under FIN 48.

The Company has elected to recognize interest and penalties related to uncertain tax positions in income tax expense on its condensed consolidated statements of operations. As of March 31, 2007, the Company has not accrued any interest or penalties related to uncertain tax positions.

5. Commitments and Contingencies

Agreements

In August 2006, the Company entered into a data license and marketing services agreement with Mothers Work, Inc., the world s largest designer and retailer of maternity apparel. Mothers Work operates several large maternity store retail chains such as Motherhood Maternity ®, A Pea in the Pod ®, Mimi Maternity ®, and Destination Maternity tm. Under the terms of the agreement, Mothers Work has granted the Company an exclusive license within the field of preserving stem cells from cord blood and other sources to market directly to those Mothers Work customers who have affirmatively agreed to permit disclosure of their data and information. Mothers Work has also agreed to provide certain in-store marketing services related to the ViaCord service offering. Under the terms of the agreement, the Company will pay Mothers Work $5.0 million per year over the three-year term of the agreement which began on January 1, 2007 and, unless earlier terminated, ends on December 31, 2009. Under certain circumstances, the Company will also be obligated, at the beginning of 2009, to issue Mothers Work a warrant to purchase 100,000 shares of the Company s common stock with an exercise price of $6.29, which represents a 30% premium to the average closing price of the Company s common stock over the ten trading days immediately preceding January 1, 2007. The warrant would be exercisable for a one year period beginning on January 1, 2010. The fair market value of the warrant will be remeasured at each reporting period and recognized over the three year term of the agreement. The agreement can be terminated early by either company if the other company commits a material breach of the agreement or under certain circumstances arising from claims by a third party alleging that the third party has rights that supersede Mothers Work s commitment to the Company. The dispute between Mothers Work and the

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third party is the subject of an ongoing arbitration proceeding. In February 2007, the arbitrator ruled in favor of Mothers Work. The arbitrator has denied a challenge to his ruling by the third party. While there is no assurance that the third party will not again challenge the ruling, the Company believes that reversal of this ruling is unlikely and that the termination rights under its agreement with Mothers Work are unlikely to be triggered. As a condition to commencing the agreement on January 1, 2007, the Company agreed to indemnify Mothers Work for any damages that Mothers Work may be assessed in the event that Mothers Work is found to be in breach of its agreement with the third party as a result of having entered into an agreement with the Company. The Company also agreed to reimburse Mothers Work for certain legal fees if the fees exceed a specified threshold. The Company s potential obligation to Mothers Work under the indemnification agreement is unlimited. However, based on the Company s assessment of the low likelihood that it might have to pay damages or legal fees given the arbitrator s ruling, the Company concluded the fair value of its indemnification obligation is not material and has not recorded a liability as of March 31, 2007.

In June 2006, the Company entered into a research collaboration agreement with the Stem Cell Internal Venture (SCIV) of Centocor Research and Development, Inc. to evaluate ViaCell s proprietary cord blood-derived multi-potent stem cells in preclinical testing as a potential treatment for cardiac disease. The collaboration is also supported by the Biologics Delivery Systems Group of Cordis Corporation, and is focused on dosing, delivery and targeting of ViaCell s expanded proprietary cord blood stem cells using Cordis NOGA XP delivery system. Under the terms of the agreement, ViaCell received an initial up-front payment of $350,000 which it recorded as a liability and is amortizing as a reduction of research and development expense, as work is performed. SCIV will be responsible for its own costs under the collaboration and will pay 50% of the research costs that ViaCell incurs under the collaboration, consistent with the agreed upon budget. As of March 31, 2007, SCIV has reimbursed the Company approximately $0.2 million of these costs. In addition, the agreement provides SCIV with the first right to negotiate a collaboration with ViaCell on the clinical development and commercialization of a cardiac product offering based on ViaCell s proprietary cord blood stem cells.

In January 2005, the Company entered into a supply agreement with Miltenyi Biotec GmbH (Miltenyi). The supply agreement with Miltenyi provides for the exclusive supply by Miltenyi to ViaCell of cell separation kits for ViaCell consisting of various antibodies conjugated with magnetic particles to be used in Selective Amplification,ViaCell s proprietary technology for the expansion of stem cell populations for the development and commercialization of certain of ViaCell s proprietary cellular therapy product candidates. The initial term of the supply agreement is seven years. The Company purchased $1.3 million of cell separation kits in 2006. The Company purchased $0.1 million of kits in the first quarter of 2007 and has a firm order to purchase an additional $0.2 million of cell separation kits in 2007. Since the Company has decided not to advance CB001 into further clinical trials, the Company intends to use these cell separation kits in its other research and development activities.

In addition to the revenues generated by the Company s ViaCord service offering, the Company recorded revenues in the periods presented from a grant agreement with the Economic Development Board (EDB) of the Government of Singapore. The Company maintains a research facility in Singapore. In April 2007, the Company reached a tentative agreement (Agreement) with the EDB with respect to the conclusion of the grant, which expires in May 2007, resolving a dispute related to the impact of a prior period increase in the EDB s cost reimbursement percentage on the cost reimbursement percentage provisions of the grant, and a related dispute concerning an assertion by the EDB that the Company had not fulfilled a commitment to employ a specified number of people in Singapore which was an original condition of the grant. The Company recorded a reduction of grant revenues of approximately $0.2 million during the fourth quarter of 2006 to reflect the estimated potential settlement costs. As a result of the Agreement, the Company revised its settlement estimate resulting in the recognition of $0.1 million of grant revenues in the quarter ended March 31, 2007. The Company expects

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to finalize the Agreement in the quarter ended June 30, 2007. As of March 31, 2007, the Company had received grant payments from EDB totaling approximately $1.9 million and had recognized cumulative grant revenues of approximately $1.8 million. The Company plans to cease operations in Singapore in the quarter ended June 30, 2007. As a result, the Company expects to record a restructuring charge in the range of $0.2 million to $0.3 million related to employee severance and facility-related costs in the quarter ended June 30, 2007.

