

ACUSPHERE, INC. AND SUBSIDIARIES
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To the Board of Directors and Stockholders of
Acusphere, Inc. and subsidiaries
Tewksbury, Massachusetts

We have audited the accompanying consolidated balance sheets of Acusphere, Inc. and subsidiaries (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of operations, stockholders' equity/(deficit) and comprehensive loss, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2008 and 2007, and the results of its operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company's recurring losses from operations, negative cash flows from operations, and stockholders' deficit raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 1 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

March 30, 2009

ACUSPHERE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands except share data)

	December 31, 2007	December 31, 2008
CURRENT ASSETS:		
Cash and cash equivalents	\$26,102	\$16,450
Other current assets	1,265	1,253
Total current assets	27,367	17,703
PROPERTY AND EQUIPMENT		
Property and equipment, at cost:	54,941	23,225
Less accumulated depreciation and amortization	(31,699)	(19,116)
Property and equipment, net	23,242	4,109
OTHER ASSETS	1,411	1,301
TOTAL ASSETS	\$52,020	\$23,113
LIABILITIES AND STOCKHOLDERS' EQUITY/(DEFICIT)		
CURRENT LIABILITIES:		
Current portion of long-term obligations	\$8,556	\$4,069
Current portion of deferred revenue	4,667	2,545
Current portion of deferred revenue – Cephalon	-	750
Derivative liability	13	-
Accounts payable	1,994	954
Dividend payable	-	996
Accrued expenses	3,596	4,614
Total current liabilities	18,826	13,928
LONG-TERM LIABILITIES:		
Long-term obligations, net of current portion	8,206	7,342
Deferred rent	1,248	908
Long-term obligations – Cephalon	-	15,000
Deferred revenue, net of current portion	-	750
Deferred revenue – Cephalon, net of current portion	-	13,688
Total long-term liabilities	9,454	37,688
COMMITMENTS (Note 13)		
STOCKHOLDERS' EQUITY/(DEFICIT):		
Preferred stock, \$0.01 par value per share		
Authorized - 5,000,000 shares as of December 31, 2007 and 2008; Designated 6.5% convertible exchangeable – 1,000,000 as of December 31, 2007 and 2008; issued and outstanding, 690,000 as of December 31, 2007 and 240,000 shares as of December 31, 2008 (liquidation value \$12,000,000 as of December 31, 2008)	7	2
Common stock, \$0.01 par value per share		
Authorized, 98,500,000 shares as of December 31, 2007 and 250,000,000 shares as of 2008; issued and outstanding 46,273,945 shares as of December 31, 2007 and 50,064,602 as of December 31, 2008	463	501
Additional paid-in capital	358,141	373,599
Accumulated deficit	(334,871)	(402,605)
Total stockholders' equity/(deficit)	23,740	(28,503)
TOTAL	\$52,020	\$23,113

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

ACUSPHERE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share data)

	Year Ended December 31,		
	2006	2007	2008
REVENUE (1)	\$ 1,781	\$ 2,667	\$ 2,684 ⁽¹⁾
OPERATING EXPENSES:			
Research and development	52,445	43,175	34,452
General and administrative	11,615	12,219	10,704
Impairment charge	—	—	9,161
Total operating expenses	64,060	55,394	54,317
Interest income	2,541	2,314	410
Loss on extinguishment of debt	—	(1,146)	—
Interest expense	(2,273)	(2,054)	(16,387)
Change in valuation of derivative	922	(117)	(124)
NET LOSS	\$ (61,089)	\$ (53,730)	\$ (67,734)
Dividends on preferred stock	(2,381)	(2,275)	(1,687)
NET LOSS AVAILABLE TO COMMON STOCKHOLDERS	\$ (63,470)	\$ (56,005)	\$ (69,421)
NET LOSS AVAILABLE TO COMMON STOCKHOLDERS PER SHARE—Basic and diluted	\$ (2.30)	\$ (1.31)	\$ (1.46)
WEIGHTED-AVERAGE SHARES OUTSTANDING—Basic and diluted	27,599,220	42,626,612	47,412,162

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

⁽¹⁾ Includes related-party revenue of approximately \$0.6 million for the year ended December 31, 2008 (see Note 15).

ACUSPHERE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY/(DEFICIT)
AND COMPREHENSIVE LOSS

	Convertible Exchangeable Preferred Stock		Common Stock		Additional Paid-in Capital	Deferred Stock-Based Compensation	Accumulated Deficit	Total Stockholders' Equity/Deficit
	Number of Shares	\$0.01 Par Value	Number of Shares	\$0.01 Par Value				
BALANCE, JANUARY 1, 2006	740	\$ 7	22,871	\$ 229	\$ 277,592	\$ (359)	\$ (220,052)	\$ 57,417
Exercise of stock options			68	1	122			123
Issuance of common stock from employee stock purchase plan			14		53			53
Issuance of common stock to board members for services performed			18		80			80
Stock-based compensation					2,339	298		2,637
Deferred stock- based compensation related to non-employees					(39)	39		—
Issuance of common and warrants from financing, net of offering costs			15,032	150	61,361			61,511
Preferred stock conversion including make- whole dividend	(10)		88	1	97			98
Dividends paid on preferred stock					(2,381)			(2,381)
Net loss							(61,089)	(61,089)
BALANCE, DECEMBER 31, 2006	<u>730</u>	<u>7</u>	<u>38,091</u>	<u>381</u>	<u>339,224</u>	<u>(22)</u>	<u>(281,141)</u>	<u>58,449</u>

The accompanying notes are an integral part of these consolidated financial statements. (Continued)

ACUSPHERE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY/(DEFICIT)
AND COMPREHENSIVE LOSS (Continued)

	Convertible Exchangeable Preferred Stock		Common Stock		Additional Paid-in Capital	Deferred Stock-Based Compensation	Accumulated Deficit	Total Stockholders' Equity/Deficit
	Number of Shares	\$0.01 Par Value	Number of Shares	\$0.01 Par Value				
BALANCE, DECEMBER 31, 2006	730	7	38,091	381	339,224	(22)	(281,141)	58,449
Exercise of stock options			103	1	96			97
Issuance of common stock from employee stock purchase plan			22		39			39
Issuance of common stock to board members for services performed			29		62			62
Stock-based compensation					2,214	22		2,236
Issuance of common and warrants from financing, net of offering costs			7,694	77	18,621			18,698
Preferred stock conversion including make-whole dividend	(40)		335	4	160			164
Dividends paid on preferred stock					(2,275)			(2,275)
Net loss							(53,730)	(53,730)
BALANCE, DECEMBER 31, 2007	<u>690</u>	<u>7</u>	<u>46,274</u>	<u>463</u>	<u>358,141</u>	<u>—</u>	<u>(334,871)</u>	<u>23,740</u>

The accompanying notes are an integral part of these consolidated financial statements. (Continued)

ACUSPHERE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY/(DEFICIT)
AND COMPREHENSIVE LOSS (Concluded)

	Convertible Exchangeable Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Equity/Deficit
	Number of Shares	\$0.01 Par Value	Number of Shares	\$0.01 Par Value			
BALANCE, DECEMBER 31, 2007	690	7	46,274	463	358,141	(334,871)	\$23,740
Issuance of common stock from employee stock purchase plan			23		10		10
Issuance of common stock to board members for services performed			182	2	97		99
Beneficial conversion feature of Cephalon Note					14,749		14,749
Stock-based compensation					1,493		1,493
Preferred stock conversion including make- whole dividend	(450)	(5)	3,586	36	796		827
Dividends paid on preferred stock					(1,687)		(1,687)
Net loss						(67,734)	(67,734)
BALANCE, DECEMBER 31, 2008	<u>240</u>	<u>\$ 2</u>	<u>50,065</u>	<u>\$ 501</u>	<u>373,599</u>	<u>\$ (402,605)</u>	<u>\$ (28,503)</u>

The accompanying notes are an integral part of these consolidated financial statements. (Concluded)

ACUSPHERE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	2006	2007	2008
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	\$ (61,089)	\$ (53,730)	\$ (67,734)
<i>Adjustments to reconcile net loss to net cash used in operating activities:</i>			
Stock-based compensation expense	2,718	2,299	1,592
Depreciation and amortization	10,291	10,238	10,045
Loss on disposal of property and equipment	214	250	—
Write-off of noncash intellectual property acquisition cost	1,492	—	—
Loss on extinguishment of debt	—	1,146	—
Noncash interest expense	756	855	15,492
Deferred rent expense	63	1,234	(198)
Amortization of deferred revenue	(1,524)	(2,667)	(2,684)
Amortization of fees and warrants to financial advisor	120	227	263
Change in valuation of derivative	(922)	117	124
Impairment charge	—	—	9,161
<i>Changes in operating assets and liabilities:</i>			
Deferred revenue	2,849	—	15,750
Other current assets	212	(424)	(208)
Accounts payable	(593)	(628)	(1,041)
Accrued expenses	(2,676)	(624)	929
Net cash used in operating activities	<u>(48,089)</u>	<u>(41,707)</u>	<u>(18,509)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(1,090)	(996)	(73)
Increase in other assets	(130)	3	—
Net cash used in investing activities	<u>(1,220)</u>	<u>(993)</u>	<u>(73)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payments on long-term obligations	(4,302)	(8,408)	(6,080)
Proceeds from long-term obligations	2,943	901	15,000
Net proceeds from sales of common stock	61,511	18,698	—
Payment of preferred stock dividends	(2,381)	(2,275)	—
Proceeds from exercise of stock options	123	97	—
Proceeds from issuance of common stock from employee stock purchase plan	53	39	10
Net cash provided by financing activities	<u>\$ 57,947</u>	<u>\$ 9,052</u>	<u>\$ 8,930</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS			
	8,638	(33,648)	(9,652)
CASH AND CASH EQUIVALENTS, Beginning of year	51,112	59,750	26,102
CASH AND CASH EQUIVALENTS, End of year	<u>\$ 59,750</u>	<u>\$ 26,102</u>	<u>\$ 16,450</u>
SUPPLEMENTAL SCHEDULE OF CASH FLOWS INFORMATION:			
Cash paid during the period for interest	<u>\$ 1,366</u>	<u>\$ 1,198</u>	<u>\$ 701</u>
SUPPLEMENTAL SCHEDULE OF NONCASH FINANCING TRANSACTIONS:			
Common stock issued for preferred conversion, including make whole dividend	<u>\$ 98</u>	<u>\$ 164</u>	<u>\$ 141</u>

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

ACUSPHERE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Operations and Basis of Presentation

Operations - Acusphere, Inc. and subsidiaries (“Acusphere” or the “Company”) is a specialty pharmaceutical company that develops new drugs and improved formulations of existing drugs using its proprietary microparticle technology. The Company is focused on developing proprietary drugs that can offer significant benefits over existing drugs, including improved safety and efficacy, increased patient compliance, greater ease of use, expanded indications or reduced cost. The Company’s lead product, Imagify™ (perflubutane polymer microspheres for delivery in an injectable suspension, pronounced i-maj’-i-fi, formerly known as AI-700) is a cardiovascular drug for the detection of coronary artery disease, the leading cause of death in the United States. The Company submitted a new drug application (NDA) with the U.S. Food and Drug Administration (FDA) for Imagify on April 28, 2008. The Company received the FDA response to this application in February 2009 which indicated that additional clinical trial work was necessary for approval.

