HEPALIFE TECHNOLOGIES INC
Form 10-Q
August 13, 2009
United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For quarterly period ended June 30, 2009

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

For the transition period from _____ to _____

000-29819

(Commission File Number)

HEPALIFE TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Florida

(State or other jurisdiction of incorporation)

58-2349413

(I.R.S. Employer Identification No.)

60 State Street, Suite 700, Boston, MA 02109

(Address of principal executive offices)

(800) 518-4879

(Registrant s telephone number, including area code)

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

Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every

Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [ ] No [ ] Not Applicable [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.

Large Accelerated Filer	[ ]	Accelerated Filer	[ ]
Non-accelerated Filer	[ ]	Smaller Reporting Company	[X]

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 91,996,829 shares of Common Stock, par value $0.001, were outstanding on August 11, 2009.

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HEPALIFE TECHNOLOGIES, INC.

FORM 10-Q, QUARTER ENDED JUNE 30, 2009

PART I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

HEPALIFE TECHNOLOGIES, INC.
(A Development Stage Company)

CONSOLIDATED BALANCE SHEETS
June 30, 2009 and December 31, 2008

(Expressed in U.S. Dollars)	(unaudited) **June 30, 2009**	**December 31, 2008**
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,364,126	$ 3,084,155
Prepaid expenses (Note 6)	97,041	98,716
Total current assets	2,461,167	3,182,871
Long-term deposits	5,000	-
Total assets	$ 2,466,167	$ 3,182,871
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	$ 134,949	$ 105,250
Total current liabilities	134,949	105,250
Contract commitment payable (Note 4)	-	200,000
Discount on contract commitment payable	-	(12,873)
Warrant liability (Note 8)	546,901	-
Total liabilities	681,850	292,377
STOCKHOLDERS' EQUITY		
Stockholders' equity (Note 8)		
Preferred stock: $0.10 par value; Authorized: 1,000,000 Issued and outstanding: none	-	-
Common stock: $0.001 par value; Authorized: 300,000,000 Issued and outstanding: 91,996,829 (2008: 91,996,829)	91,998	91,998
Additional paid-in capital	20,386,181	22,120,493
Accumulated other comprehensive income	-	(381)
Loss accumulated during the development stage	(18,693,862)	(19,321,616)
Total stockholders' equity	1,784,317	2,890,494
Total liabilities and stockholders' equity	$ 2,466,167	$ 3,182,871

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

HEPALIFE TECHNOLOGIES, INC.
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF OPERATIONS
for the three and six month periods ended June 30, 2009 and 2008
and from inception (October 21, 1997) to June 30, 2009
(unaudited)

(Expressed in U.S. Dollars)	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008	(C
Revenue	$ -	$ -	$ -	$ -	$
Expenses					
Salary and benefits	87,214	310,667	287,262	642,750	
Research and development	45,769	81,742	96,844	209,205	
Shareholder and investor relations	12,714	166,760	14,994	170,715	
Administrative and general	51,171	44,711	105,137	92,305	
Professional fees- accounting and legal	57,203	66,260	161,457	88,805	
Director, management and consulting fees (Note 5)	22,561	750	64,269	1,500	
Depreciation	-	2,607	-	5,214	
Stock offering costs	-	-	-	-	
	276,632	673,497	729,963	1,210,494	
Operating Loss	(276,632)	(673,497)	(729,963)	(1,210,494)	
Other income and (expenses)					
Interest on promissory note (Note 7)	-	(18,685)	-	(41,615)	
Interest, bank charges and foreign exchange loss	(362)	4	(952)	(9,173)	
Interest income	9,036	8,569	19,576	11,466	
Loss on disposal of fixed assets	-	-	-	-	
Amortization of discount on notes (Note 4 and Note 7)	(10,524)	-	(12,873)	(468,343)	
Amortization of deferred financing costs (Note 7)	-	-	-	(210,728)	
Change in fair value of warrant liability	364,119	-	(41,538)	-	
	362,269	(10,112)	(35,787)	(718,393)	
Net income (loss) available to common stockholders	**$** 85,637	**$** (683,609)	$ (765,750)	**$** (1,928,887)	$
Income (loss) per share - basic and diluted	$ 0.00	$ (0.01)	(0.01)	$ (0.02)	
Weighted average number of common shares outstanding - basic and diluted	91,996,829	81,604,652	91,996,829	79,974,458	

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

HEPALIFE TECHNOLOGIES, INC.
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
from inception (October 21, 1997) to June 30, 2009
(unaudited)

	Common Stock		Additional	Accumulated other comprehensive	Loss accumulated during development	Comprehensiv
lars)	Shares	Amount	paid-in capital	income	stage	income (los
or service rendered Dctober 21, 1997	12,000,000	$ 12,000	$ (9,000)	$ -	$ -	$
or cash ring 1997	1,200,000	1,200	73,800	-	-	
n December 31, 1997	-	-	-	-	42	
come						
, 1997	**13,200,000**	**13,200**	**64,800**	**-**	**42**	
or service rendered ember 15, 1998	16,000,000	16,000	384,000	**-**	-	
(loss) ember 31, 1998	-	-	-	**-**	(471,988)	(471,9
come						(471,9
, 1998	**29,200,000**	**29,200**	**448,800**	**-**	**(471,946)**	
or cash rch 1999	12,000,000	12,000	288,000	**-**	-	
(loss) ember 31, 1999	-	-	-	**-**	(121,045)	(121,0
come						(121,0
, 1999	**41,200,000**	**41,200**	**736,800**	**-**	**(592,991)**	
(loss) ember 31, 2000	-	-	-	-	(80,608)	(80,6
come						(80,6

, 2000	**41,200,000**	**41,200**	**736,800**	**-**	**(673,599)**	
quity at $0.015	8,933,332	8,933	125,067	-	-	
(loss) ember 31, 2001	-	-	-	-	(160,364)	(160,3
come						(160,3
, 2001	**50,133,332**	**50,133**	**861,867**	**-**	**(833,963)**	
or services , 23, 2002	10,000	10	590	-	-	
quity at $0.05 2	2,160,000	2,160	105,840	-	-	
or investor 05 per share,	2,390,000	2,390	117,110	-	-	
quity at $0.05 per 02	1,920,000	1,920	94,080	-	-	
(loss) ember 31, 2002	-	-	-	-	(375,472)	(375,4
come						(375,4
, 2002	**56,613,332**	**56,613**	**1,179,487**	**-**	**(1,209,435)**	
ursuant to s during the o $2.11 per share	282,500	283	398,317	-	-	
ursuant to se warrants .025 per share	7,300,000	7,300	175,200	-	-	
(loss) ember 31, 2003	-	-	-	-	(1,102,723)	(1,102,7
come						(1,102,7
, 2003	**64,195,832**	**64,196**	**1,753,004**	**-**	**(2,312,158)**	
ursuant ons during to $2.11 per share	1,622,000	1,622	1,339,998	-	-	

