

ARBIOS SYSTEMS INC  
Form 10-Q  
September 21, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

(MARK ONE)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2009

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE  
EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-32603

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ARBIOS SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or  
organization)

91-1955323  
(I.R.S. Employer Identification No.)

530 South Lake Avenue, #363, Pasadena, CA  
(Address of principal executive offices)

91101  
(Zip Code)

(626) 795-4641  
(Registrant's telephone number, including area code)

200 E. Del Mar Blvd., Suite 320, Pasadena, CA, 91105  
(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large Accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(do not check if a smaller reporting company)

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

On September 14, 2009, there were 24,356,247 shares of common stock, \$.001 par value per share, issued and outstanding.

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ARBIOS SYSTEMS, INC.  
FORM 10-Q  
TABLE OF CONTENTS

|                                      |   | PAGE NO.  |
|--------------------------------------|---|-----------|
| <b>PART I. FINANCIAL INFORMATION</b> |   |           |
| Item 1.                              | Financial Statements:   |           |
|                                      | Condensed Balance Sheets as of June 30, 2009 (unaudited) and December 31, 2008 (audited)  | 3         |
|                                      | Condensed Statements of Operations for the three and six months ended June 30, 2009 and 2008 and from August 23, 2000 (inception) through June 30, 2009 (unaudited) | 4         |
|                                      | Condensed Statements of Cash Flows for the six months ended June 30, 2009 and 2008 and from August 23, 2000 (inception) through June 30, 2009 (unaudited)           | 5         |
|                                      | Condensed Statement of Stockholders' Equity (Deficit) from August 23, 2000 (inception) through June 30, 2009 (unaudited)  | 6         |
|                                      | Notes to Condensed Financial Statements   | 11        |
| Item 2.                              | Management's Discussion and Analysis of Financial Condition and Results of Operations   | 16        |
| Item 3.                              | Qualitative and Quantitative Disclosures About Market Risk.   | 20        |
| Item 4T.                             | Controls and Procedures   | 20        |
| <b>PART II. OTHER INFORMATION</b>    |   |           |
| Item 1.                              | Legal Proceedings   | 20        |
| Item 1A.                             | Risk Factors  | 21        |
| Item 2.                              | Unregistered Sales of Equity Securities and Use of Proceeds   | 21        |
| Item 3.                              | Defaults Upon Senior Securities   | 21        |
| Item 4.                              | Submission of Matters to a Vote of Security Holders   | 21        |
| Item 5.                              | Other Information   | 21        |
| Item 6.                              | Exhibits  | 21        |
| <b>SIGNATURES</b>                    |   | <b>22</b> |



## PART I - FINANCIAL INFORMATION

## ITEM 1. Condensed Financial Statements

ARBIOS SYSTEMS, INC.  
(Debtor-in-Possession)  
(A Development Stage Company)  
CONDENSED BALANCE SHEETS

|   | June 30, 2009<br>(Unaudited) | December 31,<br>2008 |
|---|------------------------------|----------------------|
| <b>ASSETS</b>   |                              |                      |
| <b>Current assets</b>   |                              |                      |
| Cash  | \$ 185,598                   | \$ 370,686           |
| Restricted cash   | 199,112                      | -                    |
| Prepaid expenses  | 149,044                      | 21,506               |
| <b>Total current assets</b>   | <b>533,754</b>               | <b>392,192</b>       |
| Receivable  | -                            | 200,000              |
| Property and equipment, net   | 4,339                        | 6,177                |
| Investment  | -                            | 86,209               |
| Other assets  | 750                          | 750                  |
| <b>Total assets</b>   | <b>\$ 538,843</b>            | <b>\$ 685,328</b>    |
| <b>LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY</b>   |                              |                      |
| <b>Current liabilities</b>  |                              |                      |
| Accounts payable  | \$ 393,863                   | \$ 194,046           |
| Deposit from Arbios Acquisition Partners, LLC   | 199,112                      | -                    |
| Accrued expenses  | 530,000                      | 286,888              |
| <b>Total current liabilities</b>  | <b>1,122,975</b>             | <b>480,934</b>       |
| Liabilities subject to compromise under reorganization proceedings  | 111,029                      | -                    |
| Long term contract obligations  | -                            | 150,000              |
| <b>Total liabilities</b>  | <b>1,234,004</b>             | <b>630,934</b>       |
| <b>Stockholders' (deficit) equity</b>   |                              |                      |
| Common stock, \$.001 par value; 100,000,000 shares authorized; 24,356,247 and 25,792,747 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively | 24,356                       | 25,792               |
| Additional paid-in capital  | 21,618,511                   | 21,617,075           |
| Deficit accumulated during the development stage  | (22,338,028)                 | (21,588,473)         |
| <b>Total stockholders' (deficit) equity</b>   | <b>(695,161)</b>             | <b>54,394</b>        |
| <b>Total liabilities and stockholders' (deficit) equity</b>   | <b>\$ 538,843</b>            | <b>\$ 685,328</b>    |

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



ARBIOS SYSTEMS, INC.  
 (Debtor-in-Possession)  
 (A Development Stage Company)  
 CONDENSED STATEMENTS OF OPERATIONS  
 (Unaudited)

|  | For the three months ended June |              | For the six months ended June |                | Inception to<br>June 30, 2009 |
|--|---------------------------------|--------------|-------------------------------|----------------|-------------------------------|
|  | 2009                            | 30,<br>2008  | 2009                          | 30,<br>2008    |                               |
| Revenues   | \$ -                            | \$ -         | \$ -                          | \$ -           | \$ 320,966                    |
| Operating expenses:  |                                 |              |                               |                |                               |
| General and administrative                                     | 284,828                         | 492,121      | 404,447                       | 1,211,615      | 13,646,498                    |
| Research and development                                       | -                               | 345,971      | -                             | 1,056,397      | 9,325,632                     |
| Total operating expenses                                       | 284,828                         | 838,092      | 404,447                       | 2,268,012      | 22,972,130                    |
| Loss before reorganization costs<br>and other income (expense) | (284,828)                       | (838,092)    | (404,447)                     | (2,268,012)    | (22,651,164)                  |
| Reorganization costs and other<br>income (expense):            |                                 |              |                               |                |                               |
| Reorganization costs, primarily<br>professional fees           | (185,264)                       | -            | (259,128)                     | -              | (259,128)                     |
| Interest income  | -                               | 8,178        | 229                           | 28,478         | 497,748                       |
| Gain on sale of HepatAssist<br>program, net                    | -                               | -            | -                             | -              | 404,863                       |
| Loss on investment   | -                               | -            | (86,209)                      | -              | (86,209)                      |
| Interest expense   | -                               | -            | -                             | -              | (244,138)                     |
| Total reorganization costs and<br>other income (expense)       | (185,264)                       | 8,178        | (345,108)                     | 28,478         | 313,136                       |
| Net loss   | \$ (470,092)                    | \$ (829,914) | \$ (749,555)                  | \$ (2,239,534) | \$ (22,338,028)               |
| Net loss per share:  |                                 |              |                               |                |                               |
| Basic and diluted  | \$ (0.02)                       | \$ (0.03)    | \$ (0.03)                     | \$ (0.09)      |                               |
| Weighted-average shares:                                       |                                 |              |                               |                |                               |
| Basic and diluted  | 24,356,247                      | 25,749,458   | 24,427,675                    | 25,672,613     |                               |

