ATHEROGENICS INC
Form 10-Q
August 11, 2008

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

FORM 10-Q

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

For the quarterly period ended June 30, 2008

Commission File No. 0-31261

ATHEROGENICS, INC.
(Exact name of registrant as specified in its charter)

Georgia	58-2108232
(State of incorporation)	(I.R.S. Employer Identification Number)

8995 Westside Parkway, Alpharetta, Georgia 30004
(Address of registrant's principal executive offices, including zip code)

(Registrant's telephone number, including area code): (678) 336-2500

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Act).
Large accelerated filer [ ] Accelerated filer [X]

Non-accelerated filer [ ] 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 [X]

As of August 4, 2008 there were 39,518,492 shares of the registrant's common stock outstanding.

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PART I. – FINANCIAL INFORMATION

Item 1. Financial Statements

ATHEROGENICS, INC.
CONDENSED BALANCE SHEETS
(Unaudited)

	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 64,213,034	$ 74,795,388
Short-term investments	2,001,490	18,080,032
Accounts receivable	200,315	2,634,422
Prepaid expenses and other current assets	655,934	1,290,260
Total current assets	67,070,773	96,800,102
Equipment and leasehold improvements, net of accumulated depreciation and amortization	2,004,571	2,361,053
Debt issuance costs and other assets	3,333,154	3,977,873
Total assets	$ 72,408,498	$ 103,139,028
Liabilities and Shareholders' Deficit		
Current liabilities:		
Accounts payable	$ 1,648,117	$ 781,119
Accrued research and development	3,131,771	3,765,745
Accrued interest	2,785,970	2,876,150
Accrued compensation	1,293,065	2,258,051
Accrued and other liabilities	664,218	920,736
Current portion of convertible notes payable	30,500,000	35,968,750
Total current liabilities	40,023,141	46,570,551
Convertible notes payable, net of current portion	254,551,972	252,163,102
Shareholders' deficit:		
Preferred stock, no par value: Authorized—5,000,000 shares	—	—
Common stock, no par value:		
Authorized—100,000,000 shares; issued and outstanding — 39,518,492 shares at June 30, 2008		

and December 31, 2007	217,906,498	215,243,310
Warrants	613,021	613,021
Accumulated deficit	(440,688,351)	(411,465,815)
Accumulated other comprehensive gain	2,217	14,859
Total shareholders' deficit	(222,166,615)	(195,594,625)
Total liabilities and shareholders' deficit	$ 72,408,498	$ 103,139,028

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

ATHEROGENICS, INC.
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Revenues:				
License fees	$ —	$ 20,833,333	$ —	$ 27,083,333
Research and development	—	9,425,371	—	14,636,623
Total revenues	—	30,258,704	—	41,719,956
Operating expenses:				
Research and development	8,463,710	22,330,198	17,713,772	42,294,473
Marketing, general and administrative	2,926,498	3,587,195	6,061,657	7,532,698
Restructuring and impairment costs	—	9,996,332	—	9,996,332
Total operating expenses	11,390,208	35,913,725	23,775,429	59,823,503
Operating loss	(11,390,208)	(5,655,021)	(23,775,429)	(18,103,547)
Interest and other income	480,724	1,604,120	1,374,361	3,487,803
Interest expense	(3,421,158)	(2,087,780)	(6,821,468)	(4,175,561)
Net loss	$ (14,330,642)	$ (6,138,681)	$ (29,222,536)	$ (18,791,305)
Net loss per share – basic and diluted	$ (0.36)	$ (0.16)	$ (0.74)	$ (0.48)
Weighted average shares outstanding – basic and diluted	39,518,492	39,498,338	39,518,492	39,483,280

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

ATHEROGENICS, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six months ended June 30,	
	2008	2007
Operating activities		
Net loss	$ (29,222,536)	$ (18,791,305)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	2,663,188	4,842,775
Amortization on 4.5% convertible notes due 2011	2,388,870	—
Amortization of debt issuance costs	623,384	740,562
Depreciation and amortization	390,082	495,165
Amortization of deferred revenue	—	(27,083,333)
Asset impairment costs	—	9,005,153
Changes in operating assets and liabilities:		
Accounts receivable	2,434,107	(10,008,699)
Prepaid expenses and other assets	655,661	1,588,981
Accounts payable	866,998	7,355,260
Accrued research and development	(633,974)	(4,804,600)
Accrued interest	(90,180)	—
Accrued compensation	(964,986)	297,712
Accrued and other liabilities	(256,518)	(81,927)
Net cash used in operating activities	(21,145,904)	(36,444,256)
Investing activities		
Sales and maturities of short-term investments	16,065,900	71,295,574
Purchases of short-term investments	—	(44,306,574)
Purchases of equipment and leasehold improvements	(33,600)	(660,693)
Net cash provided by investing activities	16,032,300	26,328,307
Financing activities		
Retirement of 4.5% convertible notes due 2008	(5,468,750)	—
Proceeds from the exercise of common stock options	—	20,074
Net cash (used in) provided by financing activities	(5,468,750)	20,074

Decrease in cash and cash equivalents	(10,582,354)	(10,095,875)
Cash and cash equivalents at beginning of period	74,795,388	87,846,079
Cash and cash equivalents at end of period	$ 64,213,034	$ 77,750,204
Supplemental disclosures		
Interest paid	$ 3,899,396	$ 3,435,000

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

ATHEROGENICS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. Organization and Nature of Operations

AtheroGenics, Inc. ("AtheroGenics") was incorporated on November 23, 1993 (date of inception) in the State of Georgia to focus on the discovery, development and commercialization of novel therapeutics for the treatment of chronic inflammatory diseases, including diabetes and coronary heart disease.