ursuant chase warrants in 25 per share	2,000,000	2,000	48,000	-	-	
(loss) ember 31, 2004	-	-	-	-	(1,435,613)	(1,435,(
come						(1,435,(
, 2004	**67,817,832**	**67,818**	**3,141,002**	**-**	**(3,747,771)**	
ursuant to exercise ch 2005 at	50,000	50	154,950	-	-	
ursuant to exercise 2005 at	45,000	45	94,905	-	-	
ursuant to exercise 2005 at	100,000	100	210,900	-	-	
ursuant to exercise ber 2005 at	40,000	40	84,360	-	-	
ursuant to exercise ch 2005 at	50,000	50	105,450	-	-	
ursuant to se warrants 5 per share	1,250,000	1,250	30,000	-	-	
k issued in June 2005 ase agreement	20,000	20	37,580	-	-	
k issued in July 2005 ase agreement	691,598	692	1,382,504	-	-	
(loss) mber 31, 2005	-	-	-	-	(2,813,602)	(2,813,(
come						(2,813,(
, 2005	**70,064,430**	**70,065**	**5,241,651**	**-**	**(6,561,373)**	
k issued in January 2006 ase agreement	374,753	375	505,542	-	-	

n the first quarter of for cash	431,381	431	449,569	-	-	
n the second quarter of for cash	416,303	416	329,584	-	-	
n the third quarter of for cash	758,606	759	584,234	-	-	
n the fourth quarter of for cash	548,371	548	354,455	-	-	
s	175,000	175	12,075	-	-	
on expenses	-	-	2,607,302	-	-	
(loss) mber 31, 2006	-	-	-	-	(4,654,499)	(4,654,4
come						(4,654,4
, 2006	**72,768,844**	**72,769**	**10,084,412**	**-**	**(11,215,872)**	
n the first quarter of for cash	382,000	382	204,619	-	-	
n the second quarter of for cash	509,019	509	289,491	-	-	
ed from convertible	2,604,721	2,605	1,742,395	-	-	
on expenses	-	-	935,044	-	-	
e warrants issued with	-	-	497,689	-	-	
payment of broker's fees	-	-	64,990	-	-	
neficial conversion feature	-	-	1,220,410	-	-	
(loss) slation adjustment	-	-	-	(3,772)	-	(3,7
mber 31, 2007	-	-	-	-	(4,438,197)	(4,438,
come						(4,441,9
, 2007	**76,264,584**	**76,265**	**15,039,050**	**(3,772)**	**(15,654,069)**	

ed from convertible uary 2008	2,342,415	2,343	752,657	-	-	
ed from notes	2,065,412	2,065	975,680	-	-	
rants issued for cash, May 2008 and t and legal fees	10,924,418	10,925	4,519,875	-	-	
or services received in 2008	400,000	400	169,600	-	-	
rchase of in-process research ober 2008	-	-	98,325	-	-	
on expenses	-	-	565,306	-	-	
(loss) lation adjustment	-	-	-	3,391	-	3,
mber 31, 2008	-	-	-	-	(3,667,547)	(3,667,
come						(3,664,
, 2008	**91,996,829**	**91,998**	**22,120,493**	**(381)**	**(19,321,616)**	
ange in accounting principle	-	-	(1,898,867)	-	1,393,504	
on expenses	-	-	164,555	-	-	
(loss) lation adjustment	-	-	-	381	-	
ns ended June 30, 2009	-	-	-	-	(765,750)	(765,
come						$ (765,
	91,996,829	**$ 91,998**	**$ 20,386,181**	**$ -**	**$ (18,693,862)**	

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

HEPALIFE TECHNOLOGIES, INC.
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF CASH FLOWS
for the six month periods ended June 30, 2009 and 2008
and from inception (October 21, 1997) to June 30, 2009
(unaudited)

(Expressed in U.S. Dollars)	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008	From inception (October 21, 1997) to June 30, 2009
Cash flows from operating activities:			
Net Loss	$ (765,750)	$ (1,928,887)	$ (18,693,862)
Adjustments to reconcile net loss to net cash from operating activities:			
Depreciation	-	5,214	35,410
Amortization of license fees	37,500	-	125,000
Services paid by issuance of common stock	-	-	1,031,100
Stock offering costs paid by issuance of common stock	-	-	1,926,713
In-process research and development partially purchased by issuance of common stock warrants and a contract commitment payable, net of discount	-	-	283,903
Stock based compensation expenses	164,555	313,396	4,272,207
Amortization of discount on notes payable	12,873	468,343	2,107,522
Amortization of deferred financing costs	-	210,728	293,515
Loss on disposal of assets	-	-	3,061
Change in fair value of warrant liability	41,538	-	(1,351,966)
Change in assets and liabilities:			
Decrease (increase) in prepaid expenses and deposits	(40,825)	(2,557)	(152,043)
Increase (decrease) in accounts payable	29,699	37,464	134,949
Increase in accounts payable - related party	-	(208,330)	99,946
Net cash used in operating activities	(520,410)	(1,104,629)	(9,884,545)
Cash flows from investing activities:			
Purchase of property and equipment	-	-	(38,471)
Purchase of license fees	-	-	(75,000)
Net cash used in investing activities	-	-	(113,471)
Cash flows from financing activities:			
Payment on contract commitment	(200,000)	-	(200,000)
Proceeds from issuance of common stock and warrants, net	-	4,530,800	9,787,867
Proceeds from issuance of convertible notes	-	-	2,125,000
Net proceeds from promissory notes	-	-	877,800
Increase in deferred financing cost	-	-	(228,525)
Net cash provided by (used in) financing activities	(200,000)	4,530,800	12,362,142
Increase (decrease) in cash and cash equivalents	(720,410)	3,426,171	2,364,126
Effect of foreign exchange rate	381	4,225	-
Cash and cash equivalents, beginning of period	3,084,155	534,113	-
Cash and cash equivalents, end of period	$ 2,364,126	$ 3,964,509	$ 2,364,126
Supplemental disclosure of cash flow information:			
Interest paid in cash	$ -	$ 150,000	$ 247,575
Income tax paid in cash	$ -	$ -	$ -
Non-cash Investing and Financing Activities:			
Common stock and warrants issued for professional services	$ -	$ 112,078	$ 1,143,078

Issuance of common stock as stock offering costs	$ -	$ -	$ 1,926,713
Issuance of warrants for deferred financing costs	$ -	$ -	$ 64,990
Conversion of note payable and related interest to equity	$ -	$ 977,745	$ 977,745
Conversion of debt to equity	$ -	$ 755,000	$ 2,500,000

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

HEPALIFE TECHNOLOGIES, INC.
(A Development Stage Company)
NOTES TO INTERIM UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2009
(Expressed in U.S. Dollars)
(Unaudited)

NOTE 1 - BASIS OF PRESENTATION, AND GOING CONCERN UNCERTAINTIES

We are a development stage biotechnology company focusing on the development of a cell-based bioartificial liver system.

We have incurred net operating losses since inception. We face all the risks common to companies in early stages of development, including undercapitalization and uncertainty of funding sources, high initial expenditure levels, uncertain revenue streams, and difficulties in managing growth. We expect to continue to incur losses from business operations and we believe our cash and cash equivalents balances, anticipated cash flows from operations, and other external sources of cr13edit will be sufficient to meet our cash requirements through December 2010. Our prospects after December 2010 will depend in large part on our ability to successfully raise capital from external sources to pay for planned expenditures and to fund operations.