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

ARBIOS SYSTEMS, INC.  
 (Debtor-in-Possession)  
 (A Development Stage Company)  
 CONDENSED STATEMENTS OF CASH FLOWS  
 (Unaudited)

|  | For the six months ended June 30, |                | Inception to    |
|--|-----------------------------------|----------------|-----------------|
|  | 2009                              | 2008           | June 30, 2009   |
| <b>Cash flows from operating activities:</b>                                       |                                   |                |                 |
| Net loss   | \$ (749,555)                      | \$ (2,239,534) | \$ (22,338,028) |
| <b>Adjustments to reconcile net loss to net cash used in operating activities:</b> |                                   |                |                 |
| Amortization of debt discount  | -                                 | -              | 244,795         |
| Depreciation and amortization  | 1,838                             | 21,592         | 337,875         |
| Patent rights impairment   | -                                 | -              | 91,694          |
| Issuance of common stock, options and warrants for compensation                    | -                                 | 419,070        | 4,071,460       |
| Issuance of warrants for patent acquisition  | -                                 | -              | 74,570          |
| Settlement of accrued expense  | -                                 | -              | 54,401          |
| Deferred compensation costs  | -                                 | -              | 319,553         |
| Loss on disposition of fixed assets  | -                                 | -              | 5,037           |
| Loss on disposition of investment  | 86,209                            | -              | 86,209          |
| Gain on sale of HepatAssist program, net   | -                                 | -              | (404,863)       |
| <b>Changes in operating assets and liabilities:</b>                                |                                   |                |                 |
| Prepaid expenses   | (127,538)                         | 25,938         | (149,046)       |
| Deferred financing costs   | -                                 | 16,757         | -               |
| Other assets   | -                                 | 20,189         | (750)           |
| Accounts payable   | 199,817                           | 81,428         | 393,863         |
| Accrued expenses   | 243,112                           | 7,770          | 436,498         |
| Other liabilities  | -                                 | -              | 64,695          |
| Liabilities subject to compromise under reorganization proceedings                 | 111,029                           | -              | 111,029         |
| Long term contract obligations   | (150,000)                         | (100,000)      | -               |
| Net cash used in operating activities  | (385,088)                         | (1,746,790)    | (16,601,008)    |
| <b>Cash flows from investing activities:</b>                                       |                                   |                |                 |
| Additions of property and equipment  | -                                 | -              | (149,467)       |
| Proceeds from sale of fixed assets   | -                                 | -              | 4,176           |
| Proceeds from sale of HepatAssist program  | 200,000                           | -              | 450,000         |
| Purchase of short term investments   | -                                 | -              | (21,866,787)    |
| Maturities of short term investments   | -                                 | -              | 21,866,787      |
| Net cash provided from investing activities  | 200,000                           | -              | 304,709         |
| <b>Cash flows from financing activities:</b>                                       |                                   |                |                 |
| Proceeds from issuance of convertible debt   | -                                 | -              | 400,000         |
| Proceeds from common stock option/warrant exercise                                 | -                                 | -              | 67,900          |
| Net proceeds from issuance of common stock and warrants                            | -                                 | -              | 15,797,080      |
| Net proceeds from issuance of preferred stock                                      | -                                 | -              | 238,732         |
| Payments on capital lease obligation, net  | -                                 | -              | (21,815)        |



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|  |            |             |            |
|--|------------|-------------|------------|
| Net cash provided by financing activities                      | -          | -           | 16,481,897 |
| Net (decrease) increase in cash                                | (185,088)  | (1,746,790) | 185,598    |
| Cash at beginning of period                                    | 370,686    | 2,735,944   | -          |
| Cash at end of period  | \$ 185,598 | \$ 989,154  | \$ 185,598 |
| Supplemental disclosures of non-cash financing activity        |            |             |            |
| Issuance of securities for obligation related to finder's fees | \$ -       | \$ -        | \$ 47,500  |

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

ARBIOS SYSTEMS, INC.  
 (Debtor-in-Possession)  
 (A Development Stage Company)  
 CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)  
 PERIOD FROM AUGUST 23, 2000 (INCEPTION) TO JUNE 30, 2009  
 (Unaudited)

|   | Preferred Stock |        | Common Stock |        | Additional         | Deferred  | Deficit   | Total |         |
|---|-----------------|--------|--------------|--------|--------------------|-----------|---|-------|---------|
|   | Shares          | Amount | Shares       | Amount | Paid-In<br>Capital | Costs     | Accumulated<br>During the<br>Development<br>Stage |       |         |
| Balance, August 23, 2000 (inception) restated for effect of reverse merger with Historical Autographs U.S.A. Inc.   | -               | \$ -   | -            | \$ -   | \$ -               | \$ -      | \$ -  | \$ -  | \$ -    |
| Stock issuance in exchange for cash   |                 |        | 5,000,000    | 50     | 4,950              |           |   |       | 5,000   |
| Net loss  |                 |        |              |        |                    |           | (9,454)   |       | (9,454) |
| Balance, December 31, 2000, as restated   | -               | -      | 5,000,000    | 50     | 4,950              | -         | (9,454)   |       | (4,454) |
| Issuance of junior preferred stock for cash of \$250,000 and in exchange for \$400,000 in patent rights, research and development costs, and employee loanout costs less issuance expenses of \$11,268, June 29, 2001 | 681,818         | 7      |              |        | 958,278            | (343,553) |   |       | 614,732 |
| Issuance of common stock in exchange for  |                 |        | 362,669      | 4      | 547,284            |           |   |       | 547,288 |

|   |         |   |           |    |           |           |           |           |
|---|---------|---|-----------|----|-----------|-----------|-----------|-----------|
| patent rights and deferred research and development costs |         |   |           |    |           |           |           |           |
| Services receivable                                       |         |   |           |    |           | (550,000) |           | (550,000) |
| Deferred employee loan-out costs receivable earned        |         |   |           |    |           | 82,888    |           | 82,888    |
| Net loss  |         |   |           |    |           |           | (237,574) | (237,574) |
| Balance, December 31, 2001                                | 681,818 | 7 | 5,362,669 | 54 | 1,510,512 | (810,665) | (247,028) | 452,880   |