2. Basis of Presentation

The accompanying unaudited condensed financial statements reflect all adjustments (consisting solely of normal recurring adjustments) which management considers necessary for a fair presentation of the financial position, results of operations and cash flows of AtheroGenics for the interim periods presented. Certain footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted from the interim financial statements as permitted by the rules and regulations of the Securities and Exchange Commission (the "SEC"). Interim results are not necessarily indicative of results for the full year.

The accompanying unaudited condensed financial statements have been prepared assuming that AtheroGenics will continue as a going concern. Our ability to continue as a going concern is contingent upon us restructuring our 4.5% convertible notes due September 1, 2008 (the "2008 Notes") before they become due, or repaying the 2008 Notes and seeking to raise capital or exploring collaboration agreements to fund the development of AGI-1067. As discussed below, if we fail to adequately address our liquidity concerns, then our independent auditors may issue a qualified opinion on our December 31, 2008 audited financials if at that time there is a is substantial doubt about our ability to continue as a going concern.

The interim results should be read in conjunction with the financial statements and notes thereto included in AtheroGenics' Annual Report on Form 10-K for the year ended December 31, 2007 (the "Form 10-K"). Shareholders are encouraged to review the Form 10-K for a broader discussion of the opportunities and risks inherent in AtheroGenics' business. Copies of the Form 10-K are available on request.

3. Accounts Receivable

Accounts receivable consists of receivables related to our license and collaboration agreement with AstraZeneca (See Note 4) and a manufacturing and supply agreement with ISP Pharma Systems LLC (See Note 11).

4. Revenue Recognition

AtheroGenics recognizes license fee revenues in accordance with the SEC's Staff Accounting Bulletin ("SAB") No. 101, Revenue Recognition in Financial Statements, as amended by SAB No. 104, Revenue Recognition, ("SAB 104"). SAB 104 provides guidance in applying U.S. generally accepted accounting principles to revenue recognition issues, and specifically addresses revenue recognition for upfront, nonrefundable fees received in connection with research collaboration agreements.

In accordance with SAB 104, license fees, which are nonrefundable, are recognized over the period the related license agreements specify that efforts or obligations are required of AtheroGenics. In 2006, AtheroGenics received a $50 million license fee in connection with its license and collaboration agreement with AstraZeneca. The upfront nonrefundable license payment was being recognized on a straight-line basis over the 24-month period that

AtheroGenics estimated it was obligated to provide services to the licensee. In 2007, AstraZeneca announced that it was ending the license and collaboration agreements and any further obligations required of AtheroGenics at which time the remaining unamortized deferred revenue was recognized.

During 2006, AstraZeneca separately engaged AtheroGenics to perform FOCUS (Follow-up Of Clinical Outcomes: The Long-term AGI-1067 plus Usual Care Study), a follow-up Phase III clinical trial for patients who

have completed ARISE (Aggressive Reduction of Inflammation Stops Events). Revenues under the research and development agreement pertaining to FOCUS were recognized in accordance with Emerging Issues Task Force ("EITF") Issue No. 99-19, Reporting Gross Revenue as a Principal vs. Net as an Agent. According to the criteria established by EITF Issue No. 99-19, AtheroGenics was the primary obligor of the agreement because it was responsible for the selection, negotiation, contracting and payment of the third party suppliers. In addition, any liabilities resulting from the agreement were the responsibility of AtheroGenics. Research and development revenues were recognized, on a gross basis, as activities were performed under the terms of the related agreement. FOCUS was concluded in 2007.

5. Restructuring and Impairment Costs

In May 2007, AtheroGenics implemented an organizational restructuring plan that reduced its workforce. This action was designed to streamline AtheroGenics' operations and was the first step in the strategic plan to continue advancing the development of AGI-1067. As a result, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 146, Accounting for Costs Associated with Exit or Disposal Activities, AtheroGenics recorded a charge of approximately $1.0 million in the second quarter of 2007.

In addition to the reduction in workforce, AtheroGenics determined that in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, certain excess laboratory equipment and related leasehold improvements, as well as commercial manufacturing equipment had been impaired. As AtheroGenics has no assurance that such assets will be utilized, an impairment test was performed in accordance with SFAS No. 144 based on estimates of cash flows associated with the equipment. AtheroGenics recorded a non-cash impairment charge of approximately $9.0 million in the second quarter of 2007.

6. Income Tax

AtheroGenics files a U.S. federal and Georgia income tax return on an annual basis. AtheroGenics is no longer subject to U.S. federal income or state tax return examinations by tax authorities for years before 2002. However, since AtheroGenics has substantial tax net operating losses originating in years before 2002, the tax authorities may review the amount of the pre-2002 net operating losses. AtheroGenics is not currently under examination by any tax authority.