Principles of Consolidation

Included in our consolidated financial statements are our accounts and the accounts of our subsidiaries, HepaLife Biosystems, Inc., Phoenix BioSystems, Inc., and HepaLife Technologies Ltd. HepaLife Biosystems, Inc. was incorporated in State of Nevada on April 17, 2007 for the purpose of categorizing operations and accounting associated with our research and development efforts with the patented PICM-19 cell line, artificial liver technologies, and in vitro toxicology testing systems. Phoenix BioSystems, Inc. was incorporated under the laws of the State of Nevada on June 6, 2006 for the purpose of categorizing operations and accounting associated with our research and development efforts with the patented PBS-1 cell line. We terminated the development of the PBS-1 cell line on April 24, 2009. As a result, we dissolved Phoenix BioSystems, Inc. on May 19, 2009. HepaLife Technologies Ltd. was incorporated on April 11, 2007 in British Columbia, Canada, for the purpose of streamlining business operations in Canada. We ceased to conduct business in Canada on August 31, 2008 and closed this office. As a result, we dissolved HepaLife Technologies, Ltd. All significant intercompany transactions and accounts have been eliminated.

NOTE 2 ACCOUNTING POLICIES

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (which are of a normal recurring nature) considered necessary for a fair presentation of the financial statements have been included. Operating results for the quarter and six-months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ended December 31, 2009 or any other interim period. For further information, refer to the consolidated financial statements and notes thereto included in our 2008 Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission.

Fair Value

The carrying amount of cash, accounts payable, accrued liabilities and notes payable reported on the balance sheet approximates those assets or liabilities fair values (representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants) because of the short-term nature of these instruments. We place our cash with high credit quality financial institutions. Refer to Note 8 regarding fair value measurements relating to the warrant liability.

Recent and Adopted Accounting Pronouncements

In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. 157-1 (FSP FAS 157-1), which excludes SFAS No. 13, *Accounting for Leases* and certain other accounting pronouncements that address fair value measurements under SFAS 13, from the scope of SFAS 157. In February 2008, the FASB issued FSP No. 157-2 (FSP FAS 157-2), which provides a one-year delayed application of SFAS 157 *Fair Value Measurements* for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Therefore we were required to adopt SFAS 157 as amended by FSP FAS 157-1 and FSP FAS 157-2 on January 1, 2009, the beginning of our fiscal year, as related to nonfinancial assets and liabilities, which did not have an impact on our consolidated financial statements.

We adopted EITF 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* (EITF 07-5) effective January 1, 2009. The adoption of EITF 07-5 had a material effect on our financial position and results of operations as further explained in Note 8 under the subsection Warrants .

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of Accounting Research Bulletin No 51* (SFAS 160). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, changes in a parent s ownership of a noncontrolling interest, calculation and disclosure of the consolidated net income attributable to the parent and the noncontrolling interest, changes in a parent s ownership interest while the parent retains its controlling financial interest and fair value measurement of any retained noncontrolling equity investment. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. We adopted SFAS 160 on January 1, 2009, the beginning of our fiscal year 2009, which had no impact on the consolidated financial statements.

In December 2007, the FASB ratified a consensus opinion reached by the EITF on EITF Issue 07-1, *Accounting for Collaborative Arrangements* (EITF 07-1). The guidance in EITF 07-1 defines collaborative arrangements and establishes presentation and disclosure requirements for transactions within a collaborative arrangement (both with third parties and between participants in the arrangement). The consensus in EITF 07-1 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008. The consensus requires retrospective application to all collaborative arrangements existing as of the effective date, unless retrospective application is impracticable. The impracticability evaluation and exception should be performed on an arrangement-by-arrangement basis. We adopted EITF 07-1 effective January 1, 2009, which had no effect on our financial statements.

In April 2008, the FASB issued FASB FSP No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 removed the requirement of SFAS No. 142*, Goodwill and Other Intangible Assets* (SFAS 142), for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modification to the existing terms and conditions associated with the intangible asset. FSP FAS 142-3 replaces the previous useful life assessment criteria with a requirement that an entity considers its own experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. This should lead to greater consistency between the useful life of recognized intangibles under SFAS 142 and the period of expected cash flows used to measure fair value of such assets under SFAS No. 141(R), *Business Combinations*. This FSP shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The adoption of this statement had no material impact on our financial position, results of operations, or cash flows.

On April 9, 2009, the FASB issued several Staff Positions, as listed below, relating to fair value accounting, impairment of securities, and disclosures. All of these FSPs are effective for interim and annual periods ending after June 15, 2009. The adoption did not have a material impact on our consolidated financial statements.

- FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That are Not Orderly* ;
- FSP FAS 115-2, *Recognition and Presentation of Other-Than-Temporary Impairments* ; and
- FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Statements* .

On May 28, 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165). Under SFAS 165, companies are required to evaluate events and transactions that occur after the balance sheet date but before the date the financial statements are issued, or available to be issued in the case of non-public entities. SFAS 165 requires entities to recognize in the financial statements the effect of all events or transactions that provide additional evidence of conditions that existed at the balance sheet date, including the estimates inherent in the financial preparation process. Entities shall not recognize the impact of events or transactions that provide evidence about conditions that did not exist at the balance sheet date but arose after that date. SFAS 165 also requires entities to disclose the date through which subsequent events have been evaluated. SFAS 165 was effective for interim and annual reporting periods ending after June 15, 2009. We have adopted the provisions of SFAS 165 for the quarter ended June 30, 2009, as required.

In June 2008, the FASB issued Staff Position EITF 03-06-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-06-1). FSP EITF 03-06-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method in

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SFAS No. 128, Earnings Per Share and is effective for fiscal years beginning after December 15, 2008. Our implementation of FSP EITF 03-06-1 had no impact on our consolidated financial statements.

On June 29, 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162* (SFAS 168). SFAS 168 establishes the *FASB Accounting Standards Codification* TM as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with US GAAP. SFAS 168 will be effective for financial statements issued for interim and annual periods ending after September 15, 2009, for most entities. On the effective date, all non-SEC accounting and reporting standards will be superseded. We will adopt SFAS 168 for the quarterly period ended September 30, 2009, as required.

NOTE 3 - LOSS PER SHARE

Basic earnings or loss per share is based on the weighted average number of common shares outstanding. Diluted earnings or loss per share is based on the weighted average number of common shares outstanding and dilutive common stock equivalents. The computation of earnings (loss) per share is net loss available to common stockholders (numerator) divided by the weighted average number of common shares outstanding (denominator) during the periods presented. All earnings or loss per share amounts in the financial statements are basic earnings or loss per share, as defined by SFAS No. 128, *Earnings Per Share*. Dilutive common stock equivalents include 16,426,830 warrants and stock options that are not included in the computation of diluted loss per share because to do so would be anti-dilutive. All share and per share information are adjusted retroactively to reflect stock splits and changes in par value, when applicable.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Numerator - net income (loss) available to common stockholders	$ 85,637	$ (683,609)	$ (765,750)	$ (1,928,887)
Denominator - weighted average number of common shares outstanding	91,996,829	81,604,652	91,996,829	79,974,458
Basic and diluted income (loss) per common share	$0.00	($0.01)	($0.01)	($0.02)

NOTE 4 - PURCHASED IN-PROCESS RESEARCH AND DEVELOPMENT

We purchased certain assets from Arbios Systems, Inc. (Arbios) relating to the pig cell based liver device technology known as HepatAssist in October 2008 in order to enhance and strengthen its PICM-19 porcine liver cell line based bioartificial liver. The Company re-trademarked the device as HepaMate. The effective purchase price of $548,325 was charged to operations in 2008 as purchased in-process research and development expense. The purchase price consisted of cash for $250,000, a contract commitment of $200,000 (the Deferred Cash Purchase Price), and 750,000 Series D warrants valued at $98,325 using the Black-Scholes pricing model (refer to Note 8).