Listing Status - On January 9, 2009, the Company’s common stock was delisted from the NASDAQ Stock Market. On March 3, 2009, the Company voluntarily filed a Form 15 with the Securities and Exchange Commission (“SEC”) to suspend the Company’s SEC reporting obligations. Upon the filing of the Form 15, the Company’s obligation to file periodic and current reports with the SEC, including Forms 10-K, 10-Q and 8-K, were immediately suspended. The Company expects the registration of its common stock will be terminated 90 days after the filing of the Form 15 with the SEC. As a result of the Form 15 filing, the Company’s securities will not be eligible for trading on any national exchange and will no longer be eligible for trading on the OTC Bulletin Board.

Going Concern Presentation – As of December 31, 2008, the Company had cash and cash equivalents of \$16.5 million, current liabilities of \$13.9 million and stockholders’ deficit of \$28.5 million. During the twelve months ended December 31, 2008, cash flows from operating activities used \$18.5 million of cash and the Company continues to incur losses while developing its products. Based on the Company’s discussions with the FDA in December 2008 and February 2009 regarding Imagify, the Company believes that additional clinical trials would be required for Imagify. The Company will require significant additional funds to both fund operations and to conduct additional trials through and beyond the third quarter of 2009. These conditions raise substantial doubt about the Company’s ability to continue as a going concern. The accompanying consolidated financial statements have been prepared on the basis of a going concern assumption and do not reflect any adjustments that might result from the outcome of this uncertainty.

Management’s Plans – As discussed above, the Company will be required to raise a significant amount of additional funds to fund operations and pursue additional clinical studies that may be recommended by the FDA.

The Company is currently exploring various strategic alternatives to raise the required additional funds and implementing measures to conserve existing cash resources. Management is considering raising additional funds through: public or private sales of equity, merger with or sale to a strategic partner, selling surplus assets related to early stage development programs and monetizing the royalty stream related to other products.

To preserve cash resources, the Company began executing a number of cost reduction initiatives to reduce cash outlays during 2008 and expects to continue the initiatives in 2009. These actions include the following:

- Headcount reductions in 2008 and 2009
- Deferral of payments under intellectual property agreements obligations due in 2009
- Termination of the Watertown, Massachusetts headquarters lease and consolidation of the Company’s personnel into the Tewksbury location.

As a result of its limited capital resources, the Company has also elected to delay and may continue to delay the funding of certain development activities, including activities related to the commercialization or further development of Imagify. During 2008 the Company licensed AI-850, the Company’s formulation of paclitaxel and AI -525, a preclinical-stage injectable formulation of celecoxib (see Note 8) to Cephalon. The Company’s note payable with Cephalon (see Note 6) provides Cephalon the right to convert the note either into (i) 51% of the Company’s fully-diluted common stock, (ii) the right to enter into an exclusive license to all the intellectual property rights of the Company relating to Imagify; or (iii) the satisfaction of a milestone payment on the celecoxib license.

There are no assurances that the Company will be able to obtain additional financing or monetize its assets on favorable terms, or at all, or successfully obtain regulatory approval to allow marketing of its products. If the Company is unable to execute its operations according to its plans or to obtain additional financing prior to the third quarter of 2009, it may be forced to cease operations and liquidate the remaining assets of the Company.

Risks and Concentrations - The Company is subject to a number of risks similar to those of pre-commercial stage companies, including dependence on key individuals, uncertainty of product development and generation of revenues, dependence on outside sources of capital, risks associated with clinical trials, dependence on third party collaborators for research operations, need for regulatory approval of products, successful protection of intellectual property, and competition with larger, better-capitalized companies.

Successful completion of the Company's development program and, ultimately, the attainment of profitable operations is dependent on future events, including obtaining adequate financing to fulfill its development activities and achieving a level of revenues adequate to support the Company's cost structure.

2. Summary of Significant Accounting Policies

The accompanying consolidated financial statements reflect the application of certain accounting policies described below and elsewhere in the notes to the consolidated financial statements.

Principles of Consolidation—The accompanying consolidated financial statements include Acusphere, Inc. and its wholly-owned subsidiaries, Acusphere Securities Corporation and Acusphere Limited. Acusphere Securities Corporation was established in December 1996 as a Massachusetts securities corporation. Acusphere Limited was established in 2004 for statutory purposes and has no operations, employees or assets. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 estimated or assumed. The more significant estimates reflected in these financial statements relate to revenue recognition, asset impairments, accrued expenses, embedded derivatives, and valuation of stock-based compensation.

Cash and Cash Equivalents—Cash equivalents consist of short-term, highly liquid investments, including money market accounts, with original maturity dates of 90 days or less when purchased. Cash equivalents are carried at cost, which approximates their fair value.

Property and Equipment—Property and equipment are recorded at cost and depreciated over their estimated useful lives of three to five years using the straight-line method. The majority of equipment is related to ongoing research and development activities, including equipment intended for commercial manufacture of Imagify. The equipment in the Company's commercial manufacturing facility was placed in service in October 2005 and is being utilized in research and development related activities, including ongoing calibration and testing. Depreciation commences on equipment when it is placed in service. Expenditures for maintenance and repairs are charged to expense as incurred. Expenditures for manufacturing facility start-up, validation, commissioning and qualification costs are charged to expense as incurred. Interest costs associated with the construction of the facility were capitalized in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 34, *Capitalization of Interest*.

Equipment under capital leases and leasehold improvements are depreciated over the lesser of their useful lives or the remainder of the lease term. Depreciation of such equipment and leasehold improvements commences when it is placed in service. Property and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of certain assets might not be recoverable and recognizes a loss when it is probable that the estimated future cash flows will be less than the carrying value of the asset.

Other Assets—Other assets consist primarily of lease related deposits and deferred rent expense.

Concentrations of Credit Risk and Limited Suppliers—The financial instruments that potentially subject Acusphere to concentrations of credit risk are cash and cash equivalents. Acusphere's cash and cash equivalents are maintained in what management believes to be a highly rated commercial bank.

Acusphere relies on certain materials used in its development process, each of which is available from limited sources. The failure of a supplier or subcontractor to deliver on schedule could delay or interrupt the development process and thereby adversely affect Acusphere's operating results.

Revenue—Revenue is recognized from license arrangements in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition* ("SAB 104") and FASB Emerging Issue Task Force Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* ("EITF 00-21"). Revenue from license payments not tied to achieving a specific performance milestone is

recognized ratably over the period over which it is obligated to perform services. The period over which the Company is obligated to perform services is estimated based on available facts and circumstances. The Company periodically evaluates the assumptions underlying these estimates; significant changes in these assumptions could result in an adjustment to the period over which the revenue is recognized. Revenue from performance payments is recognized when such performance is substantially in its control and when the Company believes that completion of such performance is reasonably probable, ratably over the period in time or cost over which it estimates that it will perform such performance obligations. Substantive at-risk milestone payments, which are based on achieving a specific performance milestone when performance of such milestone is contingent on performance by others or for which achievement cannot be reasonably estimated or assured, are recognized as revenue when the milestone is achieved and the related payment is due, provided that there is no substantial future service obligation associated with the milestone. Revenue in connection with license arrangements is recognized over the term of the agreement and is limited to payments collected or due and reasonably assured of being collection. In addition, revenue is not recognized in circumstances where the arrangement includes a refund provision until the refund condition is no longer applicable unless, in its judgment, the refund circumstances are within the Company's operating control and unlikely to occur. Payments received in advance of being recognized as revenue are deferred.

In connection with the Company's feasibility study, contract amounts which are not due until the customer accepts or verifies the research results are not recognized as revenue until customer acceptance, assuming collectibility is reasonable assured.

Research and Development Expenses—Research and development costs primarily consist of salaries, consulting and contract services and material costs. These expenses include related costs for clinical sites enrolling patients in the Imagify Phase 3 clinical program, costs for clinical data management and independent clinical site monitoring and operating costs associated with efforts to build-out and qualify a commercial manufacturing facility. Research and development expenses also include costs to acquire patents, which are expensed if technological feasibility has yet to be achieved. Acusphere charges all research and development expenses to operations as incurred.

Derivative Financial Instruments—The Company's 6.5% convertible exchangeable preferred stock contains a feature whereby, prior to March 1, 2009, if the Company elects to automatically convert, or if any holder elects to voluntarily convert, the preferred stock, the Company will also make an additional payment ("make-whole payment") equal to the aggregate amount of dividends that would have been payable on the preferred stock so converted from the original date of issuance of February 24, 2005 through and including March 1, 2009, less any dividends already paid on the preferred stock. This feature represents an embedded derivative which is required to be accounted for separately from the preferred stock. The estimated fair value of this feature is valued using a risk-weighted binomial model that incorporates factors such as the Company's cost of capital, stock price volatility and the estimated timing of preferred stock conversions. Changes in the estimated fair value of the liability represented by these factors, as well as any make-whole payments, are charged to the consolidated statements of operations as unrealized gain or loss on derivative. These adjustments will be required until the feature is either triggered or expires.