AtheroGenics adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48") effective January 1, 2007. No cumulative adjustment was required or recorded as a result of the implementation of FIN 48. As of June 30, 2008, AtheroGenics had no unrecognized tax benefits. AtheroGenics will recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense when and if incurred. AtheroGenics does not anticipate that unrecognized benefits will be incurred within the next 12 months.

7. Net Loss per Share

SFAS No. 128, Earnings per Share, requires presentation of both basic and diluted earnings per share. Basic earnings per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed in the same manner as basic earnings per share except that diluted earnings per share reflects the potential dilution that would occur if outstanding options, warrants and convertible notes were exercised. Because AtheroGenics reported a net loss for all periods presented, shares associated with stock options, warrants and convertible notes are not included because their effect would be antidilutive. Basic and diluted net loss per share amounts are the same for the periods presented.

8. Stock-Based Compensation

AtheroGenics recognizes stock-based compensation in accordance with SFAS No. 123(R), Share-Based Payment. Stock-based compensation of $1.3 million and $2.7 million was recorded for the three and six months ended June 30, 2008, and $2.2 million and $4.8 million for the comparable periods in 2007. AtheroGenics' net loss per share

was increased by $(0.04) and $(0.07) for stock-based compensation related to stock options for the three and six months ended June 30, 2008, respectively, compared to $(0.06) and $(0.12) for the comparable periods in 2007. As of June 30, 2008 and 2007, AtheroGenics has a net operating loss carryforward and therefore no excess tax benefits for tax deductions related to the stock options were recognized.

For the three and six months ended June 30, 2008 and 2007, AtheroGenics calculated a forfeiture rate of 11.66% and 7.58%, respectively, based on historical data. Expected volatility is based on historical volatility of AtheroGenics' common stock. The expected term of the stock options granted is also based on historical data and represents the period of time that stock options granted are expected to be outstanding. The risk free interest rate is based on the U.S. Treasury rates in effect at the time of the grant for periods corresponding with the expected term of the options. During the three months and six months ended June 30, 2008, AtheroGenics granted 201,800 and 219,800 stock options, respectively, from the 2004 AtheroGenics, Inc. Equity Ownership Plan (the "2004 Plan"). During the three and six months ended June 30, 2007, AtheroGenics granted 1,049,029 stock options from the 2004 Plan .. For stock options granted during the three months and six months ended June 30, 2008 and 2007 the following weighted average assumptions were used:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Expected volatility	89.52%	83.10%	89.14%	83.10%
Expected term	5 years	3.5 years	5 years	3.5 years
Risk free interest rate	3.24%	4.92%	3.21%	4.92%
Fair value of grants	$0.42	$1.42	$0.41	$1.42

9. Convertible Notes Payable

In August 2003, AtheroGenics issued $100.0 million in aggregate principal amount of our 2008 Notes with interest payable semi-annually in March and September. Net proceeds to AtheroGenics were approximately $96.7 million, after deducting expenses and underwriters' discounts and commissions. The issuance costs related to the notes are recorded as debt issuance costs and other assets and are being amortized to interest expense over the five-year life of the notes. The 4.5% convertible notes may be converted at the option of the holder into shares of AtheroGenics common stock prior to the close of business on September 1, 2008 at a conversion rate of 65.1890 shares per $1,000 principal amount of notes, representing a conversion price of approximately $15.34 per share.

In January 2006, AtheroGenics exchanged $14.0 million in aggregate principal amount of the 2008 Notes for approximately 1.1 million shares of AtheroGenics common stock. In accordance with SFAS No. 84, Induced Conversion of Convertible Debt, this transaction resulted in a non-cash charge of approximately $3.5 million related to the premium paid in excess of the conversion price in order to induce conversion of the notes.

In July 2007, AtheroGenics extinguished $38.0 million in aggregate principal amount of the 2008 Notes with certain holders and issued $60.4 million in aggregate principal amount of 4.5% convertible notes due March 1, 2011 (the "2011 Notes"). This exchange was accounted for as an extinguishment of the 2008 Notes in accordance with EITF 96-19, Debtor's Accounting for a Modification or Exchange of Debt Instruments. The 2011 Notes were initially recorded at their fair value of $38.0 million. The $22.4 million difference between the principal amount and the initial fair value of the 2011 Notes, the discount, will be accreted up to the face amount of $60.4 million as additional interest expense using the effective interest method over the remaining life of the new convertible notes. As of June

30, 2008, the remaining balance of the discount on these notes was approximately $17.8 million.

In January 2008, AtheroGenics redeemed $17.5 million of its 2008 Notes and, in exchange, issued $11.5 million of 2011 Notes along with $5.5 million of cash. This transaction was accounted for as a modification in accordance with EITF 96-19. AtheroGenics determined that the carrying value of the new 2011 Notes was $12.0 million. As $11.5 million of 2011 Notes were issued, this resulted in a premium of approximately $500,000 that is being amortized as an offset to interest expense over the life of these 2011 Notes.

The terms of the 2011 Notes are substantially similar to the 2008 Notes including the same customary default events except that the 2011 Notes will mature in March 2011 as opposed to September 2008. The 2011 Notes, like the 2008 Notes, bear an interest rate of 4.5%, payable semiannually in arrears on March 1 and September 1.