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ARBIOS SYSTEMS, INC.  
 (Debtor-in-Possession)  
 (A Development Stage Company)  
 CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)  
 PERIOD FROM AUGUST 23, 2000 (INCEPTION) TO JUNE 30, 2009  
 (Unaudited)

|   | Preferred Stock |        | Common Stock |        | Additional | Deferred | Deficit     |           |
|---|-----------------|--------|--------------|--------|------------|----------|-------------|-----------|
|   | Shares          | Amount | Shares       | Amount | Paid-In    | Costs    | Accumulated | Total     |
|   |                 |        |              |        | Capital    |          | During the  |           |
|   |                 |        |              |        |            |          | Development |           |
|   |                 |        |              |        |            |          | Stage       |           |
| Amendment of December 31, 2001 agreement for the issuance of common stock agreement in exchange for research and development services |                 |        |              |        | (495,599)  | 550,000  |             | 54,401    |
| Deferred employee loan out costs receivable earned  |                 |        |              |        |            | 171,776  |             | 171,776   |
| Issuance of common stock for compensation   |                 |        | 70,000       | 1      | 10,499     |          |             | 10,500    |
| Issuance of common stock for cash   |                 |        | 999,111      | 9      | 149,857    |          |             | 149,866   |
| Net loss  |                 |        |              |        |            |          | (494,780)   | (494,780) |
| Balance, December 31, 2002  | 681,818         | 7      | 6,431,780    | 64     | 1,175,269  | (88,889) | (741,808)   | 344,643   |
| Issuance of common stock for cash less issuance expense of \$2,956  |                 |        | 417,000      | 417    | 246,827    |          |             | 247,244   |
| Issuance of common stock in private placement for cash less issuance expense of \$519,230   |                 |        | 4,000,000    | 4,000  | 3,476,770  |          |             | 3,480,770 |

|  |           |       |         |         |
|--|-----------|-------|---------|---------|
| Issuance of common stock for convertible debenture less issuance expense of \$49,500                   | 400,000   | 400   | 350,100 | 350,500 |
| Shares issued in connection with acquisition of Historical Autographs U.S.A., Inc. on October 30, 2003 | 1,220,000 | 8,263 | (8,263) | -       |

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ARBIOS SYSTEMS, INC.  
 (Debtor-in-Possession)  
 (A Development Stage Company)  
 CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)  
 PERIOD FROM AUGUST 23, 2000 (INCEPTION) TO JUNE 30, 2009  
 (Unaudited)

|  | Preferred Stock |        | Common Stock |        | Additional | Deferred | Deficit     |             |
|--|-----------------|--------|--------------|--------|------------|----------|-------------|-------------|
|  | Shares          | Amount | Shares       | Amount | Paid-In    | Costs    | Accumulated | Total       |
|  |                 |        |              |        | Capital    |          | During the  |             |
|  |                 |        |              |        |            |          | Development |             |
|  |                 |        |              |        |            |          | Stage       |             |
| Value of warrants and beneficial conversion feature of bridge loan |                 |        |              |        | 244,795    |          |             | 244,795     |
| Deferred employee loan-out costs receivable earned                 |                 |        |              |        |            | 88,889   |             | 88,889      |
| Preferred Stock converted to Common Stock                          | (681,818)       | (7)    | 681,818      | 7      |            |          |             | -           |
| Net loss   |                 |        |              |        |            |          | (885,693)   | (885,693)   |
| Balance, December 31, 2003   | -               | -      | 13,150,598   | 13,151 | 5,485,498  | -        | (1,627,501) | 3,871,148   |
| Issuance of common stock options and warrants for compensation     |                 |        |              |        | 972,430    |          |             | 972,430     |
| Exercise of common stock options                                   |                 |        | 18,000       | 18     | 2,682      |          |             | 2,700       |
| Issuance of securities for payable                                 |                 |        | 47,499       | 47     | 47,451     |          |             | 47,498      |
| Net loss   |                 |        |              |        |            |          | (3,327,827) | (3,327,827) |

|  |   |   |            |        |           |   |             |           |
|--|---|---|------------|--------|-----------|---|-------------|-----------|
| Balance,<br>December 31,<br>2004   | - | - | 13,216,097 | 13,216 | 6,508,061 | - | (4,955,328) | 1,565,949 |
| Issuance of<br>common stock in<br>private placement<br>for cash less<br>issuance expense<br>of \$384,312 |   |   | 2,991,812  | 2,992  | 6,224,601 |   |             | 6,227,593 |
| Issuance of<br>common stock<br>options and<br>warrants for<br>compensation                               |   |   |            |        | 557,080   |   |             | 557,080   |
| Exercise of<br>common stock<br>options   |   |   | 25,000     | 25     | 62,475    |   |             | 62,500    |

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ARBIOS SYSTEMS, INC.  
 (Debtor-in-Possession)  
 (A Development Stage Company)  
 CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)  
 PERIOD FROM AUGUST 23, 2000 (INCEPTION) TO JUNE 30, 2009  
 (Unaudited)

|   | Preferred Stock |        | Common Stock |        | Additional  | Deferred | Deficit      |             |
|---|-----------------|--------|--------------|--------|-------------|----------|--------------|-------------|
|   | Shares          | Amount | Shares       | Amount | Paid-In     | Costs    | Accumulated  | Total       |
|   |                 |        |              |        | Capital     |          | During the   |             |
|   |                 |        |              |        |             |          | Development  |             |
|   |                 |        |              |        |             |          | Stage        |             |
| Net loss  |                 |        |              |        |             |          | (3,823,903)  | (3,823,903) |
| Balance, December 31, 2005  | -               | -      | 16,232,909   | 16,233 | 13,352,217  | -        | (8,779,231)  | 4,589,219   |
| Issuance of common stock in private placement for cash less issuance expense of \$95,013  |                 |        | 1,227,272    | 1,227  | 1,253,760   |          |              | 1,254,987   |
| Issuance of common stock options and warrants for compensation  |                 |        |              |        | 703,839     |          |              | 703,839     |
| Stock warrant term extension  |                 |        | -            |        | 482,964     |          |              | 482,964     |
| Warrant liability   |                 |        |              |        | (1,284,841) |          |              | (1,284,841) |
| Net loss  |                 |        |              |        |             |          | (4,461,904)  | (4,461,904) |
| Balance, December 31, 2006  | -               | -      | 17,460,181   | 17,460 | 14,507,939  | -        | (13,241,135) | 1,284,264   |
| Cumulative effect of change in accounting principle: Adjust retained earnings at January 1, 2007 for change in accounting principle |                 |        |              |        |             |          | (521,187)    | (521,187)   |
|   |                 |        |              |        | 1,284,841   |          |              | 1,284,841   |



|  |           |       |           |           |
|--|-----------|-------|-----------|-----------|
| Reclassification of warrants   |           |       |           |           |
| Issuance of common stock and warrants in private placement for cash less issuance expense of \$377,169 | 7,478,462 | 7,479 | 4,476,352 | 4,483,831 |
| Exercise of common stock warrants  | 18,000    | 18    | 2,682     | 2,700     |
| Stock option based compensation expense  |           |       | 438,263   | 438,263   |