The Company's loan agreement with MassDevelopment contains a feature providing for a retroactive interest rate increase in the event the Company achieves positive operating cash flow, as defined in the agreement, prior to repayment of the loan. This feature represents an embedded derivative which is required to be accounted for separately from the related loan. The estimated fair value of this feature is valued using a risk-weighted discounted cash flow methodology that incorporates factors such as the Company's cost of capital and the probability and estimated timing of the Company achieving positive operating cash flow, as defined. Changes in the estimated fair value of the liability represented by these factors are charged to the consolidated statements of operations as unrealized gain or loss on derivative. These adjustments will be required until the feature is either triggered or expires.

Income Taxes—Deferred tax liabilities and assets are provided for differences between the book and tax bases of existing assets and liabilities and tax loss carryforwards and credits, using tax rates expected to be in effect in the years in which differences are expected to reverse. Valuation allowances are provided to the extent realization of tax assets is not considered more likely than not.

On January 1, 2007 the Company adopted FASB Interpretation No. 48 ("FIN 48"), "*Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109*," which clarifies the accounting for uncertainty in income tax positions. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

There were no unrecognized tax benefits as of the date of adoption January 1, 2007. As a result of the implementation of FIN 48, the Company did not recognize an increase in the liability for unrecognized tax benefits. There are no unrecognized tax benefits included in the balance sheet that would, if recognized, affect the effective tax rate. The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company had no accrual for interest or penalties on the Company's

balance sheets at December 31, 2007 and at December 31, 2008, and has not recognized interest and/or penalties in the statement of operations for the years ended December 31, 2007 and 2008.

Stock-Based Compensation— Effective January 1, 2006, the Company commenced accounting for stock-based compensation in accordance with the fair value recognition provisions of SFAS 123R, *Share-Based Payment* (“SFAS123R”). Under SFAS 123R, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the appropriate vesting period. Stock-based compensation expense is being recognized on a straight-line basis over the requisite period of the awards. See Note 3 of the Notes to the Consolidated Financial Statements for additional information regarding stock-based compensation expense.

Net Loss Per Share—Basic and diluted net loss per common share is calculated by dividing the net loss applicable to common stockholders by the weighted-average number of common shares outstanding during the period, reduced by the weighted-average number of restricted common shares outstanding during the period. Diluted net loss per common share is the same as basic net loss per common share, since the effects of potentially dilutive securities are antidilutive for all periods presented. Antidilutive securities, convertible exchangeable preferred stock, stock options, warrants, and restricted common stock not included in the diluted net loss per share calculation aggregated 16,028,904, 19,526,186, and 16,739,427 as of December 31, 2006, 2007, and 2008, respectively.

The following table reconciles the weighted-average common shares outstanding to the shares used in the computation of basic and diluted weighted-average common shares outstanding:

Historical	Year Ended December 31,		
	2006	2007	2008
Weighted-average common shares outstanding	27,599,537	42,626,612	47,412,162
Less weighted-average restricted common shares Outstanding	(317)	—	—
Basic and diluted weighted-average common shares Outstanding	27,599,220	42,626,612	47,412,162

Comprehensive Loss—Comprehensive loss is defined as the change in stockholders’ equity/(deficit) during a period from transactions and other events and circumstances from non-owner sources. Comprehensive loss has been the same as net loss for all periods presented.

Disclosures About Segments of an Enterprise—Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision-making group, in making decisions regarding resource allocation and assessing performance. To date, Acusphere has viewed its operations and manages its business as one operating segment.

Recent Accounting Pronouncements— In September 2006, the FASB issued SFAS (SFAS) No. 157, *Fair Value Measurements*, which is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The purpose of FAS No. 157 is to clarify and set forth consistent rules for defining fair value, establishing a framework for measuring fair value in generally accepted accounting principles and expanding disclosures about fair value measurements. FAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements where those accounting pronouncements have determined that fair value is the relevant measurement attribute. SFAS No. 157 does not require any new fair value measurements, but for some entities the application of SFAS No. 157 could change current practice. Except as described below, we have adopted SFAS No. 157 on January 1, 2008. The adoption of SFAS No. 157 did not have a material impact on the Company’s financial statements.

In February 2008, FASB issued FASB FSP FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2). FSP 157-2 will provide a one-year deferral of the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in financial statements at fair value at least annually. For non-financial assets and non-financial liabilities subject to the deferral, SFAS No. 157 will be effective in fiscal years beginning after November 15, 2008 and in interim periods within those fiscal years. The Company is currently evaluating the impact that applying FAS No. 157 to nonfinancial assets and liabilities will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which is effective as of the beginning of an entity’s first fiscal year beginning after November 15, 2007. This statement allows the measurement at fair value of financial instruments and certain other items that are currently not required to be measured at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting

provisions. The fair value option established by this statement permits the measurement of eligible items at fair value at specified election dates, with unrealized gains and losses on the items for which the fair value option has been elected reported in earnings at each subsequent reporting date. SFAS No. 159 was effective for the Company in the first quarter of 2008. The adoption of SFAS No. 159 did not have an impact on the Company's financial statements or condition as the Company did not elect to use fair value measurements on any assets or liabilities under this statement and have not subsequently elected to carry any assets or liabilities at fair value.

In June 2007, the Emerging Issues Task Force issued EITF 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities*, which is effective as of the beginning of an entity's first fiscal year beginning after December 15, 2007. This abstract discusses the treatment of the nonrefundable portion of advance payments made pursuant to an executory contractual arrangement for future research and development activities. Nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the related services are performed. If an entity does not expect the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense. The Company adopted this statement as of January 1, 2008 and it had no effect on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, an amendment of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2008. This Statement changes the disclosure requirements for derivative instruments and hedging activities, requiring enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The Company is assessing the impact, if any, of this pronouncement on its consolidated financial statements.

In June 2008, the FASB ratified the consensus reached on EITF Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock* ("EITF 07-5"). EITF 07-5 clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which would qualify as a scope exception under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption for an existing instrument is not permitted. The Company has various warrants to purchase common stock outstanding which have been included in equity. We are currently evaluating the impact of the adoption of EITF 07-05 on our consolidated financial statements.

3. Stock-based Compensation

Summary of Stock-Based Compensation Plans

In June 2005, the 2005 Stock Option and Incentive Plan (the "2005 Plan") was approved. The 2005 Plan became effective on June 16, 2005 and provided for a maximum of 1.7 million shares of common stock to be issued as incentive stock options ("ISO's"), nonqualified stock options, awards of common stock and direct purchases of common stock by Acusphere employees, officers, directors and consultants. In June 2007, the 2005 Plan was amended and the number of shares available under the Amended and Restated 2005 Stock Option and Incentive Plan (the "Amended 2005 Plan") was increased by 5.0 million shares, to a maximum of 6.7 million shares. The maximum number of shares that may be granted to any employee under the Amended 2005 Plan shall not exceed 1.0 million shares of common stock during any calendar year. Options granted have a term of 10 years and generally vest over four years. The Company settles employee stock option exercises with newly issued shares. As of December 31, 2008, there were 3.9 million options outstanding under the Amended 2005 Plan, and 2.8 million shares available for future stock and option grants.

In July 2003, the 2003 Stock Option and Incentive Plan (the "2003 Plan") was approved. The 2003 Plan became effective on the closing of the Company's IPO on October 14, 2003 and provides that a maximum of 2.5 million shares of common stock may be issued as ISO's, nonqualified stock option, awards of common stock and direct purchases of common stock by Acusphere employees, officers, directors and consultants. The maximum number of shares that may be granted to any employee under the 2003 Plan shall not exceed 583,334 shares of common stock during any calendar year. Options granted have a term of 10 years and generally vest over four years. The Company settles employee stock option exercises with newly issued shares. As of December 31, 2008, there were 1.6 million options outstanding under the 2003 Plan and 0.9 million shares available for future stock and option grants.

In July 2003, the 2003 Employee Stock Purchase Plan (the "Purchase Plan") was approved which became effective on the closing of the Company's IPO on October 14, 2003. The Purchase Plan provides for the issuance of a maximum of 233,334 shares of common stock. Eligible employee may contribute up to 10% of their total cash compensation with a maximum of 417 shares semi-annually. The first sale of shares under this plan occurred on February 29, 2004. During 2006, 2007 and 2008, 14,172, 21,911 and 22,518 shares, respectively, of common stock were sold to employees under this plan. Acusphere had 162,756 shares available for future sales

of common stock under this plan at December 31, 2008.

In March 1994, the 1994 Stock Plan (the "1994 Plan") was approved. The 1994 Plan, as amended, provided that a maximum of 1,423,663 shares of common stock could be issued as ISOs, nonqualified stock options and stock grants. The Company ceased granting awards under the 1994 Plan after March 7, 2004. As of December 31, 2008, there were 0.8 million options outstanding under the 1994 Plan.

Accounting for Stock-Based Compensation Plans

Effective January 1, 2006, the Company adopted SFAS No. 123R, *Share-Based Compensation* ("SFAS 123R") using the modified prospective method, which results in the provisions of SFAS 123R being applied to the consolidated financial statements on a going-forward basis. SFAS 123R requires companies to recognize stock-based compensation awards granted to its employees as compensation expense on a fair value method. Under the fair value recognition provisions of SFAS 123R, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the service period, which generally represents the vesting period. The grant date fair value of stock options is calculated using the Black-Scholes option-pricing model and the grant date fair value of restricted stock is based on intrinsic value. The expense recognized over the service period is required to include an estimate of the awards that will be forfeited.

All stock-based awards to non-employees are accounted for at their fair value in accordance with SFAS 123R and Emerging Issues Task Force No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. Under this method, the equity-based instrument was valued at either the fair value of the consideration received or the equity instrument issued on the date of grant. The resulting compensation cost was recognized and charged to operations over the service period, which was usually the vesting period.

Stock compensation expense under SFAS 123R for the years ended December 31, 2006, 2007 and 2008 is as follows (in millions):

	Year Ended December 31,		
	<u>2006</u>	<u>2007</u>	<u>2008</u>
Research & development	\$1.1	\$1.0	\$0.7
General & administrative	<u>1.5</u>	<u>1.2</u>	<u>0.8</u>
Total	<u>\$2.6</u>	<u>\$2.2</u>	<u>\$1.5</u>

In accordance with SFAS 123R, the Company will report any excess tax benefits from the exercise of non-qualified stock options as financing cash flows. There were no excess tax benefits recorded from the exercise of non-qualified stock options for the years ended December 31, 2008, 2007 or 2006.