Like the 2008 Notes, the 2011 Notes are convertible into shares of AtheroGenics common stock at any time prior to the close of business on the final maturity date, subject to AtheroGenics' right to redeem the 2011 Notes prior to their maturity. The initial conversion rate for the 2011 Notes is 65.1890 shares per $1,000 principal amount of 2011 Notes.

Also like the 2008 Notes, AtheroGenics may be required to redeem the 2011 Notes on an accelerated basis if AtheroGenics defaults on certain other debt obligations or if AtheroGenics common stock or consideration received in exchange for such common stock is not tradable on a national securities exchange or system of automated quotations.

In January 2005, AtheroGenics issued $200.0 million in aggregate principal amount of 1.5% convertible notes due February 1, 2012 (the "2012 Notes") with interest payable semi-annually in February and August. Net proceeds to AtheroGenics were approximately $193.6 million, after deducting expenses and underwriters' discounts and commissions. The issuance costs related to the notes are recorded as debt issuance costs and other assets and are being amortized to interest expense over the seven-year life of the notes. The 2012 Notes are convertible into shares of common stock, at the option of the holder, at a conversion rate of 38.5802 shares per $1,000 principal amount of notes, which represents a conversion price of approximately $25.92 per share.

The conversion rate for all of the notes is subject to adjustment for stock dividends and other dilutive transactions. In addition, AtheroGenics' Board of Directors may, to the extent permitted by applicable law, increase the conversion rate provided that the Board of Directors has determined that such increase is in the best interest of AtheroGenics and such increase remains effective for a period of at least twenty days. AtheroGenics may also be required to redeem the notes on an accelerated basis if AtheroGenics defaults on certain other debt obligations or if AtheroGenics common stock or consideration received in exchange for such common stock is not tradable on a national securities exchange or system of automated quotations.

As of June 30, 2008, AtheroGenics has reserved a total of approximately 14.4 million shares of common stock for future issuances in connection with all of the convertible notes. In addition, as of June, 2008, there was approximately $1.5 million of accrued interest expense related to the 2008 and 2011 Notes, which is due September 1, 2008, and $1.3 million of accrued interest expense related to the 2012 Notes, which was paid on August 1, 2008.

The following table summarizes our convertible notes as of June 30, 2008:

2008 Notes	$ 30,500,000
2011 Notes	71,898,000
2012 Notes	200,000,000
Face value of convertible notes	271,898,000
Discount on the 2011 Notes	(17,809,522)
Premium on the 2011 Notes	463,494
Total 2011 Notes and 2012 Notes	$ 254,551,972

Although we expect to have enough cash on hand to repay all amounts due pursuant to the 2008 Notes on September 1, 2008, any such repayment would leave substantially less cash to fund our ongoing operations. Our options to address this situation are to attempt to restructure our 2008 Notes before they become due, repay the 2008 Notes and seek to raise additional capital to fund our ongoing operations, explore collaboration agreements to fund the development of AGI-1067, or not repay the 2008 Notes at maturity and seek relief under Title 11 of the U.S. Code

(the “Bankruptcy Code”).

10. Recently Issued Accounting Standards

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, Fair Value Measurements, ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. AtheroGenics' available-for-sale securities must be measured under the fair value standard of the fair value hierarchy as of June 30, 2008. The fair value of available-for-sale securities was determined based on quoted market prices. Available-for-sale securities are reflected on AtheroGenics condensed balance sheet in short-term investments and related gains and losses are recorded in accumulated other comprehensive gain. The adoption of SFAS 157 on January 1, 2008 did not have an impact on AtheroGenics' results of operations.

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments at fair value rather than under other GAAP, such as historical costs. This results in the financial instrument being marked to fair value every reporting period with the gain or loss from a change in the fair value recorded in the statement of operations. SFAS 159 is effective for fiscal years beginning after November 17, 2007. AtheroGenics did not elect the fair value option for any assets or liabilities previously recorded at historical cost.

11. Commitments and Contingencies

In April 2008, AtheroGenics entered into a Manufacturing and Supply Agreement (the "Agreement") with ISP Pharma Systems LLC ("ISP") for the manufacture and supply of the active pharmaceutical ingredient and an intermediate product (the "Product") of AtheroGenics' product candidate, AGI-1067.

The initial term of the Agreement expires on April 1, 2013 and the Agreement is automatically extended for successive two year terms thereafter if neither AtheroGenics nor ISP gives notice of non-renewal 180 days prior to the expiration of the initial or renewal term.

Under the terms of the Agreement, ISP has agreed to accept certain equipment used in the manufacture of the Product from AtheroGenics, in exchange for producing initial batches of the Product. If AtheroGenics elects to discontinue development of AGI-1067 after completion of an on-going clinical trial, AtheroGenics has agreed to pay ISP a specified fee for this work. In addition, ISP has agreed to supply, and AtheroGenics has agreed to purchase, specified percentages, which change over time, of the worldwide production requirements for the Product. AtheroGenics will pay ISP a specified purchase price, which varies based on annual quantities of the Product supplied. This purchase price is adjustable based on any changes in Product specifications mandated by AtheroGenics, and, following the end of each contract year, based upon certain industry price indices.