Litigation

In 2002, PharmaStem Therapeutics, Inc. filed suit against the Company and several other defendants in the U.S. District Court for the District of Delaware, alleging infringement of U.S. Patents No. 5,004,681 (681) and No. 5,192,553 (553), relating to certain aspects of the collection, cryopreservation and storage of hematopoietic stem cells and progenitor cells from umbilical cord blood. The Company believes that it does not infringe these patents and that the patents are invalid.

In 2003, a jury ruled against the Company and the other defendants, Cbr Systems Inc., CorCell, Inc., a subsidiary of Cord Blood America Inc., and Cryo-Cell International Inc, who represent a majority of the family cord blood preservation industry, finding that the patents were valid and enforceable and that the defendants infringed the patents. A judgment was entered against the Company for approximately $2.9 million, based on 6.125% royalties on the Company s revenue from the processing and storage of umbilical cord blood since April 2000. In 2004, the District Court judge in the case overturned the jury s verdict and entered judgment in the Company s favor and against PharmaStem, stating that PharmaStem had failed to prove infringement, consequently the Company has not recorded a liability as of March 31, 2007. PharmaStem has appealed the judge s decision. The Company has appealed the jury s finding as to validity of the patents. A hearing on the appeal was held at the U.S. Court of Appeals for the Federal Circuit, on April 4, 2006 and a final ruling has not been issued.

In July 2004, PharmaStem filed a second complaint against the Company. The second complaint was filed in the U.S. District Court for the District of Massachusetts, alleging infringement of U.S. Patents No. 6,461,645 (645) and 6,569,427 (427), which also relate to certain aspects of the collection, cryopreservation and storage of hematopoietic stem cells and progenitor cells from umbilical cord blood. The Company believes that the patents in this new action are invalid and/or that the Company does not infringe them in any event. On January 7, 2005, PharmaStem filed a Motion for Preliminary Injunction in the Massachusetts litigation. That motion is currently stayed. The Company believes the issues presented in this case are substantially the same as the issues presented in the original Delaware litigation. Accordingly, the Company filed a motion to consolidate the Massachusetts case with six other actions against other defendants in a single proceeding in the District of Delaware. On February 16, 2005, the Company s request was granted. The cases have been consolidated in Delaware.

On October 6, 2005, the Delaware court granted the Company s motion to stay all discovery in the second lawsuit pending decisions from the Federal Circuit on PharmaStem s appeal of the District Court of Delaware s ruling in the original case and from the U.S. Patent and Trademark Office (U.S. PTO) on the patent re-examinations described below.

In late 2006, the U.S. PTO issued final decisions in the existing re-examination of both the 553 method patent and the 681 composition patent at issue in the first case and the 645 and the 427 patents at issue in the second case based on prior art. The U.S. PTO had ordered a second re-examination of the 427 patent in order to determine whether certain claims of the patent should expire in 2008, rather than in 2010. The U.S. PTO issued notice of its intent to allow the remaining claims of all of the patents.

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In either of the pending cases, if the Company is ultimately found to infringe valid claims of the PharmaStem patents, the Company could have a significant damages award entered against it. If the Company is found to infringe at any time during the course of either case, including if the court of appeals were to overturn the district court s non-infringement ruling, the Company could also face an injunction which could prohibit it from further engaging in the umbilical cord stem cell business absent a license from PharmaStem. PharmaStem would be under no legal obligation to grant the Company a license or to do so on economically reasonable terms, and previously informed the Company that it would not do so after October 15, 2004. While the Company does not believe this outcome is likely, in the event of an injunction, if the Company is not able to obtain a license under the disputed patents on economically reasonable terms or at all and the Company cannot operate under an equitable doctrine known as intervening rights, the Company could be required to stop preserving and storing cord blood and to cease using cryopreserved umbilical cord blood as a source for stem cell products. The Company may enter into settlement negotiations with PharmaStem regarding the litigation. The Company cannot predict whether any such negotiations would lead to a settlement of these lawsuits or what the terms or timing of any such settlement might be, if it occurs at all.

The Company has undertaken a review of its various job classifications for legal compliance under state and federal employment laws. Based on that review, the Company has identified certain job classifications that may be subject to possible challenge and for which there is a reasonable possibility that the Company could incur a liability, although the Company also believes that the present classifications can be supported and defended. It is not possible based on the current available information to reasonably estimate the scope of any potential liability.

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

The following discussion and analysis by our management of our financial condition and results of operations should be read in conjunction with our unaudited consolidated financial statements and the accompanying notes appearing at the beginning of this report. This discussion and other parts of this report contain forward-looking statements that involve risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in Part II Item 1A (Risk Factors) of this report.

Overview

ViaCell is a biotechnology company dedicated to enabling the widespread application of human cells as medicine. We have a reproductive health business that generated revenues of $14.4 million in the first quarter of 2007 and $54.1 million in 2006 from sales of ViaCord, a service offering through which expectant