For purposes of recording stock option-based compensation expense as required by SFAS 123R, the fair values of each stock option granted under the Company's stock option plan for the fiscal year ended December 31, 2008 were estimated as of the date of grant using the Black-Scholes option-pricing model. The weighted average fair value of all stock option grants issued for the fiscal year ended December 31, 2006, 2007 and 2008 was \$2.14, \$1.17 and \$0.33, respectively.

The fair values of all stock option grants issued were determined using the following weighted average assumptions:

	Year Ended December 31,		
	<u>2006</u>	<u>2007</u>	<u>2008</u>
Risk-free interest rate	4.6%	4.6%	2.89%
Expected volatility of underlying stock	40.3%	51.7%	67.8%
Expected life of option grants (years)	5.0	5.0	5.0

The fair values of options granted during six-month subscription period ended February 28, 2006, 2007 and 2008 under the Company's Purchase Plan were calculated using the following weighted-average assumptions:

	<u>2006</u>	<u>2007</u>	<u>2008</u>
Risk-free interest rate	4.8%	5.1%	2.0%
Expected volatility of underlying stock	37.0%	49.8%	66.9%
Expected life of option (years)	0.5	0.5	0.5

The fair values of options granted during six-month subscription period ended August 31, 2006, 2007 and 2008 under the Company's Purchase Plan were calculated using the following weighted-average assumptions:

	<u>2006</u>	<u>2007</u>	<u>2008</u>
Risk-free interest rate	4.9%	4.2%	1.97%
Expected volatility of underlying stock	44.3%	54.4%	75.9%
Expected life of option (years)	0.5	0.5	0.5

The risk-free rates for the stock option plans and the Purchase Plan are the weighted average of the yield rates on 5-year U.S. Treasury notes on the dates of the stock option grants and the yield rates on 6-month U.S. Treasury bills at the inception of each Purchase Plan subscription period, respectively. The Company used the historical volatility of the Company's market-traded stock for the expected volatility assumption input to the model. A dividend yield of zero is based on the fact that the Company has never paid cash dividends and has no present intention to pay cash dividends on its common stock.

As share-based compensation expense is recognized based on awards ultimately expected to vest, compensation expense is reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeiture rates are calculated based on actual historical forfeitures.

The expected life of employee stock options represents the weighted-average period the stock options are estimated to remain outstanding. The expected life of employee stock options is, in part, a function of the options' remaining contractual life and the extent to which the option is in-the-money (i.e., the average stock price during the period is above the strike price of the stock option). The Company estimates that, based on these variables, options are likely on average to be exercised in approximately 5 years. The option life for options under the Purchase Plan is six months, representing the time period under which the option may be exercised as defined in the plan.

Stock Option Activity

During the year ended December 31, 2008, the Company granted stock options to existing employees, as part of the Company's performance review process and new employees and directors in lieu of cash based compensation. All such options were granted with exercise prices equal to the current market value of the underlying common stock on the date of grant. Stock option activity under the 1994, 2003 and 2005 Plans was as follows:

	<u>Number of Shares</u>	<u>Exercise Price Per Share</u>	<u>Weighted- Average Exercise Price Per Share</u>	<u>Weighted- Average Remaining Contractual Life</u>	<u>Aggregate Intrinsic Value</u>
Balance, January 1, 2008	4,679,776	\$ 0.63 - \$13.02	\$ 4.99	7.5	\$8.50
Granted	3,448,091	0.07 - 0.68	0.57		
Exercised	—	—	—		
Forfeited	(1,768,102)	0.555 - 13.02	2.58		
Balance, December 31, 2008	6,359,765	\$ 0.07 - \$13.02	\$ 3.26	6.22	\$0.00
Vested or Expected to Vest, December 31, 2008	5,711,548	\$0.07 - \$13.02	\$3.26	6.22	\$0.00
Exercisable, December 31, 2008	3,640,735	\$0.07 - \$13.02	\$4.87	5.0	\$0.00
Exercisable, December 31, 2007	2,818,213	\$0.63 - \$13.02	\$5.92	6.6	\$0.00

The following table summarizes information relating to currently outstanding and exercisable options as of December 31, 2008 as follows:

<u>Exercise Price</u>	<u>Number of Shares</u>	<u>Outstanding Weighted-Average Remaining Contractual Life (in Yrs)</u>	<u>Weighted Average Exercise Price</u>	<u>Exercisable Number of Shares</u>	<u>Weighted Average Exercise Price</u>
\$ 0.00 - 1.30	3,216,804	7.6	\$ 0.62	949,705	\$ 0.71
1.31 - 2.60	717,005	6.2	2.47	449,596	2.40
2.61 - 3.91	201,024	7.1	3.52	176,241	3.55
3.92 - 5.21	221,013	4.0	4.80	201,366	4.80
5.22 - 6.51	1,131,916	4.6	5.85	1,001,409	5.86
6.52 - 7.81	210,169	2.5	7.08	200,584	7.11
7.82 - 9.11	232,349	4.2	8.81	232,349	8.81
9.12 - 10.42	158,500	4.0	9.58	158,500	9.58
10.43 - 13.02	270,985	3.9	13.02	270,985	13.02
	<u>6,359,765</u>	<u>6.2</u>	<u>\$ 3.26</u>	<u>3,640,735</u>	<u>\$ 4.87</u>

The total cash received from employees as a result of employee stock option exercises during the years ended December 31, 2006, 2007 and 2008 was approximately \$0.1 million, \$0.1 million and \$0, respectively. The intrinsic value of options exercised in 2006, 2007 and 2008 was \$2.6 million, \$0.1 million and \$0, respectively.

As of December 31, 2008, there was \$1.3 million of total expected unrecognized compensation cost related to unvested stock options granted under the Company's stock-based compensation plans. That cost is expected to be recognized over a weighted-average period of 3.17 years.

The Company issued options to employees to purchase approximately 230,119, and 267,723 shares of common stock during the years ended December 31, 2001 and 2003, respectively, at exercise prices deemed for accounting purposes to be below market value. Acusphere has recorded the difference between the exercise price and the fair value of \$4.9 million in 2001 and \$1.4 million in 2003 as deferred stock-based compensation and amortized this deferred compensation as charges to operations over the vesting periods of the options. At December 31, 2006, approximately \$22,000 of deferred compensation had yet to be recognized. This amount was recognized in the first quarter of fiscal 2007.

4. Balance Sheet Data

(in thousands)

	<u>As of December 31,</u>	
	<u>2007</u>	<u>2008</u>
Other assets consist of the following:		
Lease deposits	\$ 1,126	\$ 1,126 (1)
Other assets	<u>285</u>	<u>175</u>
	<u>\$ 1,411</u>	<u>\$ 1,301</u>
Accrued expenses consist of the following:		
Accrued contract services	\$ 1,404	\$ 826
Accrued vacation	517(2)	135
Accrued bonus	129	1,113(3)
Other accrued expenses	<u>1,546</u>	<u>2,540(4)</u>
	<u>\$ 3,596</u>	<u>\$ 4,614</u>

(1) – In March 2009, as a result of the Watertown lease termination agreement, the Company released to the landlord the entire amount of the security deposit of \$997,500.

(2) – The Company’s current vacation policy allows employees to carry over unused vacation time as of December 31 of each year, up to a maximum of two weeks. However, several employees who joined the Company prior to the institution of this vacation policy had accumulated more than two weeks vacation at December 31, 2007. These employees had been allowed to carry this excess vacation accrual forward each year. In April 2008 approximately \$0.7 million of this accumulated vacation liability to employees was paid in a lump sum payment.

(3) – In September 2008, the Board approved a supplemental bonus program for full time employees employed by the Company as of September 15, 2008. Employees who carry the title of Vice President or above are not eligible for this program. The amount of the bonus will be 25% of such employee’s base salary at the time of the payment. The bonus is contingent upon such employees remaining an employee of the Company through receipt of the FDA’s complete response letter to the Company’s NDA for Imagify which was on the Prescription Drug User Free Act (“PDUFA”) action date of February 27, 2009

On December 12, 2008, the Board also adopted an Executive Retention Bonus Plan (the “Retention Bonus Plan”), which provides that each Executive shall receive a retention bonus equal to one-third of their base salary in effect as of December 16, 2008. The Company will pay the Retention Bonus if (a) such Executive remains employed by the Company through the date that is fifteen days after the PDUFA date for Imagify™, which was February 27, 2009 (the “Payment Date”) or (b) such Executive is terminated by the Company as a result of the termination of their position prior to the Payment Date.

Amounts due under the supplemental bonus and Retention Bonus Plan were accrued for over the service period. The potential bonuses total approximately \$1.9 million at the end of the service period, or February 27, 2009 and is expected to be paid in full by March 31, 2009.

(4) – Includes \$0.6 million payable under an intellectual property license agreement with Bracco. On July 29, 2008, the Company entered into an amendment (the “Amendment”) to the Bracco International BV (“Bracco”) patent license agreement. See “Footnote 6. Intellectual Property”.

5. Impairment Charges and Property and Equipment

It was determined in the fourth quarter of 2008 as a result of the FDA Advisory Panel’s meeting (and subsequently validated with correspondence and discussion with FDA) that additional clinical trials relative to Imagify would likely be required and, therefore, the Company determined that it needed to perform an impairment review specific to the carrying value of our long lived assets in accordance with the provisions of SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets* (“SFAS No. 144”). In assessing the carrying value of the Company’s long-lived assets the Company determined that the probability weighted expected cash flows for the long lived assets suggested that the undiscounted cash flows were not determinable at this time to recover the carrying value of the related assets during the remaining life of the asset. To determine the fair value of the assets, the Company used a market approach estimating the amount that we would received from a willing buyer and seller based upon prices of similar assets. The Company recognized impairment charges of \$9.2 million related to leasehold improvements.