The Agreement also contains certain provisions regarding the rights and responsibilities of the parties with respect to manufacturing specifications, forecasting and ordering, delivery arrangements, payment terms, change orders, intellectual property rights, confidentiality and indemnification, as well as other customary terms and provisions.

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

The following should be read with the financial statements and related footnotes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in AtheroGenics' Annual Report on Form 10-K for the fiscal year ended December 31, 2007. The results discussed below are not necessarily indicative of the results to be expected in any future periods. The following discussion contains forward-looking statements that are subject to risks and uncertainties which could cause actual results to differ from the statements made. These risks are set forth in

more detail in our Form 10-K for the fiscal year ended December 31, 2007 under the headings “Risk Factors” and “Forward –Looking Statements” below. In this report, "AtheroGenics," "we," "us" and "our" refer to AtheroGenics, Inc.

Overview

AtheroGenics is a research-based pharmaceutical company focused on the discovery, development and commercialization of novel drugs for the treatment of chronic inflammatory diseases, including diabetes and coronary heart disease. We currently have one late stage clinical drug development program.

AGI-1067 is our investigational drug with demonstrated anti-inflammatory and antioxidant properties. AGI-1067 works by selectively inhibiting signaling pathways that are activated in response to oxidative stress and pro-inflammatory stimuli. Oxidative stress and inflammation have been implicated as playing a key role in the pathogenesis of insulin resistance and diabetes.

In 2003, we initiated a Phase III trial, referred to as ARISE (Aggressive Reduction of Inflammation Stops Events), which evaluated the impact of AGI-1067 on a composite measure of heart disease outcomes, including death due to coronary disease, myocardial infarction (heart attack), stroke, coronary re-vascularization and unstable angina. Important measures of glycemic control were included for patients with diabetes who also had coronary heart disease. The study assessed the incremental benefits of AGI-1067 versus the current standard of care therapies in this patient population. As such, all patients in the trial, including those on placebo, received other appropriate heart disease and diabetes medications, including statins and other cholesterol-lowering therapies, and glycemic control agents.

The ARISE trial results were reported in March 2007 and demonstrated that while AGI-1067 did not show a difference from placebo in the composite primary endpoint, the study did achieve a number of other important predefined endpoints. These endpoints included a reduction in the composite of “hard” atherosclerotic clinical endpoints, composed of cardiovascular death, resuscitated cardiac arrest, myocardial infarction and stroke. AGI-1067 achieved a significant reduction of 19% in the rate of these combined hard endpoints. There were also improvements in the key diabetes parameters of new-onset diabetes and glycemic control. Based on our review of the ARISE results, we are pursuing continued development of the compound, initially as a diabetes medication. We expect that two positive registration studies in patients with diabetes will be required to submit a New Drug Application (“NDA”) for marketing approval.

In August 2007, we commenced the first registration study for diabetes called ANDES, a multi-center, double-blind study with 6-month dosing using two doses (150mg and 75mg), designed to compare the effects of AGI-1067 versus placebo on glycemic endpoints in subjects with confirmed Type 2 diabetes. In July 2008, we announced top-line results that showed both doses, 150mg and 75mg, of AGI-1067 met the primary efficacy endpoint of the reduction in glycosylated hemoglobin (A1c) versus placebo at the end of the study’s six month dosing regimen. Further development activity, including design of the second registration study, will be determined after conducting in-depth analysis of the ANDES data and discussions with the FDA.

In 2005, we entered into a license and collaboration agreement with AstraZeneca for the global development and commercialization of AGI-1067. Under the terms of the agreement, we received a license fee of $50 million. In April 2007, AstraZeneca notified us that pursuant to the terms of the agreement, it was ending the collaboration. The agreement was terminated in July 2007.

In the second half of 2006, we were engaged by AstraZeneca to conduct FOCUS (Follow-up Of Clinical Outcomes: The Long-term AGI-1067 plus Usual Care Study). FOCUS was a follow-up Phase III clinical trial for patients exiting ARISE, designed to collect extended safety information. Pursuant to the terms of our license agreement, AstraZeneca funded the entire cost of the trial, which has been concluded.

AGI-1096, our second v-protectant® candidate, is a novel antioxidant and selective anti-inflammatory agent to address the accelerated inflammation of grafted blood vessels, known as transplant arteritis, common in chronic organ transplant rejection. We worked with Astellas Pharma Inc. ("Astellas") to further develop AGI-1096, with Astellas funding the costs for development activities under the agreement. Astellas has informed us that they have completed their current development activities and do not have further development plans. We are not currently undertaking any development activities on AGI-1096.

The following table provides information regarding our research and development expenses for our major product candidates:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Direct external AGI-1067 costs	$4,702,957	$15,168,587	$10,138,944	$25,611,487
Unallocated internal costs and other programs	3,760,753	7,161,611	7,574,828	16,682,986
Total research and development	$8,463,710	$22,330,198	$17,713,772	$42,294,473

From inception, we have devoted the large majority of our research and development efforts and financial resources to support development of the AGI-1067 product candidate.