According to the purchase agreement, the Deferred Cash Purchase Price was due and payable on the earlier of (i) the date on which we consummate one or more debt or equity financings in which the gross proceeds received in the aggregate equal or exceed $4,000,000, or (ii) the eighteen month anniversary of the closing date. The deferred payable does not bear interest. In accordance with Accounting Principles Board (APB) Opinion No. 21 *Interest on Receivables and Payables*, we discounted the payable with an effective annual interest rate of 5% and the associated amortization of the discount is to be charged to interest expense over the 18 month expected life of the note. As of December 31, 2008, the contract commitment payable of $200,000, net of unamortized discount of $12,873 was recorded in noncurrent liabilities.

On April 1, 2009, we entered into a Repurchase Agreement with Arbios whereby we reacquired the Series D Warrants effective April 22, 2009 in consideration for the accelerated payment of the Deferred Cash Purchase Price. Due to the early retirement of the contract commitment, we recognized the full unamortized discount outstanding as of April 22, 2009 in the amount of $10,524.

For the three and six months ended June 30, 2009, $10,524 and $12,873, respectively, of discount amortization was charged to interest expense.

NOTE 5 - RELATED PARTY TRANSACTIONS

Director and Management Fees: For the three and six month periods ended June 30, 2009, we incurred $10,000 (2008: $750) and $20,000 (2008: $1,500), respectively, in board fees for our non-employee directors. In addition, for the three and six month periods ended June 30, 2009, we recorded $6,148 (2008: $820) and $12,656 (2008: $820), respectively, as stock compensation expense relating to stock options grants to directors (refer to Note 9). There are no management or consulting agreements in effect.

Legal Fees: During the three and six months ended June 30, 2009, we incurred $25,175 (2008: $31,375) and $61,163 (2008: $46,425), respectively, for legal services rendered by a law firm of which a non-employee director is a member.

NOTE 6 - COOPERATIVE AND LICENSE AGREEMENTS

USDA, ARS CRADA: In November 2002, we entered into a Cooperative Research and Development Agreement (CRADA) with the U.S. Department of Agriculture (USDA), Agricultural Research Service (ARS) pertaining to the continued development and use of patented liver cell lines in artificial liver devices and in-vitro toxicological testing platforms. This agreement was amended several times, with a final agreement termination date of November 2009. We terminated the CRADA effective November 30, 2008.

USDA, ARS License: On November 20, 2007, we exercised our license right under the CRADA by entering into an exclusive license agreement with the USDA, ARS for existing and future patents related to the PICM-19 hepatocyte cell lines. Under this license agreement, we incurred a license execution fee of $150,000 with $75,000 paid in December 2007 and $75,000 paid in November 2008. In addition to these payments during the first two years of the contract, we are responsible for annual license maintenance fees commencing in year 2010 for the term of the license, which is until the expiration of the last to expire licensed patents unless terminated earlier. These annual fees are capitalized to prepaid license costs when incurred and amortized to operating expense over the course of each year. The license agreement also requires certain milestone payments, if and when milestones are reached, as well as royalties on net sales of resulting licensed products, if any.

MSU License: On June 15, 2006, we entered into an exclusive worldwide license agreement with Michigan State University (MSU) through our subsidiary, Phoenix BioSystems, Inc. (PBS), for the development of new cell-culture based flu vaccines to protect against the spread of influenza viruses among humans, including potentially the high pathogenicity H5N1 virus.

In January 2009, we provided notice to MSU to terminate the license agreement effective April 24, 2009. For the three and six months ended June 30, 2009, we incurred $nil and $30,848, respectively, in expenses related to this contract. The $30,848 consisted of a $15,000 milestone payment charged to research and development and $15,848 in legal fees. Total costs incurred to date relating to this license agreement are $104,201.

The license agreement provided us with exclusive rights to certain issued patents, for which we paid an initial fee of $1,000 upon execution of the agreement in 2006. The agreement mandated royalties on net sales of resulting licensed products, if any, with minimum payments due commencing in year 2010 for the term of the license, which is until the expiration of the last to expire of the patents, or until fifteen (15) years after the effective date of June 15, 2006, whichever is longer.

Under the license agreement we also were required to make certain milestone payments to MSU, if and when achieved.

As part of the license agreement, on October 2, 2006 PBS issued 17,650 common shares at par value, or 15% of the total issued and outstanding shares of PBS, to an individual who is also a member of our scientific advisory board. After issuance of the shares, we hold 85% of the total issued and outstanding shares of PBS. We recorded the fair value of the 15% issued shares at a nominal value. As PBS had no assets or liabilities, no value was allocated to the minority interest.

NOTE 7 - CONVERTIBLE PROMISSORY NOTE

On May 11, 2007, we entered into a Securities Purchase Agreement with GCA Strategic Investment Limited for the sale of a convertible note with a $2,500,000 aggregate principal amount and maturity date of May 11, 2009. The convertible note was issued on May 11, 2007 at a purchase price of $2,125,000 (eighty-five per cent of the principal amount). The convertible note does not bear interest, except upon an event of default at which time interest would accrue at the rate of 18% per annum. Under the terms of the agreement, the purchaser agreed not to effect, or cause any affiliate or associate to effect, a short sale of our common stock. In connection therewith, we also issued to the purchaser warrants to purchase up to an aggregate of 670,000 shares of our common stock at a price of $1.50 per share (the warrants) for a term of five years.

In connection with this transaction, we also agreed to pay the purchaser s adviser out of pocket fees of $15,000; and pay to Equinox Securities, Inc., a NASD (now FINRA) registered broker/dealer, pursuant to an agreement dated April 19, 2007, 10% of the amount funded plus a warrant to purchase a number of shares of our common stock equal to 10% of the number of shares subject to the warrants issued in connection with the convertible at the same exercise price of $1.50 per share, or 67,000 shares, in consideration of its efforts in securing, on our behalf, the financing with the purchaser.

The convertible note contained a prepayment option and redemption feature under certain conditions and circumstances. A registration statement relating to the resale of the common shares issuable under the conversion of the convertible note and exercise of the warrants was declared effective on July 5, 2007.

Conversion of the Convertible Note

The convertible note (and any accrued and unpaid interest or liquidated damages amount) may be converted into shares of our common stock at a conversion price of 95% of the trading volume weighted average price, as reported by Bloomberg LP for the five trading days immediately prior to the date of notice of conversion.

In 2007, $1,745,000 of the convertible note was converted into 2,604,721 shares of common stock. In January 2008, the remaining $755,000 of the convertible note was converted into 2,342,415 shares of common stock. For the year ended December 31, 2008, the remaining discount of $468,343 (2007: $1,624,756) and issuance costs of $210,728 (2007: $82,787) relating to the convertible note were charged to operations.