Property and equipment at cost consist of the following (in thousands):

	As of December 31,		Estimated Useful Life
	2007	2008	
Equipment	\$ 22,630	\$ 22,755	3-5 years
Furniture and fixtures	470	470	5 years
Leasehold improvements	31,648	—	Lease term (a)
Sub-total depreciable assets	54,748	23,225	
Less: accumulated depreciation and amortization	(31,699)	(19,116)	
Total depreciable assets, net	23,049	4,109	
Deposits on equipment purchases	193	—	N/A
Total property and equipment, net	\$ 23,242	\$ 4,109	

(a) The Company depreciates leasehold improvements and equipment under capital leases over the lesser of their useful lives or the remainder of their respective lease terms.

Leasehold improvements primarily represented costs incurred for the build-out of the Company’s commercial manufacturing facility in Tewksbury, Massachusetts, which were being depreciated over the remaining initial lease term. Deposits on equipment purchases generally represent progress payments made for long-lead time capital equipment purchases. Depreciation on leasehold improvements related to this commercial manufacturing facility commenced upon the latter of completion of the improvements or October 2005, at

which time the Company received an occupancy permit and began operating use of the facility.

6. Intellectual Property

The Company expenses intellectual property costs incurred in obtaining license rights and patent rights to technology or products for which technological feasibility has not been commercially demonstrated and no alternative future use has been shown to exist. No amount has been capitalized by the Company relating to the costs of intellectual property developed or acquired by the Company.

GE Healthcare - On June 1, 2006, the Company entered into an agreement to license on a non-exclusive basis various ultrasound-related intellectual property from GE Healthcare (“GE”), a division of General Electric Company. In consideration of the non-exclusive license of these patents, the Company agreed to pay GE \$10.0 million prior to commercial approval of Imagify, of which \$5.0 million was paid in June 2006 and \$5.0 million was due in June 2007. Effective May 11, 2007 the Company entered into an amendment (the “First GE Amendment”) to the GE patent license agreement. Under the First GE Amendment, \$1.5 million was paid to GE in May 2007 and the Company was due to make a series of six (6) consecutive quarterly installments of approximately \$0.9 million due on the first day of the third month of each calendar quarter, commencing on June 1, 2008. Under this First Amendment, the present value of the revised cash flows exceeded 10% of the original cash flows and therefore the modification of the terms has been accounted for as a debt extinguishment. As a result of the debt extinguishment, the Company recognized \$1.1 million in other expense—extinguishment of debt, during the second quarter of 2007, representing the present value of the modified payment terms. The difference between the present value of the modified liability and the actual cash payments due, or approximately \$0.9 million, is being amortized as interest expense over the remaining term of the liability using the revised effective interest rate.

On May 15, 2008, the Company entered into a second amendment (the “Second GE Amendment”) to the GE patent license agreement. The Second GE Amendment provides that, in lieu of the series of payments from the First Amendment, the Company modified the payments such that the first installment of \$0.9 million was due on June 1, 2008 and was paid in May 2008 and the remaining installment was due and payable on October 1, 2009 in an amount consisting of (i) the amount of approximately \$4.6 million in principal plus (ii) interest accruing on such principal amount from July 1, 2008 at the rate of 6% per annum until paid in full. If receipt of regulatory approval by the U.S. Food and Drug Administration to market Imagify in the United States, or the approval of a Marketing Authorization Application (“MAA”) to market Imagify in Europe, is received prior to the October 1, 2009 due date, any then remaining balance of the approximately \$4.6 million (plus interest accrued to such date) payable as described above was to be immediately due and payable in full.

On February 11, 2009, the Company entered into an amendment (the “Third GE Amendment”) to the License Agreement by and between the Company and GE dated as of June 1, 2006. The Third GE Amendment provides that, in lieu of the payments from the Second Amendment, the Company shall make a series of payments due as follows: (i) \$250,000 due on February 11, 2009, (ii) \$250,000 due upon the closing of an equity or debt investment in the Company or credit facility made available to the Company in an amount of at least \$5 million, and (iii) \$4,271,333 payable with accrued interest at a rate of 6% on December 31, 2013; provided, that, within sixty days after the first commercial sale of Imagify in the United States or Europe, prior to December 31, 2013, any then remaining balance of the \$4,271,333 (plus interest accrued to such date) shall be immediately due and payable in full. The terms of the license agreement with GE are otherwise unchanged. The Company has included the approximately \$0.5 million of the current carrying value of the remaining installment in the current portion of long-term liabilities and the remaining \$4.0 million carrying value has been included in long-term obligations at December 31, 2008.

Bayer Schering Pharma AG - On May 11, 2005, the Company entered into a Patent Transfer Agreement with Bayer Schering Pharma AG (“Schering”) pursuant to which the Company acquired rights, title and interest in certain ultrasound-related patents from Schering. In consideration of the transfer and assignment of these patents, the Company agreed to pay Schering a total of \$7.0 million of which \$1.0 million was paid in May 2005, \$3.0 million was paid in May 2006, and \$3.0 million was due in May 2007.

Effective April 27, 2007 the Company entered into an amendment (the “First BSP Amendment”) to the Schering patent transfer agreement. The First BSP Amendment provided that, in lieu of this final \$3.0 million payment due in May 2007, the Company agreed to make a series of payments as follows: \$1.5 million was paid in May 2007; \$1.0 million was due in May 2008 and \$1.0 million was due in May 2009.

On May 15, 2008, the Company entered into a second amendment (the “Second BSP Amendment”) to the Schering patent transfer agreement. The Second BSP Amendment provides that, in lieu of the payments required in the First BSP Amendment, the Company shall make a series of payments due as follows: \$200,000 on or before fifteen days following execution of the Second BSP Amendment and \$1.8 million on or before fifteen days after May 11, 2009. The \$200,000 payment was paid in May 2008.

On February 12, 2009, the Company entered into a third amendment (the “Third BSP Amendment”) to the Patent Transfer Agreement by and between the Company and Schering dated as of May 11, 2005. The Third BSP Amendment provides that, in lieu of the \$1.8

million payment due on or before fifteen days after May 11, 2009, the Company shall instead pay Schering a total of \$1.8 million as follows: (i) \$100,000 on or before fifteen days after the execution of the Third BSP Amendment; (ii) \$100,000 on or before fifteen days after the earlier of (a) the closing by Acusphere of an equity financing in excess of \$10 million or (b) May 11, 2013; and (iii) \$1.6 million on or before fifteen days after May 11, 2013. The terms of the patent transfer agreement with Schering are otherwise unchanged. The Company has included \$0.2 million of the current carrying value of the \$1.8 million in the current portion of long-term obligations and the remaining \$1.6 million current carrying value in long-term obligations at December 31, 2008.

Bracco International BV - On June 1, 2006, the Company entered into an agreement to license on a non-exclusive basis various ultrasound-related intellectual property from Bracco International BV (“Bracco”). The agreement provides the Company with use of Bracco’s ultrasound-related patents and patent applications in combination with the Company’s lead product candidate Imagify in the field of ultrasound diagnostic imaging. The term of the agreement extends until expiration of the last of the patents licensed under the agreement. In consideration for the non-exclusive license of these patents, the Company agreed to pay Bracco up to a total of Euros 3.0 million, of which Euros 0.5 million (approximately \$0.6 million USD) was paid in June 2006. On July 29, 2008, the Company entered into an amendment to the Bracco patent license agreement (“amendment”). Under the Bracco patent license agreement, the Company was obligated to make a payment of Euros 500,000 (approximately \$0.8 million USD) to Bracco within five business days after the acceptance by the FDA of a new drug application filing package for Imagify. The FDA accepted the Company’s application on June 28, 2008, making such payment to Bracco due on July 8, 2008. The Amendment reduces the amount of the payment due on July 8, 2008 to Euros 100,000 (approximately \$0.2 million USD), and provides that an additional payment of Euros 400,000 (approximately \$0.6 million USD) will be due on the first anniversary of such acceptance by the FDA, or June 28, 2009. The Amendment further provides that the Company grants Bracco a perpetual non-exclusive and royalty-free right and license within the field of ultrasound diagnostic imaging to use and exploit any intellectual property that the Company has developed or may develop after June 1, 2006 which relates to, or to the use or performance of, the patents licensed by Bracco under the Agreement. The Company has made the payment of Euros 100,000 (approximately \$0.2 million USD) in August 2008 and the remaining payment of Euros 400,000 (approximately \$0.6 million) that is due on the first anniversary of such acceptance by the FDA, or June 28, 2009 is classified in accrued expenses as of December 31, 2008. An additional Euros 2.0 million is payable upon the Company’s achievement of certain defined regulatory milestones. The Company also agreed to pay a royalty on future Imagify revenue, up to a maximum royalty amount of Euros 10.0 million, less a portion of the above-referenced milestone payments. These regulatory milestone and royalty obligations have not been recorded at this time since they are contingent upon the outcome of future events.

7. Long-term Obligations

The carrying value of long-term obligations was as follows (in thousands) to the table:

	As of December 31,	
	2007	2008
Capital lease obligations	\$ 67	\$ 39
Notes payable	10,029	20,093
Amounts due under intellectual property agreements	6,666	6,279
Subtotal	16,762	26,411
Less current maturities	8,556	4,069
Long-term obligations, net	\$ 8,206	\$ 22,342

Future payments under all capital leases, notes payable and other long-term obligations are as follows as of December 31, 2008 (in thousands):

Year Ending December 31,	Capital Lease Obligations	Notes Payable	Other Long-Term Obligations
2009	\$32	\$3,582	\$700
2010	9	548	—
2011	—	15,335	—
2012	—	335	—
2013	—	—	5,579
Thereafter	—	763	—
Total future minimum payments	41	20,563	6,279
Less amount representing future interest	2	469	—
Present value of future minimum payments	39	20,094	6,279
Less current portion of long-term obligations	30	3,339	700
Long-term portion of long-term obligations	\$ 9	\$ 16,755	\$ 5,579

Capital Lease Obligations

The Company leases capital equipment through Banc of America Leasing Corporation. The remaining monthly payments range from \$460 to \$1,019 with maturities through June 2010. Interest rates for the above leases range from 7.3% to 9.4%. Acusphere does not have any additional borrowing availability under these lease arrangements as of December 31, 2008. At December 31, 2007 and 2008, the net carrying value of equipment under capital leases amounted to approximately \$67,000 and \$39,000, respectively.