The nature, timing and costs of the efforts to complete the successful development of any of our product candidates are highly uncertain and subject to numerous risks, and therefore cannot be accurately estimated. These risks include the rate of progress and costs of our clinical trials, clinical trial results, cost and timing of regulatory approval and establishing commercial manufacturing supplies. These risks and uncertainties, and their effect on our operations and financial position, are more fully described in our risk factors included in our Form 10-K under the headings Risks Related to Development and Commercialization of Product Candidates and Dependence on Third Parties and Risks Related to Regulatory Approval of Our Product Candidates.

We have not derived any commercial revenues from product sales. We expect to incur significant losses in most years prior to deriving any such product revenue. We have funded our operations primarily through sales of equity and debt securities. We have incurred significant losses since we began operations and, as of June 30, 2008, had an accumulated deficit of $440.7 million. We cannot assure you that we will become profitable. We expect that losses will fluctuate from quarter to quarter and that these fluctuations may be substantial. Our ability to achieve profitability depends upon our ability, alone or with others, to complete the successful development of our product candidates, to obtain required regulatory clearances and to manufacture and market our future products.

Critical Accounting Policies and Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions and select accounting policies that affect the amounts reported in our financial statements and the accompanying notes. Actual results could significantly differ from those estimates. AtheroGenics considers certain accounting policies related to use of estimates, research and development accruals, revenue recognition and stock-based compensation to be critical policies. There have been no material changes in the critical accounting policies from what was previously disclosed in our Form 10-K.

Results of Operations

Comparison of the Three and Six Months Ended June 30, 2008 and 2007

Revenues

No revenues were recorded for the three and six months ended June 30, 2008 compared to total revenues of $30.3 million and $41.7 million, respectively, for the comparable periods in 2007. License fee revenues of $20.8 million and $27.1 million for the three and six months ended June 30, 2007, respectively, were related to the AGI-1067 license agreement with AstraZeneca that was concluded in 2007. The research and development revenues of $9.4 million and $14.6 million for the three and six months ended June 30, 2007, respectively, were for services performed

for AstraZeneca related to the FOCUS clinical trial, which was also concluded in 2007.

Expenses

Research and Development. Research and development expenses were $8.5 million and $22.3 million for the three months ended June 30, 2008 and 2007, respectively, and $17.7 million and $42.3 million for the six

months ended June 30, 2008 and 2007, respectively. The decrease in research and development expenses in the three and six months ended June 30, 2008 is primarily due to decreased expenditures for the ARISE and FOCUS clinical trials, which were concluded in 2007, and lower personnel costs resulting from the organizational restructuring in May 2007. This is partially offset by expenditures in the three and six months ended June 30, 2008 for the ANDES clinical trial which commenced in the second half of 2007.

Marketing, General and Administrative. Marketing, general and administrative expenses were $2.9 million and $3.6 million for the three months ended June 30, 2008 and 2007, respectively, and $6.1 million and $7.5 million for the six months ended June 30, 2008 and 2007, respectively. The decrease in both periods is primarily due to lower personnel related costs and professional fees.

Restructuring and Impairment Costs. Restructuring and impairment costs of $10.0 million for the three and six months ended June 30, 2007 were incurred for the write-off of impaired manufacturing assets, as a result of the transition of commercial manufacturing activities from AstraZeneca, as well as severance and asset impairment costs from an organization restructuring the occurred during the second quarter of 2007.

Interest and Other Income

Interest and other income is primarily comprised of income earned on our cash and short-term investments. Interest and other income decreased to $480,724 for the three months ended June 30, 2008 from $1.6 million for the comparable period in 2007 and to $1.4 million for the six months ended June 30, 2008 from $3.5 million for the comparable period in 2007. The decrease for the three and six months ended June 30, 2008 was primarily due to the lower balance of cash and short-term investment funds than in the comparable period in 2007 as well as lower interest rates.

Interest Expense

Interest expense is primarily comprised of interest expense related to our convertible notes. Interest expense increased to $3.4 million for the three months ended June 30, 2008 from $2.1 million for the comparable period in 2007 and to $6.8 million for the six months ended June 30, 2008 from $4.2 million in the comparable period in 2007. This increase is due to the additional debt incurred as a result of the extinguishment of $38.0 million of the 2008 Notes and issuing $60.4 million of the 2011 Notes in the third quarter of 2007, as well as the accretion of the discount recorded in connection with the new notes.

Liquidity and Capital Resources

Since inception, we have financed our operations primarily through sales of equity securities and convertible notes. At June 30, 2008, we had cash, cash equivalents and short-term investments of $66.2 million, compared with $92.9 million at December 31, 2007. Working capital at June 30, 2008 was $27.0 million, compared to $50.2 million at December 31, 2007. The decrease in cash, cash equivalents and short-term investments and working capital for the six months ended June 30, 2008 is due to the use of funds for operating purposes and retiring $5.5 million of the 2008 Notes.

Although we expect to have enough cash on hand to repay all amounts due pursuant to the 2008 Notes on September 1, 2008, any such repayment would leave substantially less cash to fund our ongoing operations. Our options to address this situation are to attempt to restructure our 2008 Notes before they become due, repay the 2008 Notes and seek to raise additional capital to fund our ongoing operations, explore collaboration agreements to fund the development of AGI-1067, or not repay the 2008 Notes at maturity and seek relief under the Bankruptcy Code.