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

ARBIOS SYSTEMS, INC.  
(Debtor-in-Possession)  
(A Development Stage Company)  
CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)  
PERIOD FROM AUGUST 23, 2000 (INCEPTION) TO JUNE 30, 2009  
(Unaudited)

|   | Preferred Stock |        | Common Stock |         | Additional Paid-In Capital | Deferred Development Costs | Deficit Accumulated During the Stage | Total       |
|---|-----------------|--------|--------------|---------|----------------------------|----------------------------|--------------------------------------|-------------|
|   | Shares          | Amount | Shares       | Amount  |                            |                            |                                      |             |
| Stock warrant term extension                |                 |        | -            |         | 59,025                     |                            |                                      | 59,025      |
| Restricted stock based compensation expense |                 |        | 621,818      | 621     | 315,604                    |                            |                                      | 316,225     |
| Issuance of warrants for patent acquisition |                 |        |              |         | 74,570                     |                            |                                      | 74,570      |
| Net loss                                    |                 |        |              |         |                            |                            | (5,552,650)                          | (5,552,650) |
| Balance, December 31, 2007                  | -               | -      | 25,578,461   | 25,578  | 21,159,276                 | -                          | (19,314,972)                         | 1,869,882   |
| Stock option based compensation expense     |                 |        |              |         | 114,824                    |                            |                                      | 114,824     |
| Stock warrant term extension                |                 |        |              |         | 175,256                    |                            |                                      | 175,256     |
| Restricted stock based compensation expense |                 |        |              |         | 107,933                    |                            |                                      | 107,933     |
| Issuance of common stock for compensation   |                 |        | 214,286      | 214     | 59,786                     |                            |                                      | 60,000      |
| Net loss                                    |                 |        |              |         |                            |                            | (2,273,501)                          | (2,273,501) |
| Balance, December 31, 2008                  | -               | -      | 25,792,747   | 25,792  | 21,617,075                 | -                          | (21,588,473)                         | 54,394      |
|   |                 |        | (1,436,500)  | (1,436) | 1,436                      |                            |                                      | -           |

|  |   |   |            |           |               |           |                              |
|--|---|---|------------|-----------|---------------|-----------|------------------------------|
| Common stock<br>shares surrendered<br>by shareholder |   |   |            |           |               |           |                              |
| Net loss   |   |   |            |           |               | (749,555) | (749,555)                    |
| Balance, June 30,<br>2009                            | - | - | 24,356,247 | \$ 24,356 | \$ 21,618,511 | \$ -      | \$ (22,338,028) \$ (695,161) |

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

Arbios Systems, Inc.  
(Debtor-in-Possession)  
(A Development Stage Company)  
Notes to Condensed Financial Statements (Unaudited)  
Six Months Ended June 30, 2009

(1) Basis of Presentation

Arbios Systems, Inc. is a Delaware corporation with its corporate office in Pasadena, California. To date, our goal was to seek to develop, manufacture and market liver assist therapies to meet the urgent need for medical treatment of liver failure.

Since Arbios Systems, Inc. was incorporated in February 1999, we have been a medical device and cell-therapy company that was focused on the development of products for the treatment of liver failure. Our lead product candidate was under development during 2008 and consisted of a novel extracorporeal blood purification therapy called the SEPET™ Liver Assist Device. Until recently, we also owned the rights to an extracorporeal, bioartificial liver therapy referred to as the HepatAssist™ Cell-Based Liver Support System which incorporated porcine pig liver cells, which we sold to HepaLife Technologies, Inc. in October 2008. Because of our limited financial resources, all of our development activities during the past few years have focused on our SEPET™ Liver Assist Device. In February 2008, the U.S. Food and Drug Administration (“FDA”) granted us conditional approval of an Investigational Device Exemption, or IDE, application to begin the pivotal clinical trial for SEPET™. In May 2008, we received approval to begin the first segment of our pivotal clinical trial for SEPET™. The budget to complete this clinical trial and our other projected operating expenses, however, far exceeded the limited financial resources available to us at that time, and we have, therefore, not commenced the clinical trial.

As a development stage company engaged solely in the development of new products, we did not generate revenues from our activities and, accordingly, we were solely dependent upon our ability to raise funding from investors to finance both our operating expenses and the cost of developing our technologies. Due in part to the global economic crisis that commenced in 2008 and the dramatic decline in the availability of financing, particularly to development stage companies, we were unable to raise the capital we needed to finance our operational and developmental activities. As a result, in order to preserve our remaining cash while seeking financing and while attempting to otherwise maximize the value of our assets, in mid-2008, we terminated all of our employees and suspended the majority of our operations. Since then, all of our activities have been conducted by our interim Chief Executive Officer and our interim Chief Financial Officer, both of whom we engaged as part-time consultants. We have not conducted any active operations since mid-2008, and our sole activity since that time has been to (i) seek sufficient capital to re-initiate our operations, (ii) find a strategic partner to co-develop our technologies with us, or (iii) sell our technologies and assets in a manner that will maximize shareholder value. Consistent with this Plan, in October 2008, we sold the HepatAssist™ Cell-Based Liver Support System to HepaLife Technologies, Inc. (“HepaLife”) for (a) \$450,000 in cash, of which \$250,000 was paid in October 2008 and the remaining \$200,000 was deferred for up to 18 months from the date of sale, and (b) a warrant to purchase 750,000 shares of HepaLife common stock at an exercise price of \$0.35 per share. On April 22, 2009, HepaLife paid us the \$200,000 deferred payment immediately, in return for the cancellation of the warrant to purchase 750,000 shares of HepaLife common stock that was part of the consideration in our sale of HepatAssist™ to HepaLife.

Liquidity and Going Concern

The accompanying condensed financial statements have been prepared on a going concern basis which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred a net operating loss of \$749,555 for the six months ended June 30, 2009 and an accumulated deficit of \$22,338,028 at

June 30, 2009. This factor raises substantial doubt about the Company's ability to continue as a going concern.

## Voluntary Chapter 11 Filing

On January 9, 2009, the Company filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code (the “Bankruptcy Code”) with the United States Bankruptcy Court for the District of Delaware (the “Bankruptcy Court”), Case Number 09-10082 (the “Bankruptcy”). We are continuing to operate as a debtor-in-possession under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code and the orders of the Bankruptcy Court. In general, as a debtor-in-possession, our current part-time management supervises our activities as authorized under the Bankruptcy Code, but may not engage in transactions outside the ordinary course of business without the prior approval of the Bankruptcy Court.

## Pending \$1,000,000 Investment and Recapitalization

One of the principal reasons for commencing the Bankruptcy was to permit the orderly sale of our remaining assets and technologies under court protection and/or to recapitalize our company. Consistent with our goals, on March 9, 2009 we entered into a binding term sheet (the “Term Sheet”) with Arbios Acquisition Partners, LLC (“Acquisition Partners”), an unrelated, privately held, limited liability company formed for the purpose of effecting the transaction contemplated by the Term Sheet. Pursuant to the Term Sheet, subject to the approval of the Bankruptcy Court, we agreed that we would (i) cancel all of our currently existing equity (including, but not limited to, any and all outstanding common and preferred shares of stock, warrants, and options), (ii) issue new shares of our common stock to Acquisition Partners representing 90% of our newly issued shares, and (iii) issue to our existing shareholders new shares of our common stock equal to 10% of our newly issued shares pro rata. In consideration for issuing the new shares to it, Acquisition Partners agreed to pay us \$1,000,000.