Notes Payable

Equipment Promissory Notes— The Company borrowed an aggregate of \$12.9 million under an equipment financing line with General Electric Capital Corporation. No additional amounts may be borrowed under this line. Borrowings are collateralized by the equipment financed, with repayment due in monthly installments over 36 to 48 months, with the last such repayment scheduled for December 2010. Interest rates on these borrowings were fixed at the time of each borrowing and range from 8.7% to 10.7%. The loans under this line are subject to acceleration upon certain events of default, including but not limited to: i) the failure to make timely payments of principal and interest, ii) a default on other material obligations, or iii) a material adverse change in the financial condition of the borrower. As of December 31, 2008, the Company had \$1.7 million outstanding under the line. No additional amount may be borrowed under this line. Subsequent to year end, the company has paid off the outstanding balances under the line.

The Company borrowed an aggregate of \$7.0 million under an equipment financing line with Oxford Finance Corporation. As of December 31, 2008, the Company had \$1.6 million outstanding under the line. Borrowings are collateralized by the equipment financed, with repayment due in monthly installments over 36 to 48 months, with the last such repayment scheduled for March 2010. Interest rates on these borrowings were fixed at the time of each borrowing and range from 10.3% to 10.9%. The loans under this line are subject to acceleration upon certain events of default, including but not limited to the failure to make timely payments of principal and interest, a default on other material obligations, or a material adverse change in the financial condition of the borrower. No additional amount may be borrowed under this line.

Cephalon Note— On November 3, 2008, the Company closed a transaction in which Cephalon, Inc. (“Cephalon”), a related party (see Note 10) purchased a \$15 million senior secured convertible note (the “Cephalon Note”). The Cephalon Note includes an annual interest rate of 8.0% payable annually over three years in cash or shares of the Company’s common stock at the Company’s election. The Cephalon Note is secured by certain assets of the Company, including all of the Company’s intellectual property, pursuant to the terms of a Pledge and Security Agreement with Cephalon. The Cephalon Note is subject to acceleration and an increased interest rate of 15% upon the happening of customary events of default, including the failure to make timely payments of principal and interest.

The Cephalon Note is convertible at Cephalon’s option any time prior to November 3, 2009 into one of the following: (i) the greater of (A) the number of shares of the Company’s common stock equal to \$15 million divided by \$0.486 (subject to certain adjustments as provided in the Cephalon Note) or (B) the number of shares of the Company’s common stock equal to 51% of the Company’s outstanding common stock on a fully-diluted basis as calculated as set forth in the Cephalon Note on the date of conversion of the Cephalon Note, (ii) the right to enter into an exclusive license to all intellectual property rights of the Company relating to Imagify™ (Perflubutane Polymer Microspheres) for Injectable Suspension (the “Imagify License”) to use, distribute and sell Imagify for all current and future indications including coronary heart disease, in a worldwide territory, excluding those European countries for which Nycomed Danmark ApS has rights pursuant to that certain Collaboration, License and Supply Agreement dated as of July 6, 2004, as amended, or (iii) the satisfaction of Cephalon’s obligation to pay the Company the \$15 million milestone payment for approval of the injectable formulation of celecoxib by the FDA for any indication pursuant to the Celecoxib License. In connection with the possible conversion of the Cephalon Note into shares of the Company’s common stock, the Company has also entered into a registration rights agreement with Cephalon pursuant to which the Company has agreed to register for resale shares of the Company’s common stock held by Cephalon.

The Company compared the effective conversion price for the conversion option of the note into the Company’s common stock with the value of the common share on the transaction date to determine if the note had an embedded beneficial conversion feature in accordance with EITF 00-27, *Application of Issue No. 98-5 to Certain Convertible Instruments*. Based on this computation, the Company determined that the beneficial conversion feature was \$14.7 million and recorded this amount as a discount on the note payable with an offsetting amount credited to additional paid-in capital. As Cephalon may redeem the value of the note under certain conversion options described above, the note was considered callable and the discount was immediately recognized into interest expense. If Cephalon elects to convert the Cephalon Note into the right to enter into the Imagify License, the Company is entitled to a \$40 million regulatory milestone payment upon final FDA approval of the first NDA for Imagify for the detection of coronary artery disease and certain royalty payments based on future sales by Cephalon of Imagify. The term of the Imagify License would extend until the expiration of the last of the patent rights licensed under such agreement.

The Cephalon Note was issued pursuant to a Note Purchase Agreement between the Company and Cephalon (the “Note Purchase Agreement”), which provides for customary representations and warranties and covenants regarding the conduct of the Company’s business for so long as the Cephalon Note remains outstanding or Cephalon holds at least 25% or more of the Company’s outstanding voting securities (the “Restricted Period”). The Company has also granted Cephalon preemptive rights during the Restricted Period. In addition, from and after the conversion of the Cephalon Note and for so long as Cephalon holds at least 25% or more of the Company’s outstanding voting securities, Cephalon will have the right to designate that number of directors to the Company’s Board of Directors that is proportional to its equity interest, provided that any future transaction between the Company and Cephalon must be approved by a committee of directors consisting entirely of directors that are independent of Cephalon.

Facility Loan Agreement— In March 2005 the Company borrowed \$2.0 million under a loan agreement with MassDevelopment to help finance certain tenant improvements to its commercial manufacturing facility in Tewksbury, Massachusetts. The loan is secured by certain improvements made at the facility, interest accrues at 5.0% per annum with retroactive adjustments to 9.0% in the event the Company achieves positive operating cash flow, as defined in the agreement, prior to repayment of the loan. Accrued principal and interest are being repaid over a 10 year term. The loan is subject to acceleration upon certain customary events of default, including failure to timely pay principal and interest, events of defaults under other indebtedness or obligations, or if the Company does not extend its lease on its facility by October 30, 2009. Acusphere began making payments on this loan in May 2007 and as of December 31, 2008, has \$1.8 million outstanding under the loan, including principal and interest.

The retroactive interest rate adjustment feature of the loan agreement was deemed to be an embedded derivative instrument requiring separate accounting under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and was initially valued at \$62,000. The derivative asset is being amortized as interest expense over a term beginning with the loan agreement effective date and ending with the currently expected payment date of the retroactive interest. The fair value of the derivative liability will be re-measured at each reporting period, with any change in value charged or credited to interest expense. There was no change in the estimated fair value of the derivative liability at December 31, 2008 and is immaterial.

FASB Statement No. 157 *Fair Value Measurements* (“SFAS No. 157”) establishes a three-tier fair value hierarchy, which classifies the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices for identical instruments in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions. The fair value of the derivative liability is determined utilizing a model which is classified as Level 3 under SFAS No. 157.

Amounts Due Under Intellectual Property Agreements

As discussed in Note 6 there are amounts due under Intellectual Property Agreements. As of December 31, 2008, the Company has included approximately \$0.7 million in the current portion of long-term obligations, representing payments due under the GE and Schering agreements within the next twelve months. Under the Company’s Patent License Agreement with Bracco, a payment of Euros 400,000 (approximately \$0.6 million USD) which has been included in accrued expenses is due on the first anniversary of such acceptance by the FDA, or June 30, 2009.

Operating Leases

Lease expense for the Company’s real estate leases, which generally have escalating lease payments over the term of the leases, is recorded on a straight-line basis over the lease term, as defined in SFAS No. 13, *Accounting for Leases*. The difference between the expense recorded in the consolidated statements of operations and the amount paid is recorded as deferred rent and is included in the consolidated balance sheets.

8. Revenue and Deferred Revenue

Cephalon

On March 28, 2008, the Company entered into a license agreement (the “Cephalon License”) with Cephalon, Inc. a related party (See Note 10), providing Cephalon with an exclusive, worldwide license to the Company’s Hydrophobic Drug Delivery System (HDDS)TM for oncology applications, along with the rights to AI-850, the Company’s formulation of paclitaxel, in exchange for a cash payment of \$10.0 million, paid upon the execution of the agreement. The term of the agreement extends until expiration of the last of the patents licensed under the agreement. During the term of the license the Company is obligated to support Cephalon activities in connection with AI-850. This support includes allowing access to Acusphere personnel for discussions relating to regulatory, scientific and medical technology and to allow access to any records that may be required in connection with any regulatory filings or submissions. On September 2, 2008, the Company entered into a letter agreement amending the Cephalon License. The amendment

did not modify the accounting treatment with respect to the Cephalon License. The Company has recorded this payment in deferred revenue at December 31, 2008, and is recognizing it as income ratably over the remaining estimated useful life of the patents, or approximately 13 years. The Company began recognizing revenue under the Cephalon License in the second quarter of 2008.

On November 3, 2008 the Company closed a transaction with Cephalon and Cephalon paid a \$5 million upfront fee for an exclusive worldwide license to AI-525, a preclinical-stage injectable formulation of celecoxib using the Company's proprietary Hydrophobic Drug Delivery System (HDDS™) technology (the "Celecoxib License"). The terms of the Celecoxib License also include a milestone payment of \$15 million upon the receipt from the US Food and Drug Administration ("FDA") of final approval of the first New Drug Application or NDA with respect to celecoxib for any indication, and certain royalty payments based on future sales by Cephalon of celecoxib. The Company has recorded the \$5.0 million upfront payment in deferred revenue at December 31, 2008 as revenue was not fixed or determinable.

Nycomed

In July 2004, the Company entered into a collaboration, license and supply agreement with Nycomed Danmark APS ("Nycomed") in which the Company granted Nycomed rights to develop and market Imagify in Europe. As of December 31, 2008, Nycomed has paid \$12.0 million in license fees for the Company's research and development efforts, which is being recognized ratably in revenue over the development period. Estimation of this development period involves the evaluation of many assumptions and uncertainties inherent in the performance of a long-term development project. The Company regularly evaluates these assumptions and uncertainties and the estimated development recognition period may change if facts and circumstances change. There was no change in the amortization period during the year ended December 31, 2007. During the third quarter of 2008, management reevaluated the assumptions underlying the development term and revised the estimated development period from 54 months to 66 months. The remaining \$2.2 million of the \$12.0 million in development payments already received, but yet to be recognized as revenue, is included in deferred revenue at December 31, 2008 and will be recognized over the remaining estimated development period.