Bifurcation of the Warrants from the Convertible Note and the Intrinsic Value of the Beneficial Conversion Feature of the Note

The convertible note contained a conversion feature that allowed the holder to convert the debt into equity shares at any time within a specified period at a price equal to 95% of the volume weighted average price of our common shares for the five trading days prior to the conversion date. As the host contract did not embody a claim to the residual interest in us, the economic characteristics and risks of the host contract was considered that of a debt instrument and classified as a liability.

We determined that the embedded conversion option did not meet the definition of a derivative as described under SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities* paragraph 12(a) and 12(c) as the conversion option results in a fixed monetary benefit to the holder known at the measurement date.

The convertible note was a complex hybrid instrument bearing an option, the alternative choices of which could not exist independently of one another. Thus, the beneficial conversion feature could not be separated from the debt according to paragraph 7 and 12 of APB Opinion No. 14 *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* (ABP 14). The embedded beneficial conversion feature was recognized and measured in accordance with paragraph 5 of EITF 98-5 *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios* (EITF 98-5) and paragraph 5 of EITF 00-27 *Application of Issue No. 98-5 to Certain Convertible Instruments* (EITF 00-27), whereby the intrinsic value of the beneficial conversion feature was calculated at the commitment date as the difference between the effective conversion price of the convertible note and the fair value of the common stock into which the convertible note was convertible, multiplied by the number of shares into which the convertible note was convertible. The intrinsic value of the beneficial conversion feature, $1,220,410, was treated as a discount on issuance of the convertible note and amortized over the life of the convertible note (paragraph 10 of EITF 98-5 and paragraph 19 of EITF 00-27).

The warrants are detached from the convertible note with no put option feature. There is no liquidated damage or cash penalty payable to the warrant holder if we were not able to register the shares underlying the warrants. As of the transaction date and in accordance with paragraph 16 of APB 14, the portion of the proceeds of the convertible note issued with the detachable warrants which is allocable to the warrants was accounted for as paid-in capital. The allocation was based on the relative fair values of the two securities at the time of issuance. The portions of the proceeds allocated to the convertible note and warrants were $1,627,311 and $497,689 (refer to Note 8), respectively. The resultant debt discount was amortized over the life of the convertible note (paragraph 16 of APB14).

NOTE 8 STOCKHOLDERS EQUITY

We completed a private placement of 10,660,705 units at a price of $0.425 per unit or $4,530,800 in the aggregate in May 2008. Each unit consists of one share of our common stock and one Series C stock purchase warrant (Series C warrant) to purchase a share of common stock at the initial exercise price of $0.55 per share for a period of two years from the date of issuance. The relative fair value of the common stock was estimated to be $2,972,407 and the relative fair value of the warrants was estimated to be $1,558,393 as determined based on the relative fair value allocation of the proceeds received. The warrants were valued on the transaction date using the Black-Scholes option pricing model. In conjunction with our completion of the acquisition of the HepatAssist related assets in October 2008, we reduced the initial exercise price of the Series C warrants to $0.34 per share. In connection with the private placement, the agent was due a sales commission equal to $90,828 or two (2%) percent of the gross proceeds, which was settled by issuing to the agent 213,713 units. In addition, we issued an aggregate of 50,000 units in payment of legal fees in the amount of $21,250. These units were otherwise issued on the same terms and conditions as the units sold in the private placement.

Pursuant to the Subscription Agreement and the Registration Rights Agreement relating to the private placement, we and the investor parties made other covenants and representations and warranties regarding matters that are customarily included in financings of this nature. In the event that during the twelve month period following the closing date we issue shares at a price per share which is less than $0.425 per share (the Base Share Price), then we are required to issue to the investors the number of shares equal to (1) the quotient of the aggregate purchase price payable under the Securities Purchase Agreement divided by Base Share Price less (2) the quotient of the aggregate purchase price divided by the per share purchase price under the Securities Purchase Agreement (the Dilutive Issuance Adjustment).

On August 18, 2008, the Board of Directors agreed to issue 400,000 shares of its restricted common stock for services provided by its investment banker for the period January 1, 2008 to August 31, 2008. The value of the issuance was agreed to be the value of services provided, $170,000. These shares were issued November 8, 2008.

Warrants

Each of our warrants outstanding entitles the holder to purchase one share of our common stock for each warrant share held. No warrants were exercised during the six month period ended June 30, 2009. As stated in Note 4, we entered into a Repurchase Agreement on April 22, 2009 with Arbios whereby we repurchased all of the 750,000 shares outstanding of the Series D warrants from Arbios in consideration for the early payment of the Deferred Cash portion of the Purchase Price. A summary of our outstanding warrants and the assumptions used to determine fair value as of the date of the respective transactions, which are also described in Notes 4 and 7, is as follows:

	Warrants	**Series C Warrants**
Warrants outstanding and exercisable at June 30, 2009	737,000	12,989,830
Exercise price	$1.50	$0.34
Fair value on date of grant	$714,890	$1,898,867
Black-Scholes option pricing model assumptions:		
Risk-free interest rate	4.58%	2.46%
Expected term	5 years	2 years
Expected volatility	96.20%	94.10%
Dividend per share	$0	$0
Expiration date	May 11, 2012	May 23, 2010

The potential of a Dilutive Issuance Adjustment to the Series C Warrants exercise price and number of underlying shares of common stock may result in a settlement amount that does not equal the difference between the fair value of a fixed number of the Company s common stock and a fixed exercise price. Accordingly, the Series C Warrants fall under the scope of EITF 07-5, which is effective January 1, 2009, the beginning of our fiscal year 2009. Pursuant to EITF 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* (EITF 07-5), the Series C Warrants are not considered indexed to the Company s own stock and, therefore, do not meet the scope exception in paragraph 11(a) of FASB 133 and thus need to be accounted for as a derivative. As of June 30, 2009, we have not sold any shares of common stock or common stock equivalents that would result in an adjustment to the exercise price or number of shares of common stock underlying the Series C Warrants.

We measure the fair value of the warrant liability in accordance with SFAS 157. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, SFAS 157 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy). At June 30, 2009, we valued the warrant liability using a Black-Scholes model (Level 3 inputs) containing the following assumptions: volatility 105.19%, risk-free rate 0.56%, and term of 11 months. The warrant liability recorded fair value is summarized below:

		Warrant liability
Beginning balance, January 1, 2009	$	505,363
Change in fair value of warrant liability		405,657
Ending balance, March 31, 2009		911,020
Change in fair value of warrant liability		(364,119)
Ending balance, June 30, 2009	$	546,901

The Warrants are accounted for in accordance with EITF 00-19 *Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company s Own Stock.* In accordance with the EITF, the fair value of such warrants is classified as a component of permanent equity within additional paid-in capital and was calculated on the date of grant using the Black-Scholes Option pricing model.

A total of 13,726,830 shares of our common stock have been reserved for issuance upon exercise of warrants shares outstanding as of June 30, 2009.