The \$1,000,000 purchase price to be paid by Acquisition Partners for 90% of our new shares of common stock is currently required to be paid as follows: (1) \$100,000 was paid to us at the time that the Term Sheet was signed, (2) approximately \$100,000 was paid to us on May 1, 2009, and (3) \$200,000 was paid to us in August 2009 and deposited into an escrow account. These deposit amounts are non-refundable to Acquisition Partners. In addition, Acquisition Partners has agreed to pay us \$400,000 on or about September 21, 2009 and to provide the final \$200,000 following the Effective Date, on an as needed basis on terms and conditions to be determined. We expect to complete the stock sale to Acquisition Partners in late September 2009 and to emerge from Bankruptcy shortly thereafter.

Our Plan of Reorganization to approve the investment by Acquisition Partners has been confirmed by the Bankruptcy Court on June 22, 2009. To date we have received an aggregate of \$400,000 from Acquisition Partners, a portion of which has been deposited into an escrow account and will be released to us upon the Plan with Acquisition Partners going Effective. The funds received from Acquisition Partners will primarily be used to pay our creditors and to begin to fund our operating costs, including the costs of remaining a public company.

## Plan of Reorganization; Recapitalization of our Company

On April 3, 2009, we filed a motion to conditionally approve our Chapter 11 Plan of Reorganization as the disclosure statement (the motion to conditionally approve the disclosure statement and the Plan of Reorganization is herein referred to as the “Plan”). On April 20, 2009, the Bankruptcy Court confirmed the use of the Plan of Reorganization as a disclosure statement.

Now that the Bankruptcy Court has confirmed the Plan, we expect to consummate the transaction with Acquisition Partners as described in the Term Sheet, and our Company is expected to thereafter emerge from Bankruptcy as follows:

- Administrative and Priority Claims are expected to be paid in full and Allowed General Unsecured Claim Holders are expected to receive 90% of the principal amount of their Allowed Claim.

- 90% of our common stock is expected to be owned by Acquisition Partners, and 10% will be owned by all of our stockholders who own shares on the date that the Plan is confirmed. The 10% of our stock that is expected to be issued to our existing stockholders will be issued pro rata based on the number of shares each stockholder owned prior to the confirmation. All currently outstanding shares of our common stock are expected to be cancelled on the date that the Plan goes effective, and new shares will thereafter be issued for the shares that are cancelled.

- All currently outstanding options and warrants are expected to be cancelled and will cease to exist.
- The \$1,000,000 investment from Acquisition Partners (of which \$800,000 will be paid before we emerge from Bankruptcy, and \$200,000 will be provided to us as needed after the Plan has become Effective on terms and conditions to be determined) is expected to be used to pay our creditors, to fund our working capital needs, and possibly for the further development of our technology. Through August 31, 2009, \$400,000 of the \$1,000,000 has been received.
- All of our officers and directors will resign, and new officers and directors designated by Acquisition Partners will be appointed. Currently, Acquisition Partners has designated the following persons to hold the following offices with this company after the Bankruptcy: Tom Fagan—Director, Chairman of the Board, CEO and President; and John Desiderio—Director.
- Arbios Systems, Inc. is expected to remain a public company whose shares are listed for trading on the OTC Bulletin Board, or some other trading platform.
- We previously in-licensed a family of issued U.S. patents and various U.S. and foreign patent applications from Immunocept LLC, including five issued U.S. patents, four pending U.S. patents, and two pending European patents. On January 2, 2009, Immunocept, LLC declared a default in the foregoing license with us. As part of the Bankruptcy proceedings, upon the confirmation of the Plan on June 22, 2009, the Immunocept license agreement was terminated and will therefore no longer be in effect. Accordingly, this company's post-Bankruptcy assets will not include this License Agreement, which may affect our ability to develop and commercialize our technologies as previously planned.

The unaudited condensed financial statements and notes are presented as permitted by Form 10-Q. These unaudited condensed financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America, have been omitted pursuant to such SEC rules and regulations. In the opinion of the management of the Company, the accompanying unaudited condensed financial statements include all adjustments, including those that are normal and recurring considered necessary to present fairly the financial position of the Company as of June 30, 2009, and the results of operations for the periods presented. These unaudited condensed financial statements should be read in conjunction with the Company's audited financial statements and the accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 as filed with the SEC. Because of the Bankruptcy and the change in the Company's ownership and management, the Company expects that its operating results will vary from its operating results before the Bankruptcy. Therefore, period-to-period comparisons should not be relied upon as predictive of the results in future periods. The results of operations for the six months ended June 30, 2009 are not necessarily indicative of the results to be expected for any subsequent periods or for the entire 2009 fiscal year.

#### Sale of HepaLife Technologies, Inc. Warrant

Pursuant to a Bankruptcy Court Order, on April 22, 2009, the Company sold the five-year Series D warrant to purchase up to 750,000 shares of HepaLife's common stock at an exercise price of \$0.35 per share (the "Warrant") back to HepaLife in consideration for the early payment of the \$200,000 Deferred Purchase Price, which funds were received by the Company on April 22, 2009. The closing price of HepaLife's common stock on the OTC Bulletin Board on April 22, 2009 was \$0.19 per share. The surrender of the Warrant in exchange for the acceleration of the \$200,000 Deferred Purchase Price payment resulted in a "loss on investment" of \$86,209.





## Termination of Immunocept, LLC License Agreement

On January 2, 2009, Immunocept, LLC declared a default in the foregoing license with the Company. On May 26, 2009, Immunocept filed an amended proof of claim in the amount of \$3.2 million plus unliquidated damages. In turn, the Company moved to reject the License Agreement with the Bankruptcy Court on May 28, 2009. As part of the rejection of the License Agreement, the Company objected to Immunocept's damages claims and filed a modified Plan of Reorganization that rejected assumption of this License Agreement on June 9, 2009. The confirmation of the Plan occurred on June 22, 2009. In an effort to end the costly litigation in this matter and to move the Plan of Reorganization forward with the Court, the Company and Immunocept LLC reached a settlement on July 21, 2009.

Pursuant to the settlement agreement between Arbios Systems, Inc. and Immunocept, LLC, the license agreement was terminated on June 22, 2009 and the Company agreed that Immunocept, LLC will receive a pre-petition claim of \$350,000 (to be paid at 90%). The Company has acknowledged that it owed \$100,000 to Immunocept, LLC on January 1, 2009, as part of a milestone payment, along with an additional \$150,000 payment due for the issuance of a new patent. Arbios will also pay up to \$100,000 to Immunocept as part of the settlement agreement for legal and administrative costs. Immunocept will have no rights to the pre-clinical, clinical data, or IDE for SEPET devices and the Company shall remain bound by confidentiality regarding the Immunocept, LLC patent portfolio.