In October 2005 and February 2006, the Company and Nycomed amended the collaboration agreement to accelerate \$2.0 million in milestone payments in order to fund certain activities associated with brand development and qualification of a commercial manufacturing facility. The \$2.0 million in payments received pursuant to these amendments were considered advances against a future milestone payment for a European regulatory filing, or Marketing Authorization Application ("MAA"). In September 2008, the arrangement with Nycomed was amended. This amendment removed a contingency associated with the \$2.0 million of payments. As a result the \$2.0 million has been included with the aforementioned \$12 million and is being recognized over the 66 month development period utilizing the cumulative catch-up methodology. Approximately \$0.4 million of the \$2.0 million in development payments already received, but yet to be recognized as revenue, is included in deferred revenue at December 31, 2008 and will be recognized over the remaining estimated development period.

On June 26, 2008, the Company executed the Third Amendment (the "Third Amendment") to the Collaboration, License and Supply Agreement dated July 6, 2004 with Nycomed, as amended, for the European development and marketing rights to Acusphere's product candidate AI-700 or Imagify™ (the "Product"). Pursuant to the Third Amendment, Nycomed shall reimburse the Company for expenses arising from and after June 1, 2008 and related to the Company's qualification of its commercial manufacturing facility in Tewksbury, Massachusetts. Such amounts shall not, in the aggregate, exceed \$750,000 and are payable by Nycomed upon receipt of monthly invoices. The Third Amendment further provides that \$750,000 shall be credited against Nycomed's initial purchases of the Product so that Nycomed shall only pay for Products delivered after such \$750,000 has been fully credited. The Company has included the \$750,000 in long-term deferred revenue.

On March 20, 2009, the Company entered into an agreement to terminate and transition its collaboration, license and supply agreement dated as of July 6, 2004, as subsequently amended, with Nycomed. Under the Termination and Transition Agreement (the "Agreement"), the Company reacquires the rights previously granted to Nycomed to develop, promote, market and distribute Imagify™ (Perflubutane Polymer Microspheres) for Injectable Suspension in the European Union, Turkey, Russia and the other members of the Commonwealth of Independent States. Both parties have agreed to an orderly transition of all records and other documents related to regulatory filings and the product from Nycomed to Acusphere. Each party to the Agreement shall incur their own expenses and there shall be no further payments to either party.

In connection with the Company's agreement with Nycomed, the Company is obligated to pay a fee to its financial advisor in this transaction. The total fee \$180,000, \$45,000 and \$0 was paid by the Company in 2006, 2007 and 2008, respectively, is comprised of cash and warrants.

9. Income Taxes

The Company is subject to taxation in the United States and Massachusetts. The Company's tax years for 1994 and forward are subject to examination by the United States and Massachusetts tax authorities due to the carry forward of unutilized net operating losses and R&D credits.

At December 31, 2008, Acusphere had a federal net operating loss ("NOL") carryforward for income tax purposes of approximately \$258 million and a Massachusetts NOL of approximately \$210 million. Acusphere also has approximately \$8.7 million of research and development ("R&D") credits as of December 31, 2008 available to offset future income taxes payable, if any.

The components of Acusphere's deferred tax asset at December 31, 2007 and 2008 are as follows:

(in thousands)	2007	2008
Net operating loss carryforwards	\$89,302	\$101,147
Temporary timing differences:		
Revenue recognition	1,879	7,141
Start-up costs	3,286	1,113
Depreciation	5,721	12,006
Capitalized patent costs	6,303	6,392
Other	<u>1,708</u>	<u>2,046</u>
Subtotal	18,897	28,698
Research and development credit carryforwards	<u>7,696</u>	<u>12,122</u>
Deferred tax asset	115,895	141,967
Less valuation allowance	<u>(115,895)</u>	<u>(141,967)</u>
	<u>\$ —</u>	<u>\$ —</u>

The Tax Reform Act of 1986 contains provisions that may limit the utilization of tax attributes (including NOL carryforwards and R&D credits) available to be used to offset taxable income in any given year, in the event of significant changes in ownership interests, as defined in IRC Section 382. Such limitations are triggered by changes in control in ownership of the Company. The amount of such annual limitation is partially based upon the value of the company and upon the applicable risk free interest rate in effect at the time a cumulative change in control occurs. The Company has not quantified the amount of the limitation, if any. Historically, the Company has financed itself, both as a private company and as a public company, through a series of equity offerings.

Acusphere has established a full valuation allowance equal to the amount of its deferred tax asset as the realization of such asset is uncertain. The Company's effective income tax rate is zero for all periods presented due to the full valuation allowance. The increase in the valuation allowance over the prior year is primarily due to the increase in the NOL carryforward. The valuation allowance increased \$26.0 million in 2006, \$17.0 million in 2007 and \$25.9 million in 2008, primarily as a result of the Company's net loss.

The primary factors affecting our income tax rates for U.S. federal statutory purposes were as follows:

	2006	2007	2008
Federal Income Taxes	(35.0)%	(35.0)%	(34.0)%
Permanent differences	2.9	9.0	8.0
Other	(10.5)	(5.6)	(12.6)
Valuation allowance	<u>42.6</u>	<u>31.6</u>	<u>38.6</u>
Effective tax rate	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>

10. Stockholders' Equity/(Deficit)

Convertible Exchangeable Preferred Stock

On February 24, 2005, the Company issued 900,000 shares of 6.5% convertible exchangeable preferred stock (the "Preferred Stock") at \$50.00 per share resulting in aggregate gross proceeds to the Company of \$45.0 million (net proceeds of approximately \$41.9 million after deducting underwriting discounts, commissions and offering expenses). Each share of Preferred Stock has a liquidation preference of \$50.00 per share. Dividends on the Preferred Stock are cumulative from the date of original issue at the annual rate of \$3.25 per share, payable quarterly on the first day of March, June, September, and December. Any dividends must be declared by the Company's board of directors and must come from funds that are legally available for dividend payments. As of December 31, 2008, dividends accumulated on the Preferred Stock totaled \$8.8 million, of which \$6.9 million have been paid in cash or issuance of

common stock.

On February 10, 2009, the Board of Directors of the Company elected not to declare a quarterly cash dividend in the amount of \$0.8125 per share on its Preferred Stock that was otherwise payable on March 1, 2009. This is the fifth quarterly dividend that has not been declared and paid on the Preferred Stock. Under the terms of the Preferred Stock, the holders thereof shall be entitled to vote as a separate class to elect two directors if the Company has not paid the equivalent of six or more quarterly dividends, whether or not consecutive. These voting rights will continue until the Company pays the full accrued but unpaid dividends on the Preferred Stock.

After March 1, 2009, the Company will no longer be obligated to make an additional payment (the "Make-Whole Payment") to any holder of the Preferred Stock who elects to voluntarily convert his, her or its shares of Preferred Stock equal to the aggregate amount of dividends that would have been payable on the Preferred Stock so converted from the original date of issuance through and including March 1, 2009, less any dividends already paid on the Preferred Stock. The Make-Whole Payment is payable by the Company, at its option, in cash, in additional shares of its common stock or in a combination of both.

The Preferred Stock is convertible into the Company's common stock at any time at the option of the holder at a conversion rate of 7.2886 shares of common stock for each share of Preferred Stock, based on an initial conversion price of \$6.86 per share. The initial conversion price is subject to adjustment in certain events, but is not subject to "price based" anti-dilution adjustment. The Company has reserved approximately 1.7 million shares of common stock for issuance upon such conversion.

The Company may elect to automatically convert some or all of the Preferred Stock into shares of common stock if the closing price of the Company's common stock has exceeded \$10.30 per share (150% of the conversion price) for at least 20 trading days during any 30-day trading period, ending within five trading days prior to notice of automatic conversion. Prior to March 1, 2009, if the Company elects to automatically convert, or if any holder elects to voluntarily convert, the Preferred Stock, the Company will also make a Make-Whole Payment equal to the aggregate amount of dividends that would have been payable on the Preferred Stock so converted from the original date of issuance through and including March 1, 2009, less any dividends already paid on the Preferred Stock. This additional payment is payable by the Company, at its option, in cash, in additional shares of its common stock, or in a combination of cash and shares of common stock. The Company has reserved a maximum of approximately 0.2 million shares of common stock for issuance under this Make-Whole provision.

Through December 31, 2008, 660,000 shares of Preferred Stock have been voluntarily converted into 4,810,493 shares of the Company's common stock. In connection with such conversions, the Company issued an additional 653,819 shares of the Company's common stock in satisfaction of the required Make-Whole Payment. The cumulative fair value of these Make-Whole Payments was approximately \$1.8 million, which was charged against the derivative liability.

In accordance with SFAS No. 133, the Company is required to separate and account for as an embedded derivative, the dividend Make-Whole Payment feature of the Preferred Stock offering. As an embedded derivative instrument, the dividend Make-Whole Payment feature must be measured at fair value and reflected as a liability. Changes in the fair value of the derivative are recognized in earnings as unrealized gain or loss on derivative in the statement of operations. The Company determined the fair value of the dividend Make-Whole Payment feature to be \$3.1 million at February 24, 2005 (the commitment date). This amount was allocated from the proceeds of the Preferred Stock to the derivative liability. During 2007, Make-Whole Payments related to the conversion of 40,000 shares were made and the derivative liability was reduced for the fair value of these payments. At December 31, 2007, the derivative liability was valued at approximately \$13,000. During 2008, Make-Whole Payments related to the conversion of \$124,000 were made and the derivative liability was reduced for the fair value of these payments. At December 31, 2008, the derivative liability was valued at approximately \$0. The fair value of the derivative liability is determined utilizing a model which is classified as Level 3 under SFAS No. 157.

The Company may elect to redeem the Preferred Stock at declining redemption prices on or after March 6, 2009.

The Preferred Stock is exchangeable, in whole but not in part, at the option of the Company on any dividend payment date for the Company's 6.5% convertible subordinated debentures ("Debentures") at the rate of \$50 principal amount of Debentures for each share of Preferred Stock. The Debentures, if issued, will mature 25 years after the Exchange Date and have terms substantially similar to those of the Preferred Stock.