NOTE 9 - STOCK OPTIONS

We have an active stock option plan that provides shares available for option grants to employees, directors and others. A total of 40,000,000 shares of our common stock have been reserved for award under the stock option plan, of which 35,098,000 were available for future issuance as of June 30, 2009. Options granted under our option plan generally vest over two to five years or as otherwise determined by the Board of Directors, have exercise prices equal to the fair market value of the common stock on the date of grant, and expire no later than ten years after the date of grant.

During the three month period ended June 30, 2009, total compensation expense charged to operations was $23,924 (2008: $162,648) with $17,776 (2008: $820) classified as salaries and benefits and $6,148 (2008: $820) included in director fees.

During the six month period ended June 30, 2009, total compensation expense charged to operations was $164,555 and (2008: $313,396) with $151,898 (2008: $312,576) classified as salaries and benefits and $12,656 (2008: $820) included in director fees.

As of June 30, 2009, we had $120,731 of total unrecognized compensation cost related to unvested stock options, which is expected to be recognized over a weighted average period of approximately 3.5 years.

We do not repurchase shares to fulfill the requirements of options that are exercised. Further, we issue new shares when options are exercised.

NOTE 10 SUBSEQUENT EVENTS

We have evaluated subsequent events for the period from June 30, 2009, the date of these financial statements, to the date these finacial statements are being filed with the Securities Exchange Commission (SEC) which is August 13, 2009. There were no events or transactions occurring during this subsequent event reporting period which require recognition or disclosure in the financial statements.

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

Forward-Looking Statements

Except for the historical information presented in this document, the matters discussed in this Form 10-Q for the three months ending June 30, 2009, this report contains forward-looking statements. Such forward-looking statements include statements regarding, among other things, (a) our projected sales and profitability, (b) our growth strategies, (c) anticipated trends in our industry, (d) our future financing plans, and (e) our anticipated needs for working capital. Forward-looking statements, which involve assumptions and describe our future plans, strategies, and expectations, are generally identifiable by use of the words may, will, should, expect, anticipate, estimate, believe, intend, or negative of these words or other variations on these words or comparable terminology. This information may involve known and unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from the future results, performance, or achievements expressed or implied by any forward-looking statements. These statements may be found under Management's Discussion and Analysis of Financial Condition and Results of Operations, Business, Properties, as well as in this report generally.

The following discussion and analysis is based upon our interim unaudited consolidated financial statements, which have been prepared in accordance with Form 10-Q instructions and accounting principles generally accepted in the United States of America, and should be read in conjunction with those financial statements and related notes. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed 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 from these estimates under different assumptions or conditions.

Overview

We are a development stage biotechnology company focusing on the development of a cell-based bioartificial liver system, HepaMate , as a potentially lifesaving treatment for liver failure patients. The technology has previously been successfully tested in a clinical phase I study. As an extracorporeal cell-based bioartificial liver system, HepaMate is designed to combine blood detoxification with liver cell therapy to provide whole liver function in patients with the most severe forms of liver failure.

On October 3, 2008, in order to enhance and strengthen our pre-existing bioartificial liver development program, we acquired HepatAssist Related Assets from Arbios Systems, Inc. (Arbios), which assets included over 12 patents and patent licenses; miscellaneous scientific equipment; FDA Investigative New Drug (IND) application, including orphan drug and fast track designation; Phase I and Phase II/III clinical protocols and clinical data; and standard operating procedures for manufacturing and quality control. The acquired assets relate to a bioartificial liver device formerly known as HepatAssist. HepatAssist passed clinical Phase I studies and was evaluated in the largest-ever Phase II/III clinical study (prospective, randomized, multicenter, controlled trial involving over 170 patients) to test the safety and efficacy of a bioartificial liver assist device. The clinical data was published in 2004 and demonstrated a significant survival advantage for bioartificial liver device treated patients in fulminant and sub-fulminant hepatic failure compared with the patient control group receiving standard-of-care treatment.

We are working towards optimizing the former HepatAssist bioartificial liver device for utilization in a new, clinical Phase II/III study followed, if warranted, by commercialization upon final regulatory approval.

Previously we focused our research, development and commercialization efforts on the development of a porcine stem cell line, and subclones thereof, which we refer to as the PICM-19 cell line for use in a bioartificial liver and in-vitro toxicology testing, and on the commercialization of a chicken cell line, and subclones thereof, which we refer to as the PBS-1 cell line. The PBS-1 cell line was developed for potential use in cell-based vaccine production and was exclusively licensed from Michigan State University in June 2006. In January 2009, we provided written notice to MSU terminating the license agreement effective April 24, 2009.

The PICM-19 cell line was developed for potential use in a bioartificial liver device and in-vitro toxicology platforms and was exclusively licensed from USDA Agricultural Research Service on November 2007. In September 2008 the license was amended for the expanded field-of-use as in-vitro infection host systems for viral and protozoan agents such as malaria.

On May 23, 2008, we completed a private placement of securities for an aggregate purchase price of $4,530,800. Simultaneously with the completion of the private placement, we converted our outstanding note payable of $877,800 into equity and the note holder agreed to accept $150,000 in full payment and satisfaction of the accrued and unpaid interest on the loan in the amount of $249,945.

Asset Purchase Agreement

On October 3, 2008, we entered into and consummated the transactions contemplated by a purchase agreement with Arbios (the Asset Purchase Agreement). In order to enhance and strengthen our current PICM-19 porcine liver cell line based bioartificial liver technology, we purchased certain specified assets of Arbios relating to the pig cell based liver device technology that was being developed by Arbios.

The purchase price of the acquired assets consisted of: $450,000 in cash, of which $250,000 was paid at the closing and $200,000 has been deferred for up to 18 months; a Series D Stock Purchase Warrant to purchase up to 750,000 shares of our common stock at an exercise price of $0.35 per share for a period of 5 years (the Series D Warrant). The deferred $200,000 payment (Deferred Cash Purchase Price) is due and payable on the earlier of (i) the date on which we consummate one or more debt or equity financings in which the gross proceeds received in the aggregate equal or exceed $4,000,000, or (ii) the eighteen month anniversary of the closing date.

The issuance of the Series D Warrant was deemed to be exempt from registration under the Securities Act of 1933, as amended (the Securities Act) in reliance on Section 4(2) of the Securities Act in that the issuance did not involve a public offering. We granted Arbios certain registration rights, as more fully set forth in the Registration Rights Agreement dated October 3, 2008 between us and Arbios, with respect to the shares of our common stock issuable upon exercise of the Series D warrant. Pursuant to the Registration Rights Agreement, if we have not filed with, and have declared effective by, the Securities and Exchange Commission, a registration statement within nine months of October 3, 2008, Arbios, to the extent applicable, will be entitled to utilize the cashless exercise provisions of the Series D Warrant. Because of our subsequent repurchase of the Series D Warrant, our obligation to register the underlying shares has terminated. Please refer to Warrant Repurchase Agreement below.

Warrant Repurchase Agreement

On April 22, 2009, we consummated the transactions contemplated by a Warrant Repurchase Agreement between us and Arbios.

Pursuant to the Repurchase Agreement, we repurchased the Series D stock purchase warrants previously issued to Arbios as partial consideration pursuant to the Asset Purchase Agreement. In consideration thereof we accelerated payment of the Deferred Cash Purchase Price to April 22, 2009. The Series D Warrants entitled the holder to purchase up to 750,000 shares of our common stock at a price of $0.35 per share.