## (2) Reorganization Items Related to Chapter 11 Proceeding

According to Statement of Position 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code," we have prepared the financial statements to reflect items which are affected by our Chapter 11 bankruptcy status. Accordingly, \$111,029 of pre-petition liabilities (liabilities recorded prior to our bankruptcy petition filing on January 9, 2009) have been segregated from accounts payable on the balance sheet. Professional fees consisting primarily of legal costs incurred for services rendered in connection with the Chapter 11 proceeding for the three and six months ended June 30, 2009 totaled approximately \$185,000 and \$259,000, respectively, and are recorded as reorganization costs.

Listed below is a schedule depicting the Company's cash flows as it relates to reorganization and bankruptcy related costs for the six month period ending June 30, 2009.

## Cash flows from operating activities:

|  |           |
|--|-----------|
| Cash received from refunds of operating costs  | \$ 5,165  |
| Cash paid to vendors   | (355,417) |
| Net cash used by operating activities before reorganization items                        | (350,252) |
| Operating cash flows from reorganization items:  |           |
| Interest received on cash accumulated because of the Chapter 11 proceeding               | 3         |
| Professional fees paid for service rendered in connection with the Chapter 11 proceeding | (34,839)  |
| Net cash used by reorganization items  | (34,836)  |
| Net cash used by operating activities  | (385,088) |

## Cash flows from investing activities:

|   |           |
|---|-----------|
| Proceeds from sale of HepatAssist program | 200,000   |
| Net cash provided by investing activities | 200,000   |
| Net decrease in cash                      | (185,088) |
| Cash at beginning of period               | 370,686   |

Cash at end of period

\$ 185,598

14

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## Reconciliation of net loss to net cash provided by operating activities

|   |              |
|---|--------------|
| Net loss  | \$ (749,555) |
| Adjustments to reconcile net loss to net cash used by operating activities: |              |
| Depreciation  | 1,838        |
| Loss on disposition of investment   | 86,209       |
| Increase in prepaid insurance expense                                       | (127,538)    |
| Increase in post-petition payables  | 199,817      |
| Increase in post-petition accrued expenses                                  | 243,112      |
| Increase in pre-petition payables   | 111,029      |
| Decrease in long term contract obligation                                   | (150,000)    |
| Net cash used by operating activities                                       | \$ (385,088) |

## (3) Recent Accounting Pronouncements

On June 27, 2007, the FASB reached a final consensus on EITF Issue No. 07-03: "Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development Activities" ("EITF 07-03"). Currently, under FASB Statement No. 2: "Accounting for Research and Development Costs," nonrefundable advance payments for future research and development activities for materials, equipment, facilities and purchased intangible assets that have no alternative future use are expensed as incurred. EITF 07-03 addresses whether such non-refundable advance payments for goods or services that have no alternative future use and that will be used or rendered for research and development activities should be expensed when the advance payments are made or when the research and development activities have been performed. The consensus reached by the FASB requires companies involved in research and development activities to capitalize such non-refundable advance payments for goods and services pursuant to an executory contractual arrangement because the right to receive those services in the future represents a probable future economic benefit. Those advance payments will be capitalized until the goods have been delivered or the related services have been performed. Entities will be required to evaluate whether they expect the goods or services to be rendered. If an entity does not expect the goods to be delivered or services to be rendered, the capitalized advance payment will be charged to expense. The consensus on EITF 07-03 is effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier application is not permitted. Entities are required to recognize the effects of applying the guidance in EITF 07-03 prospectively for new contracts entered into after the effective date. In accordance with EITF 07-03, the Company does evaluate its research and development contracts and payments within the guidance of EITF 07-03 and either expenses or capitalizes such payments based upon the contract terms.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable users of the financial statements to better understand the effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company has determined that there is no impact of adopting SFAS 161 on our financial statements.

The Company has adopted the guidance espoused in SFAS No. 165, "Subsequent Events" ("SFAS 165"), effective beginning in the quarter ended June 30, 2009 and have evaluated for disclosure subsequent events that have occurred up to September 21, 2009, the date of issuance of our financial statements. The adoption of this statement has not had a material impact to the financial statements.

## (4) Stock-Based Compensation:

During the three months ended June 30, 2009 and 2008, the Company recognized equity based compensation expense for stock options of \$0 and \$29,000, respectively, which was recognized in the Statement of Operations. During the six months ended June 30, 2009 and 2008, the Company recognized equity based compensation expense for stock options of \$0 and \$76,000, respectively, which was recognized in the Statement of Operations in general and administrative expenses. As of June 30, 2009, there was no unrecognized compensation costs related to non-vested awards. As of June 30, 2009, there were 1,429,677 options to purchase common stock outstanding under the Company's 2005 Stock Option Plan. However, if the Plan of Reorganization is approved and the funding from AAP has been achieved, all of these outstanding options will be canceled.

(5) Subsequent Event

Arbios Acquisition Partners Transaction.

In July 2009, Arbios Acquisition Partners funded an additional \$200,000 deposit to an escrow account. As of the end of August 2009, the Company had received a total of \$400,000 from AAP. Upon receipt of an additional \$400,000 from AAP, the Company intends to file the Notice of Effectiveness in the form of Counsel Certification with the Bankruptcy Court, and to emerge from Bankruptcy within the next few weeks.

Immunocept, LLC Settlement Agreement.

On July 21, 2009, the Company reached a settlement agreement with Immunocept whereby the Company agreed to terminate its license agreement in consideration for Immunocept to lower its amended proof of claim to an aggregate of no more than \$350,000.

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

SAFE HARBOR STATEMENT

In addition to historical information, the information included in this Quarterly Report on Form 10-Q contains forward-looking statements, such as those pertaining to the pending Chapter 11 bankruptcy proceedings, our ability to sell our assets in the bankruptcy proceedings, and the approval of the pending Plan of Reorganization. Forward-looking statements involve numerous risks and uncertainties and should not be relied upon as predictions of future events. Certain such forward-looking statements can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," "seeks," "approximately," "intends," "plans," "pro forma," "estimates," or "anticipates" or other variations thereof or comparable terminology, or by discussions of strategy, plans or intentions. Such forward-looking statements are necessarily dependent on assumptions, data or methods that may be incorrect or imprecise and may be incapable of being realized. The following factors, among others, including those risks set forth under "Factors That May Affect our Business And Our Future Results and Market Price of Our Stock," included in Item 6 "Management's Discussion and Analysis of Plan of Operation" of our Annual Report on Form 10-K for the year ended December 31, 2008 and other filings we make with the Securities and Exchange Commission could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements: need for a significant amount of additional capital, lack of revenue, uncertainty of product development, ability to obtain regulatory approvals in the United States and other countries, and competition. Readers are cautioned not to place undue reliance on forward-looking statements, which reflect our management's analysis only. We assume no obligation to update forward-looking statements.

Overview

During the past few years, our efforts have been principally devoted to research and development activities, raising capital, and recruiting additional scientific and management personnel and advisors. We have not marketed or sold any product and have not generated any revenues from commercial activities.