The Preferred Stock has no maturity date and no voting rights prior to conversion into common stock, except under limited circumstances.

Conversions to Common Stock—During the years ended December 31, 2008 and 2007, 450,000 and 40,000 shares of Preferred Stock, respectively, were voluntarily converted into 3,279,880 and 291,545 shares of the Company’s common stock, respectively. In connection with such conversions, during 2008 and 2007 the Company issued 306,216 and 43,551 additional shares of the Company’s common stock in satisfaction of the required Make-Whole Payment, respectively.

Common Stock

As of December 31, 2008, there were 250 million shares of common stock authorized. On October 31, 2008, the Company increased the authorized shares from 98.5 million to 250.0 million shares. As of December 31, 2008, there were 50.1 million shares of common stock outstanding and 20.7 million shares of common stock reserved for issuances, representing 1.7 million shares reserved for issuance for in connection with the preferred stock, 0.1 million shares reserved for issuance in connection with the Make-Whole Payments provisions of the outstanding convertible exchangeable preferred stock, 8.6 million shares reserved for issuance in connection with outstanding common stock warrants, 6.4 million shares reserved for issuance in connection with outstanding stock options, 3.6 million shares reserved for issuance, in aggregate, in connection with shares available for future stock or option grants under the 2003 Stock Option Plan and Amended 2005 Stock Option Plan and 0.2 million shares reserved for issuance under the Employee Stock Purchase Plan.

On June 15, 2007, the Company sold 7,694,220 units, each unit consisting of (i) one share of common stock and (ii) one warrant to purchase 0.4 shares of common stock at an exercise price of \$3.10 per share, for a purchase price of \$2.60 per unit, resulting in aggregate gross proceeds to the Company of approximately \$20.0 million (net proceeds of approximately \$18.7 million after deducting underwriting discounts and commissions and estimated offering expenses). The shares of common stock and warrants were immediately separable and were issued separately. The warrants had a fair value of approximately \$3.2 million, were exercisable beginning on December 15, 2007 and expire June 15, 2012, and are included in Additional Paid-in Capital.

11. Common Stock Warrants

As of December 31, 2008, warrants to purchase shares of the Company’s common stock, the origination of which were derived in connection with debt and lease financing transactions, the collaborative agreement with Nycomed and April 2006, December 2006 and June 2007 common stock offerings, were outstanding for an aggregate of 8,630,391 shares of common stock at an effective weighted average price of \$4.28 per shares as follows:

<u>Number of Shares</u>	<u>Exercise Price Per Share</u>	<u>Expiration Date</u>
55,732	6.28	November 30, 2009
2,688	19.80	January 5, 2010
30,844	28.50	March 30, 2011
28,138	28.50	September 27, 2011
1,731,600	7.97	April 12, 2011
3,703,701	3.11	December 12, 2011
<u>3,077,688</u>	<u>3.10</u>	June 15, 2012
8,630,391	\$4.28	

On November 30, 2004, Acusphere issued a warrant to purchase up to 55,732 shares of its common stock at an exercise price of \$6.28 per share to a financial adviser in consideration of its services to the Company in connection with the consummation of its collaborative agreement with Nycomed. The warrant may be exercised any time and expires on November 30, 2009. The number of shares issuable upon exercise of the warrant and the exercise price thereof is subject to adjustment from time to time in the event of stock subdivisions, stock splits and stock combinations. The warrant does not include a cashless exercise feature. Acusphere recorded the deemed fair value of the warrant of \$241,639, based upon the Black-Scholes option-pricing model, as a deferred consulting expense included in other assets, which is being amortized over the collaborative agreement’s revenue recognition term as consulting expense. Amortization expense recorded within general and administrative costs during 2006, 2007 and 2008 totaled \$31,000, \$54,000 and \$43,000 respectively. No warrants were exercised during 2006, 2007 or 2008.

12. Research and License Agreements

Acusphere has clinical and pre-clinical study research agreements with various institutions. Total expenses incurred amounted to approximately \$5.3 million, \$7.1 million and \$3.2 million in sponsored-research expenses relating to such agreements during the years ended December 31, 2006, 2007 and 2008, respectively.

13. Commitments

Operating Leases—Acusphere has leased office, laboratory and manufacturing space under various agreements accounted for as operating leases. During 2006, 2007 and 2008, rent expense totaled approximately \$3.4 million, \$4.5 million and \$3.5 million, respectively.

Watertown, Massachusetts

Acusphere's Watertown, Massachusetts headquarters is under a lease with an original term of 10-years, which began in December 2001. During 2005, the term of this lease was extended by six months. Acusphere maintains a \$1.0 million security deposit as a condition of this lease. This deposit amount is included in other assets in the consolidated balance sheet at December 31, 2007 and 2008. In conjunction with the lease agreement Acusphere issued a warrant to the lessor allowing for the purchase of 30,844 shares of common stock. Acusphere recorded the \$0.5 million fair value of the warrant, based upon the Black-Scholes option-pricing model, as deferred rent expense included in other assets. This deferred rent is being amortized over the lease term as rent expense, with \$0.1 million recorded within rent expense for each of the years ended December 31, 2006, 2007 and 2008.

On March 3, 2009, the Company entered into a lease termination agreement with the Landlord of the Watertown lease. Pursuant to the Watertown lease termination agreement, the Company was obligated to (i) pay to landlord \$800,000 in cash, (ii) release to landlord the entire amount of the security deposit currently held by landlord in the amount of approximately \$997,500, (iii) make regular rental payments pursuant to the terms of the lease through March 31, 2009 and (iv) pay the Company's portion of operating expenses from April 2009 through the Termination Date of July 1, 2009 or earlier if specified by the Landlord, estimated at approximately \$65,000 per month.

Tewksbury, Massachusetts

In July 2004, Acusphere entered into a lease agreement for 58,000 square feet of commercial manufacturing space in Tewksbury, Massachusetts. This lease has a five year, nine month term with options to extend the lease for up to two additional five-year terms at predetermined rental rates. Under the lease, Acusphere received nine months of occupancy free of base rent, followed by base rent of approximately \$0.4 million for the next twelve months with scheduled annual rental rate increases thereafter. In October 2004, Acusphere paid an initial \$1.0 million security deposit to the landlord as part of the lease, subject to reduction if the Company made certain improvements to the facility. During 2005, \$0.9 million of this deposit was refunded to the Company. The remaining \$0.1 million is included in other assets in the consolidated balance sheets at December 31, 2007 and 2008.

Operating Leases

Future minimum payments due under the non-cancelable facility leases after consideration of the Watertown lease termination agreement are as follows as of December 31, 2008 (in thousands):

<u>Year Ending December 31,</u>	
2009	\$3,274 ⁽¹⁾
2010	214
	<u>\$3,488</u>

(1) – Reflects the effect of the Watertown lease termination agreement in which the Company paid to the Landlord \$800,000 in cash on March 3, 2009, the release to the Landlord of the entire amount of the security deposit of \$997,500 which is reflected in other assets and the regular rental payments pursuant to the terms of the lease through March 31, 2009 and excludes the Company's portion of operating expenses through July 1, 2009.

14. Employee Savings Plan

Acusphere has an employee savings plan covering all employees of the Company who meet certain defined requirements. Under this plan, which was adopted under Section 401(k) of the Internal Revenue Code, employees may elect to make tax-deferred contributions of up to 20% of their salaries, subject to certain limitations. During 2006, 2007 and 2008, the Company provided a matching contribution of \$205,000, \$238,000 and \$162,000, respectively, representing 50% of contributions per employee, up to a maximum Company contribution per employee of \$2,500 in 2006 and of \$3,000 in 2007 and of \$3,000 in 2008. Under the 401(k) plan, employees are not eligible to invest directly in shares of Acusphere stock.

15. Related Party Transaction

On March 28, 2008, the Company entered into a license agreement with Cephalon providing Cephalon with an exclusive, worldwide license to the Company's Hydrophobic Drug Delivery System (HDDS)TM for oncology applications, along with the rights to AI-850, the Company's formulation of paclitaxel, in exchange for a cash payment of \$10.0 million, paid upon the execution of the agreement. The term of the agreement extends until expiration of the last of the patents licensed under the agreement.

As discussed in Note 7, on November 3, 2008, the Company closed a transaction in which Cephalon purchased a \$15 million senior secured convertible note. In addition, as discussed in Note 6, in the same transaction that closed on November 3, 2008 the Company and Cephalon agreed to license agreement whereby Cephalon paid a \$5 million upfront fee for an exclusive worldwide license to AI-525, a preclinical-stage injectable formulation of celecoxib using the Company's proprietary HDDSTM technology (the "Celecoxib License").

The Chairman, founder and CEO of Cephalon is also the current Presiding Director of the Board of Directors of the Company. As of December 31, 2008, approximately \$0.8 million is included in current portion of deferred revenue and approximately \$13.7 million is included in the long-term deferred revenue. In addition, the Company recognized approximately \$0.6 million in the year ended December 31, 2008 of revenue associated with this agreement.

16. Subsequent Events

As discussed in Note 6, on February 11, 2009, the Company entered into an amendment (the "Third GE Amendment") to the License Agreement by and between the Company and GE dated as of June 1, 2006.

As discussed in Note 6, on February 12, 2009, the Company entered into a third amendment (the "Third BSP Amendment") to the Patent Transfer Agreement by and between the Company and Schering dated as of May 11, 2005.

As discussed in Note 13, on March 3, 2009, the Company entered into a lease termination agreement for its Watertown, Massachusetts location.

As discussed in Note 8, on March 20, 2008, the Company entered into an agreement to terminate and transition its collaboration, license and supply agreement dated as of July 6, 2004, as subsequently amended, with Nycomed.

On February 25, 2009, the Company eliminated 13 positions, or approximately twenty-two percent (22%) of its workforce and notified employees of the Company's intention to eliminate another 27 positions between February 25, 2009 and the middle of April 2009, or approximately forty-five percent (45%) of its workforce. On February 25, 2009, the Company began notifying the affected employees. The Company currently estimates that, in connection with these employee reductions, it will incur pre-tax costs in the first quarter of 2009 of approximately \$0.3 million, which is related to severance and benefit costs.