In addition, we received a notice from Nasdaq of a violation of the listing standard related to failure to maintain a closing bid price of our common stock above $1.00. We have scheduled a hearing date with the Nasdaq Listing

Qualifications Panel (the “Panel), which automatically stays the delisting of our common stock pending the Panel’s review and determination. We will present our plan for regaining compliance with the Nasdaq bid price requirement to the Panel, which may include effecting a reverse stock split. If our common stock fails to be listed on the Nasdaq Global Market or another national securities exchange, each holder of the notes will have the right to

require us to redeem the notes at face value. If the maturity of the outstanding notes were accelerated, we would attempt to refinance or restructure these obligations. If we are unable to refinance or restructure these obligations, or both, we may seek relief under the Bankruptcy Code.

Net cash used in operating activities was $21.1 million for the six months ended June 30, 2008 compared to $36.4 million for the six months ended June 30, 2007. The net cash used in operating activities for the six months ended June 30, 2008 was primarily for expenditures related to the ANDES clinical trial. The net cash used in operating activities for the six months ended June 30, 2007 was principally for the closeout of ARISE, the ongoing FOCUS clinical trial, and our other ongoing product development programs. For 2008, expenditures for the ANDES clinical trial are expected to be in the range of $12 million to $15 million.

Net cash provided by investing activities was $16.0 million for the six months ended June 30, 2008 compared to $26.3 million for the six months ended June 30, 2007. Net cash provided by investing activities for the six months ended June 30, 2008 and 2007 consisted primarily of the net sales of short-term investments.

Net cash used in financing activities was $5.5 million for the six months ended June 30, 2008 compared to net cash provided by financing activities of $20,074 for the six months ended June 30, 2007. Net cash used in financing activities for the six months ended June 30, 2008 was due to the retirement of $5.5 million of the 2008 Notes. Net cash provided by financing activities in the six months ended June 30, 2007 consisted of the proceeds received upon exercise of common stock options.

In August 2003, we issued $100 million in aggregate principal amount of 2008 Notes through a Rule 144A private placement to qualified institutional buyers. These notes initially are convertible into our common stock at a conversion rate of 65.1890 shares per $1,000 principal amount of notes, or approximately $15.34 per share. Net proceeds were approximately $96.7 million. Interest of 4.5% on the 2008 Notes is payable semi-annually in arrears on March 1 and September 1. In January 2006, we exchanged $14.0 million in aggregate principal amount of the 2008 Notes for 1,085,000 shares of our common stock. In July 2007, we extinguished $38.0 million of the 2008 Notes and in exchange, issued $60.4 million of 2011 Notes. The 2011 Notes were initially recorded at their fair value of $38.0 million. The $22.4 million difference between the principal amount and the initial fair value of the debt, the discount, is being accreted up to the face amount as additional interest expense over the remaining life of the 2011 Notes. As of June 30, 2008, the remaining balance of the discount on these notes was approximately $17.8 million. In January 2008, we redeemed $17.5 million in aggregate principal amount of our 2008 Notes, and in exchange issued $11.5 million of 2011 Notes and repaid $5.5 million in cash. We recorded the new 2011 Notes at their fair value of $12.0 million. This resulted in a premium of approximately $500,000 that is being amortized as an offset to interest expense over the life of these 2011 Notes. As of June 30, 2008, we have recorded $1.5 million of accrued interest expense related to the 2008 and 2011 Notes, which is due September 1, 2008. From time to time, we may enter into additional exchange offers and/or purchases of these notes.

In January 2005, we issued $200 million in aggregate principal amount of 2012 Notes through a Rule 144A private placement to qualified institutional buyers. These notes are convertible into shares of our common stock at a conversion rate of 38.5802 shares per $1,000 principal amount of notes, or approximately $25.92 per share. Interest of 1.5% on the 2012 Notes is payable semi-annually in arrears on February 1 and August 1. Net proceeds were approximately $193.6 million. As of June 30, 2008, we have recorded $1.3 million of accrued interest expense related to the 2012 Notes, which is due August 1, 2008.

Based upon the current status of our product development and commercialization plans, we believe that our existing cash, cash equivalents and short-term investments will be adequate to satisfy our capital needs for at least the next 12 months. However, our actual capital requirements will depend on many factors, including those factors potentially impacting our financial condition as discussed in Item 1A. Risk Factors of our Form 10-K and the following:

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our inability to raise additional capital before or after the maturity date of the 2008 Notes, enter into collaboration arrangements for AGI-1067 or restructure the 2008 Notes before they become due;

- the scope and results of our research, preclinical and clinical development activities;

- the timing of, and the costs involved in, obtaining regulatory approvals;
- our ability to maintain and establish collaborations and the financial terms of any collaborations;
- the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims and other patent-related costs; and
- the extent to which we acquire or invest in businesses, products and technologies.