In May 2008, we received approval from the FDA to commence a Phase II/III pivotal clinical trial for SEPETTM. We estimated that the cost of completing these trials was between \$5 million and \$10 million. As we have done since our inception, we intended to raise the funds to complete our development from financing transactions. Unfortunately, because of the global economic crisis that began in 2008 and the dramatic decline in the availability of financing, particularly to development stage companies like ours, we were unable to raise the capital we needed to finance our operations and development activities. As a result, in order to preserve our remaining cash

while seeking financing and while attempting to otherwise maximize the value of our assets, in July of 2008 we terminated all of our employees and suspended most of our operations. We have not conducted any active operations since mid-2008, and our sole activity since that time has been to (i) seek sufficient capital to re-initiate our operations, (ii) find a strategic partner to co-develop our technologies with us, or (iii) sell our technologies and assets in a manner that will maximize shareholder value.

On January 9, 2009, this Company filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code (the “Bankruptcy”) with the United States Bankruptcy Court for the District of Delaware (the “Bankruptcy Court”). We are continuing to exist as a debtor-in-possession under the jurisdiction of the Bankruptcy Court.

On March 9, 2009, we entered into a Term Sheet with Arbios Acquisition Partners (“Acquisition Partners”) pursuant to which Acquisition Partners agreed to invest \$1,000,000 for the purchase of 90% of our common stock. The Bankruptcy Court confirmed the Plan on June 22, 2009. Through September 15, 2009, Acquisition Partners had paid us \$400,000 in installments (a portion of which is held in an escrow account). Another \$400,000 payment is expected to be received, thereby permitting the sale to be consummated (Acquisition Partners will provide the final \$200,000 following the Effective Date, on an as needed basis to fund our working capital requirements). The Plan of Reorganization to approve that transaction has been submitted to our creditors and stockholders and approved according to the Plan of Reorganization.

In order to have sufficient funds to operate, in October 2008, we sold our HepatAssist™ Cell-Based Liver Support System to HepaLife Technologies, Inc. (“HepaLife”). We purchased HepatAssist™ in April 2004 for \$450,000 but had not further developed that technology. We sold our HepatAssist™ system to HepaLife for (a) \$450,000 in cash, of which \$250,000 was paid in October 2008 and \$200,000 was deferred for up to 18 months from the date of sale, and (b) a warrant to purchase 750,000 shares of Series D common stock at an exercise price of \$0.35 per share. HepaLife prepaid the \$200,000 deferred payment on April 22, 2009, in consideration for the cancellation of the warrant to purchase 750,000 shares of HepaLife Series D common stock.

As part of the plan of reorganization to emerge from Bankruptcy, all of our current officers and directors will resign upon the Plan becoming Effective and prior to the time that we emerge from Bankruptcy, and new officers and directors will be appointed upon the plan or reorganization becoming Effective. Because current management will no longer be involved with the Company, current management is unable to address the future plans of this Company following the Bankruptcy proceedings. Accordingly, all information regarding the future operations, if any, of this Company, and the future liquidity needs of this Company have been omitted from this report.

#### Critical Accounting Policies

This discussion is based on our unaudited condensed financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these unaudited condensed financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates, including those related to revenue recognition, impairment of long-lived assets and their useful lives, including finite lived intangible costs, accrued liabilities and certain expenses. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates under different assumptions or conditions.

Our significant accounting policies are summarized in Note 1 to our audited financial statements for the year ended December 31, 2008 included in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our unaudited condensed financial statements:

#### Development Stage Enterprise



We are a development stage enterprise as defined by the Financial Accounting Standards Board's, or FASB, Statement of Financial Accounting Standards, or SFAS, No. 7, "Accounting and Reporting by Development Stage Enterprises." All losses accumulated since our inception have been considered part of our development stage activities.

## Cash

Cash consists of a debtor-in-possession checking account.

## Stock-Based Compensation

Commencing January 1, 2006, we adopted SFAS No. 123R, "Share Based Payment", or SFAS 123R, which requires all share based payments, including grants of stock options, to be recognized in the income statement as an operating expense, based on fair values.

Prior to adopting SFAS 123R, we accounted for stock-based employee compensation under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," as allowed by SFAS No. 123, "Accounting for Stock-Based Compensation," the predecessor to SFAS 123R. Accordingly, we have applied the modified prospective method in adopting SFAS 123R whereby periods prior to adoption have not been restated.

## Accounting for Uncertainty in Income Taxes

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," or FIN 48. This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements and prescribes a recognition threshold of more-likely-than-not to be sustained upon examination. Measurement of the tax uncertainty occurs if the recognition threshold has been met. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. In the normal course of business we are subject to examination by taxing authorities. At present, there are no ongoing audits or unresolved disputes with the various tax authorities that we file with. Given our substantial net operating loss carryforwards as well as historical operating losses, the adoption of FIN 48 on January 1, 2007 did not have any effect on our financial position, results of operations or cash flows as of or for the period ended June 30, 2009.

## Results of Operations

Since we have been involved in developing our product candidates and do not have any products available for sale, we have not yet generated any revenue from sales. Inception to date revenue represents revenue recognized from an SBIR government grant.

General and administrative expenses of approximately \$285,000 and \$492,000 were incurred for the three months ended June 30, 2009 and 2008, respectively. General and administrative expenses for the three months ended June 30, 2009 decreased by approximately \$207,000 from the prior year's level, reflecting our suspended operations beginning in the September 30, 2008 fiscal quarter. The decrease is primarily attributed to a \$67,000 decrease in legal and consulting fees from the curtailment of patent work and a decline in contract negotiating costs in 2009. In addition, there also was an overall decline in virtually all expense categories as a result of curtailed operations due to a lack of capital resources and our voluntary Chapter 11 bankruptcy filing on January 9, 2009. General and administrative expenses of approximately \$404,000 and \$1,212,000 were incurred for the six months ended June 30, 2009 and 2008, respectively. General and administrative expenses for the six months ended June 30, 2009 decreased by approximately \$808,000 over the prior year level. The decrease is primarily attributed to a \$303,000 decrease in non cash option and warrant charges due to a decline in the number of stock options granted and a non recurring 2008 charge incurred for warrant extensions, a \$71,000 decline in payroll costs due to staff reductions and a \$169,000 decrease in legal and consulting fees from the curtailment of patent work and a decline in contract negotiating costs in 2009. In addition, there also was an overall decline in virtually all expense categories as a result of curtailed operations due to a lack of capital resources and our voluntary Chapter 11 bankruptcy filing on January 9, 2009.

Research and development expenses of approximately \$0 and \$346,000 were incurred for the three months ended June 30, 2009 and 2008, respectively. The research and development expenses for the three months ended June 30, 2009 decreased by approximately \$346,000 over the comparable prior year level. Research and development expenses of approximately \$0 and \$1,056,000 were incurred for the six months ended June 30, 2009 and 2008, respectively. The research and development expenses for the three months ended June 30, 2009 decreased by approximately \$1,056,000 over the comparable prior year level. The decline in research and development expenses for the three and six months ended June 30, 2009 is due to the curtailment of all research and development activities in the fourth quarter of 2008 due to a lack of capital resources and our voluntary Chapter 11 bankruptcy filing on January 9, 2009.