Warrants

As of June 30, 2009, the following warrants were outstanding: 12,989,830 Series C warrants with an exercise price of $0.34 per share exercisable into common stock until May 23, 2010; and 737,000 warrants with an exercise price of $1.50 per share exercisable into common stock until May 11, 2012.

On July 8, 2009, we filed a registration statement to register the resale of the shares issuable upon the exercise of the Series C Warrants issued in connection with the private placement completed on May 23, 2008. The registration statement was declared effective as of July 17, 2009.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses and related disclosures. We review our estimates on an ongoing basis.

We consider an accounting estimate to be critical if it requires assumptions to be made that were uncertain at the time the estimate was made; and changes in the estimate or different estimates that could have been made could have a material impact on our results of operations or financial condition. While our significant accounting policies are described in more detail in the notes to our financial statements included in our annual Form 10-K filed with the Securities and Exchange Commission, we believe the following accounting policies to be critical to the judgments and estimates used in the preparation of our financial statements:

Research and Development Expenses

Research and development expenses represent costs incurred to develop our technology, as well as purchased in-process research and development programs. Until October 2008, the majority of costs incurred were pursuant to our CRADA with the USDA s Agricultural Research Service and pursuant to our sponsored research agreement with MSU. Third-party costs paid by us relating to these agreements include salaries and benefits for research and development personnel, allocated overhead and facility occupancy costs, contract services and other applicable costs. In addition, costs may include third party laboratory work. We charge all research and development expenses to operations as they are incurred, including internal costs, costs paid to sponsoring organizations, and purchased in-process research and development programs. We do not track research and development expenses by project.

General and Administrative Expenses

Our general and administrative expenses consist primarily of personnel related costs, legal costs, including intellectual property that is expensed when incurred, investor relations costs, stock based compensation costs, accounting costs, and other professional and administrative costs.

Stock-Based Compensation Expense

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," (SFAS 123R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. Our consolidated financial statements reflect the impact of SFAS 123(R) from the date of adoption.

Results of Operations

Operating Expenses

A summary of our operating expenses for the three and six months ended June 30, 2009 and 2008 are as follows:

	Three Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
Expenses				
Salary and benefits	$ 87,214	$ 310,667	$ (223,453)	(72%)
Research and development	45,769	81,742	(35,973)	(44%)
Shareholder and investor relations	12,714	166,760	(154,046)	(92%)
Administrative and general	51,171	44,711	6,460	14%
Professional fees- accounting and legal	57,203	66,260	(9,057)	(14%)
Director, management and consulting fees	22,561	750	21,811	2908%
Depreciation	-	2,607	(2,607)	(100%)
	$ 276,632	$ 673,497	$ (396,865)	(59%)

	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
Expenses				
Salary and benefits	$ 287,262	$ 642,750	$ (355,488)	(55%)
Research and development	96,844	209,205	(112,361)	(54%)
Shareholder and investor relations	14,994	170,715	(155,721)	(91%)
Administrative and general	105,137	92,305	12,832	14%
Professional fees- accounting and legal	161,457	88,805	72,652	82%
Director, management and consulting fees	64,269	1,500	62,769	4185%
Depreciation	-	5,214	(5,214)	(100%)
	$ 729,963	$ 1,210,494	$ (480,531)	(40%)

Salaries and benefits: We incurred salaries and benefits expense of $87,214 for the three-month period ended June 30, 2009 representing a decrease of $223,453 or 72% compared to the same period in 2008. The majority of the decrease, representing $144,871, is due to a decrease in stock compensation expense as certain option grants have been fully expensed. The remaining decrease of $78,582 is due to fewer employees as we terminated our research scientists effective November 30, 2008 as a result of the Arbios Systems, Inc. asset acquisition and due to our closing of the corporate office in Vancouver, British Columbia on August 31, 2008 as we repositioned our strategic direction.

We incurred salaries and benefits expense of $287,262 for the six-month period ended June 30, 2009 representing a decrease of $355,488 or 55% compared to the same period in 2008. Approximately 55% of the decrease, or $193,992, is due to fewer employees as we terminated our research scientists effective November 30, 2008 as a result of the Arbios Systems, Inc. asset acquisition in October 2008, and due to our closing of the corporate office in Vancouver, British Columbia on August 31, 2008 as we repositioned our strategic direction. The remaining 45% of the decrease, or $161,496, is due to a decrease in stock compensation expense as certain option grants have been fully expensed.

Research and development: We incurred $45,769 in research and development expenses for the three month period ended June 30, 2009 representing a decrease of $35,973 or 44% compared to the same period in 2008. This decrease is due primarily to the cancellation of our purchased research and development program with the USDA as of October 2008. The expenses incurred during this period were for the development of HepaMate.

We incurred $96,844 in research and development expenses for the six month period ended June 30, 2009 representing a decrease of $112,361 or 54% compared to the same period in 2008. This decrease is due primarily to the cancellation of our purchased research and development program with the USDA effective October 2008 and the cancellation of our sponsored research agreement with Michigan State University (MSU) effective April 24, 2009. We cancelled both the USDA and MSU research programs as a result of repositioning our strategic direction.

Shareholder and investor relations: We incurred $12,714 of shareholder and investor relations expense for the three-month period ended June 30, 2009 representing a decrease of $154,046 or 92% compared to the same period in 2008. We incurred $14,994 of shareholder and investor relations expense for the six-month period ended June 30, 2009, which is $155,721 or 91% lower than the same period in 2008. Both of these decreases represent higher costs during 2008 due to completing a private placement funding in May 2008.

Administrative and general: We incurred $51,171 in administrative and general expenses for the three-month period ended June 30, 2009 representing an increase of $6,460 or 14% compared to the same period in 2008. The change is comprised of a decrease of $29,763 in facilities and travel expenses due to closing of the corporate office in Vancouver, British Columbia on August 31, 2008, offset by an increase of $36,223 for the first time incurrence of license maintenance fees and director and officer insurance.

We incurred $105,137 in administrative and general expenses for the six-month period ended June 30, 2009 representing an increase of $12,832 or 14% compared to the same period in 2008. The change is comprised of a decrease of $61,425 in facilities and travel expenses due to closing of the corporate office in Vancouver, British Columbia on August 31, 2008, offset by an increase of $74,257 for the first time incurrence of license maintenance fees and director and officer insurance.

Professional fees: We incurred a total of $57,203 in professional fees for the three month period ended June 30, 2009 for a decrease of $9,057 or 14% which is comprised of the following: an increase of $10,425 for external accounting fees as these services were primarily performed by the corporate office in Vancouver, British Columbia in 2008 and are now outsourced; a decrease of $18,384 in legal fees due the July 2008 private placement; and an $1,098 decrease due to audit and other consulting services.

We incurred a total of $161,457 in professional fees for the six month period ended June 30, 2009 for an increase of $72,652 or 82%, which is comprised of the following: an increase of $37,946 for external accounting fees as these services were primarily performed by the corporate office in Vancouver, British Columbia in 2008 and are now outsourced; an increase of $20,409 in legal fees due primarily to legal fees incurred relating to the sponsored research agreement with Michigan State University which was terminated April 24, 2009; and an increase of $14,297 in audit and other consulting services.