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 (the "Reform Act") provides a safe harbor for forward-looking statements made by or on behalf of AtheroGenics. AtheroGenics and its representatives may from time to time make written or oral forward-looking statements, including statements contained in this report and our other filings with the Securities and Exchange Commission and in our reports to our shareholders. All statements which address operating performance, events or developments that we expect or anticipate will occur in the future, such as projections about our future results of operations, our financial condition, our access to capital, our research, development and commercialization of our product candidates and anticipated trends in our business, are forward-looking statements within the meaning of the Reform Act. The forward-looking statements are and will be based on management's then current views and assumptions regarding future events and operating performance, and speak only as of their dates. AtheroGenics undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The following are some of the factors that could affect our financial performance or could cause actual results to differ materially from those expressed or implied in our forward-looking statements:

- if we are unable to raise additional capital before or after the maturity date of the 2008 Notes, enter into collaboration arrangements for AGI-1067 or restructure the 2008 Notes before they become due, we may seek relief under the Bankruptcy Code;
- our independent auditor may issue a qualified opinion on our December 31, 2008 audited financials if at that time there is substantial doubt about our ability to continue as a going concern;
- our inability to successfully develop and commercialize AGI-1067;
- the actual results of clinical studies of AGI-1067 to treat diabetes and related regulatory judgments concerning AGI-1067 for use in diabetes management;
- if our common stock is no longer traded on a national securities exchange or system of automated quotations, the holders of our convertible notes have the right to require us to immediately repay amounts outstanding under such notes, together with accrued interest up to such date;
- our ability to generate positive cash flow in light of our history of operating losses;
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generally evolving regulatory requirements for drug product approval and marketing;

- our ability to successfully develop AGI-1096 or our other product candidates;
- our ability to commercialize our product candidates if we fail to demonstrate adequately their safety and efficacy;
- possible delays in our clinical trials;

- our inability to predict whether or when we will obtain regulatory approval to commercialize our product candidates or the timing of any future revenue from these product candidates;

- our need to comply with applicable regulatory requirements in the manufacture and distribution of our products to avoid incurring penalties that may inhibit our ability to commercialize our products;

- regulatory authorities may require that we conduct additional clinical trials or modify existing clinical trials;

- our ability to protect adequately or enforce our intellectual property rights or secure rights to third party patents;

- the ability of our competitors to develop and market anti-inflammatory products that are more effective, have fewer side effects or are less expensive than our current or future product candidates;

- third parties' failure to synthesize and manufacture our product candidates, which could delay our clinical trials or hinder our commercialization prospects;

- our ability to create sales, marketing and distribution capabilities or enter into agreements with third parties to perform these functions;

- our ability to attract, retain and motivate skilled personnel and cultivate key academic collaborations;

- our ability to obtain an adequate level of reimbursement or acceptable prices for our products;

- we may face product liability lawsuits which may cause us to incur substantial financial loss or we may be unable to obtain future product liability insurance at reasonable prices, if at all, either of which could diminish our ability to commercialize our future products;

- the conversion of our convertible notes would dilute the ownership interest of existing shareholders and could adversely affect the market price of our common stock.

The foregoing list of important factors is discussed in more detail in our Form 10-K in Item 1A. Risk Factors and is not an exhaustive list.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may impact our financial position, operating results or cash flows due to changes in U.S. interest rates. This exposure is directly related to our normal operating activities. Our cash, cash equivalents and short-term investments are invested with high quality issuers and are generally of a short-term nature. Interest rates payable on our convertible notes are fixed. As a result, we do not believe that near-term changes in interest rates will have a material effect on our future results of operations.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures. Our chief executive officer and chief financial officer are responsible for establishing and maintaining "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) for AtheroGenics. Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report, have concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

Changes in internal control over financial reporting. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 4. Submission of Matters to a vote of Security Holders

Our annual meeting of shareholders was held on May 22, 2008. At the annual meeting, the shareholders of AtheroGenics (1) elected four Class II directors to serve until the 2011 Annual Meeting of Shareholders, (2) approved the AtheroGenics 2008 Equity Ownership Plan and (3) ratified the appointment of Ernst & Young LLP as our independent auditors for the fiscal year ending December 31, 2008.

We had 39,518,492 shares of common stock outstanding as of March 24, 2008, the record date of the annual meeting. At the annual meeting, we had 27,288,012 shares of common stock present in person or represented by proxy for the three proposals indicated above. The following sets forth detailed information regarding the results of the voting at the annual meeting.

Proposal 1. Election of four Class II directors

Name of Nominee	No. of Votes For	No. of Votes Withheld
R. Wayne Alexander	24,270,306	3,017,706
Samuel L. Barker	24,564,271	2,723,741
Margaret E. Grayson	24,732,250	2,555,762
William A. Scott	24,693,468	2,594,544

Proposal 2. Approval of the AtheroGenics 2008 Equity Ownership Plan

No. of Votes For	No. of Votes Against	Abstention	Broker Non-Votes
7,780,179	2,835,382	87,584	16,584,867

Proposal 3. Ratification of the appointment of independent auditors

No. of Votes For	No. of Votes Against	Abstention
26,607,812	443,634	236,566

Item 6. Exhibits

Exhibits

Exhibit 31.1 - Certifications of Chief Executive Officer under Rule 13a-14(a).

Exhibit 31.2 - Certifications of Chief Financial Officer under Rule 13a-14(a).

Exhibit 32 - Certifications of Chief Executive Officer and Chief Financial Officer under Section 1350.

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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.

ATHEROGENICS, INC.

Date: August 11, 2008

/s/MARK P. COLONNESE
Mark P. Colonnese
Executive Vice President, Commercial Operations and
Chief Financial Officer