Reorganization costs for the three and six months ended June 30, 2009 were approximately \$185,000 and \$259,000, respectively, and consist primarily of legal fees incurred in the Bankruptcy proceedings.

Loss on investment for the six months ended June 30, 2009 resulted from the surrender and cancellation of the HepaLife warrant in exchange for an acceleration and prepayment of a \$200,000 receivable payment due from HepaLife.

Interest income of \$0 and \$8,200 was earned for the three months ended June 30, 2009 and 2008, respectively. Interest income of \$200 and \$28,500 was earned for the six months ended June 30, 2009 and 2008, respectively. The change in interest income primarily reflects lower cash and cash equivalent balances in 2009 from prior year levels and a decline in interest rates earned on our cash account.

Our net loss was approximately \$470,000 and \$830,000 for the three months ended June 30, 2009 and 2008, respectively. Our net loss was approximately \$750,000 and \$2,240,000 for the six months ended June 30, 2009 and 2008, respectively. The decrease in net loss for the three and six month periods ended June 30, 2009 compared to the comparable period in 2008 is due to the curtailment of operating and research and development activities due to the lack of capital resources.

#### Liquidity and Capital Resources

Because we did not have the financial resources to continue to develop our products, on January 9, 2009 we filed for protection under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. The Bankruptcy enabled us to continue to seek investors in our equity and bids for the purchase of our assets while working with our creditors. Our Board of Directors determined that, in light of our limited cash position and the current economic conditions and financial markets, the best course of action was to obtain financing and/or sell our assets under bankruptcy protection.

As of June 30, 2009, we had cash of approximately \$186,000, restricted cash of approximately \$200,000, current liabilities of approximately \$1,123,000 and liabilities subject to settlement under reorganization proceedings of approximately \$111,000. Prior to our Bankruptcy filing, we funded our operations primarily from the sale of equity securities and, to a lesser extent, from SBIR grants. Since our Bankruptcy commenced, we have funded our operating expenses and bankruptcy costs through our remaining cash resources and the \$450,000 we received in October 2008 and April 2009 from the sale of certain assets to the HepatAssist™. In addition, we have also received a total of approximately \$400,000 in cash deposits from Acquisition Partners, portions of which are currently held in an escrow account with our Bankruptcy counsel as part of the \$1,000,000 investment we will receive from Acquisition Partners when the sale of shares to Acquisition Partners is completed. The foregoing funds constitute our sole source of liquidity. Assuming the Reorganization Plan becomes Effective, closing the transaction with Acquisition Partners, we anticipate that we may have sufficient funds to pay our post petition administrative costs and expenses, and 90% of the principal amount of allowed claims of general unsecured claim holders.

As a development stage company that is in bankruptcy, we do not have any bank credit lines or any other sources of capital. All of our operations have been terminated pending our emergence from Bankruptcy. As part of our Bankruptcy plan of reorganization, we agreed to sell 90% of our common stock to Acquisition Partners in exchange for a total of \$1,000,000 of consideration (\$800,000 in cash for the plan to become effective and \$200,000 after the Effective date to fund operations, as needed on terms and conditions to be determined). When we emerge from Bankruptcy, which we expect will occur by no later than October, 2009, we expect to have some of the \$1,000,000 purchase price available to us. However, any funds that we will have on hand following the Bankruptcy will not be sufficient to continue the development of our product candidates. Accordingly, if the new officers and directors (who will replace the current officers and directors at the time that the Plan becomes Effective) elect to continue to develop

our liver technologies, we will have to obtain additional funding. However, the current management of this company is not aware of the future development or other plans of the new officers and directors, and it is possible that the new management of the company will choose not to develop our liver technologies (or not develop them in the manner that we had planned to do before the Bankruptcy).

Our license agreement with Immunocept, LLC has been terminated as part of the bankruptcy proceeding. As part of the termination of this license, we will have to pay Immunocept \$350,000 as a general unsecured claim once the Reorganization Plan becomes Effective. This payment is expected to be funded from the funds we have received from Acquisition Partners.

In the event, Acquisition Partners is unable to deliver the remaining money needed to confirm the Plan of Reorganization in the next few weeks, we may be forced to liquidate the remaining assets of the Company.

We do not believe that inflation has had a material impact on our business or operations.

We do not engage in trading activities involving non-exchange traded contracts. In addition, we have no financial guarantees, debt or lease agreements or other arrangements that could trigger a requirement for an early payment or that could change the value of our assets.

#### Off- Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements.

#### ITEM 3. Qualitative and Quantitative Disclosures about Market Risk.

Not applicable as we are a smaller reporting company.

#### ITEM 4T. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures. As of the end of the period covered by this report, our company conducted an evaluation, under the supervision and with the participation of our Interim Chief Executive Officer and Chief Financial Officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) of the Securities Exchange Act of 1934, as amended, or the Exchange Act). Based on this evaluation, our Interim Chief Executive Officer and Interim Chief Financial Officer concluded that our company's disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosures.

(b) Changes in Internal Controls. There was no change in our internal controls, which are included within disclosure controls and procedures, during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls.

(c) Limitations on the Effectiveness of Controls. Our management, including our interim chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within an organization have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake.

## PART II. OTHER INFORMATION

#### ITEM 1. Legal Proceedings.

On January 9, 2009, the Company filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code (the “Bankruptcy Code”) with the United States Bankruptcy Court for the District of Delaware (the “Bankruptcy Court”), Case Number 09-10082 (the “Bankruptcy”). Other than the pending legal proceedings before the Bankruptcy Court related to our Plan of Reorganization, we are not engaged in any other legal proceedings.

ITEM 1A. Risk Factors.

Information regarding risk factors appears under “Factors That May Affect our Business And Our Future Results and Market Price of Our Stock,” included in Item 6 “Management’s Discussion and Analysis of Plan of Operation” of our Annual Report on Form 10-K for the year ended December 31, 2008 as filed with the Securities and Exchange Commission. Except as set forth below, there have been no material changes from the risk factors previously disclosed in that Annual Report on Form 10-K.

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

None.

ITEM 3. Defaults Upon Senior Securities.

None.

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

None.

ITEM 5. Other Information.

None.

ITEM 6. Exhibits.

- 31.1 Certification of Principal Executive Officer Pursuant to Section 302
- 31.2 Certification of Principal Financial Officer Pursuant to Section 302
- 32 Section 906 certification of periodic financial report by Chief Executive Officer and Chief Financial Officer.



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ARBIOS SYSTEMS, INC.

DATE: September 21, 2009

By: /S/ SHAWN CAIN  
Shawn Cain  
Interim Chief Executive Officer (Principal  
Executive Officer)

DATE: September 21, 2009

By: /S/ SCOTT HAYASHI  
Scott Hayashi  
Interim Chief Financial Officer (Principal  
Financial Officer)