Director, management and consulting fees: We incurred a total of $22,561 in director, management and consulting expenses for the three month period ended June 30, 2009 for an increase of $21,811 compared to the same period in 2008. We incurred a total of $64,269 in director, management and consulting expense for the six month period ended June 30, 2009 for an increase of $62,769 compared to the same period in 2008. Both of these increases are attributable to an increase in the number of positions on the Board of Directors from three to five beginning in September 2008, increasing the Director s fees from $750 to $2,500 on a quarterly basis, and also to hiring a Chief Financial Officer, on a contract basis, in February 2009.

Depreciation: Depreciation expense was zero for the three and six month periods ended June 30, 2009 as all assets were retired compared to the same periods in 2008.

Other Income and (Expense)

A summary of our other income and expense for the three and six months ended June 30, 2009 and 2008 are as follows:

	Three Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
Other income and (expense)				
Interest income	$ 9,036	$ 8,569	$ 467	5%
Interest on promissory note	-	(18,685)	(18,685)	(100%)
Interest, bank charges and foreign exchange loss	(362)	4	366	9150%
Amortization of discount on notes	(10,524)	-	10,524	100%
Amortization of deferred financing costs	-	-	-	0%
Change in fair value of warrant liability	364,119	-	(364,119)	100%
Other income and (expense)	$ 362,269	$ (10,112)	$ (372,381)	(3683%)

	Six Months Ended June 30,			
	2009	2008	Increase (Decrease)	% Change
Other income and (expense)				
Interest income	$ 19,576	$ 11,466	$ 8,110	71%
Interest on promissory note	-	(41,615)	(41,615)	(100%)
Interest, bank charges and foreign exchange loss	(952)	(9,173)	(8,221)	(90%)
Amortization of discount on notes	(12,873)	(468,343)	(455,470)	(97%)
Amortization of deferred financing costs	-	(210,728)	(210,728)	(100%)
Change in fair value of warrant liability	(41,538)	-	41,538	100%
Other income and (expense)	$ (35,787)	$ (718,393)	$ (682,606)	(95%)

Amortization of discount on notes and deferred financing costs: These accounts decreased due to the conversion of notes payable during the six-month period ended June 30, 2008.

Change in fair value of warrant liability: On January 1, 2009, we adopted EITF 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* . We determined that our Series C Warrants contained a Dilutive Issuance provision. As a result, we reclassified 12,989,830 Series C Warrants from equity to a noncurrent warrant liability and recorded a cumulative effect of the change in accounting principle adjustment that reduced our accumulated deficit as of January 1, 2009 by $1,393,504.

We account for the warrant liability in accordance with SFAS 157. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, SFAS 157 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy). At June 30, 2009, we valued the warrant liability using a Black-Scholes model (Level 3 inputs) containing the following assumptions: volatility 105.19%, risk-free rate 0.56%, and term of 11 months. Due to this re-measurement, we recorded non-operating income of $364,199 for the three months ended June 30, 2009, which represents a net decrease in the fair value our warrant liability for this period, and we recorded non-operating expense of $41,538 for the six month period ended June 30, 2009, which represents a net increase in the fair value of our warrant liability for this period.

Liquidity and Capital Resources

We had cash and cash equivalents of $2,364,126 and $3,084,155 as of June 30, 2009 and December 31, 2008, respectively. We financed our operations from cash on hand during the six month period ending June 30, 2009.

Net cash flow used in operating activities was $520,410 for the six month period ending June 30, 2009, compared to net cash used of $1,104,629 for the same period in 2008.

Net cash used in financing activities was ($200,000) for the six month period ended June 30, 2009 compared to net cash provided from financing activities of $4,530,800 for the same period in 2008. During the six-month period ended June 30, 2009, we repaid contract commitments totaling $200,000. We completed a private placement funding of $4,530,000 for the same period ended June 2008.

We had no net cash provided from investing activities during the periods ended June 30, 2009 and 2008.

The accompanying financial statements have been prepared assuming we will continue as a going concern. We incurred cumulative losses of $18,693,862 from inception through June 30, 2009. Additionally, we have expended a significant amount of cash in developing our technology and operating as a public entity. We expect to continue to incur losses from business operations and we believe our cash and cash equivalents balances, anticipated cash flows from operations, and other external sources of credit will be sufficient to meet our cash requirements through December 2010. Our prospects after December 2010 will depend in large part on our ability to successfully raise capital from external sources to pay for planned expenditures and to fund operations.

At this time, we have no agreements or understandings with any third party regarding any financings.

Related Party Transactions

Director and Management Fees: For the three and six month periods ended June 30, 2009, we incurred $10,000 (2008: $750) and $20,000 (2008: $1,500), respectively, in board fees for our non-employee directors. In addition, for the three and six month periods ended June 30, 2009, we recorded $6,148 (2008: $820) and $12,656 (2008: $820), respectively, as stock compensation expense relating to stock options grants to directors (refer to Note 9). There are no management or consulting agreements in effect.

Legal Fees: During the three and six months ended June 30, 2009, we incurred $25,175 (2008: $31,375) and $61,163 (2008: $46,425), respectively, for legal services rendered by a law firm of which a non-employee director is a member.

Off Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Recent Accounting Pronouncements

See Note 2 to the Consolidated Unaudited Interim Financial Statements in this Form 10-Q.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk is confined to our cash equivalent7

s and short-term investments. We invest in high-quality financial instruments; primarily money market funds, federal agency notes, and US Treasury obligations, with the effective duration of the portfolio within one year which we believe are subject to limited credit risk. We currently do not hedge interest rate exposure. Due to the short-term nature of our investments, we do not believe that we have any material exposure to interest rate risk arising from our investments.

ITEM 4T. Controls and Procedures

Disclosure controls and procedures.

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), as of the end of the period covered by this quarterly report. Based on this evaluation, our chief executive officer and chief financial officer concluded as of June 30, 2009 that our disclosure controls and procedures were effective such that the information required to be disclosed in our United States Securities and Exchange Commission (SEC) reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Internal control over financial reporting.

Other than as described below, there have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this report that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Subsequent to filing our Form 10-Q for the quarter ended March 31, 2009, we determined that our Series C Warrants contained a Dilutive Issuance provision, resulting in a material adjustment that was required to appropriately account for this security as a warrant liability in accordance with an accounting pronouncement that became effective on January 1, 2009. As a result, we filed an amended Form 10-Q for the quarter ended March 31, 2009 on August 4, 2009. We have strengthened our controls over financial reporting to evaluate and adopt accounting guidance in a timely manner.

PART II Other Information

Item 1. Legal Proceedings

None

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 the Chief Executive Officer pursuant to Rule 13a-14(a)

31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)

32.1 Certification by the Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification by the Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of Sections 13 or 15 (d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 12th day of August, 2009.

Hepalife Technologies, Inc.
(Registrant)

Date	Signature	Title
August 13, 2009	/s/ Frank Menzler Frank Menzler	Director, Chairman of the Board President and Chief Executive Officer
August 13, 2009	/s/ Donna A. Lopolito Donna A. Lopolito	Chief Financial Officer