STEMCELLS INC
Form 10-Q
November 05, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended: September 30, 2013

Commission File Number: 0-19871

STEMCELLS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**94-3078125**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization) **identification No)**

7707 Gateway Blvd

Newark, CA 94560

(Address of principal executive offices including zip code)

(510) 456-4000

(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 twelve months (or for such shorter periods 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 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. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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

At November 1, 2013, there were 54,971,174 shares of Common Stock, $.01 par value, issued and outstanding.

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NOTE REGARDING REFERENCES TO US AND OUR COMMON STOCK

Throughout this Form 10-Q, the words we, us, our, and StemCells refer to StemCells, Inc., including our directly and indirectly wholly-owned subsidiaries. Common stock refers to the common stock, $.01 par value, of StemCells, Inc.

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PART I-FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STEMCELLS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

	September 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 20,955,293	$ 8,471,275
Marketable securities, current		13,900,678
Trade receivables	125,487	110,159
Other receivables	491,556	200,788
Prepaid assets	464,464	537,590
Deferred financing costs, current	51,808	
Other assets, current	110,615	820,827
Total current assets	22,199,223	24,041,317
Property, plant and equipment, net	5,438,659	1,375,329
Deferred financing costs, non-current	32,571	
Other assets, non-current	999,776	947,301
Goodwill	1,973,302	1,983,426
Other intangible assets, net	1,673,051	1,822,904
Total assets	$ 32,316,582	$ 30,170,277
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,860,544	$ 999,365
Accrued expenses and other current liabilities	2,303,506	2,707,441
Accrued wind-down expenses, current		1,102,762
Deferred revenue, current	67,588	74,426
Capital lease obligation, current	20,936	6,888
Deferred rent, current	28,050	
Loan payable net of discount, current	3,602,972	
Bonds payable, current	178,750	206,250
Total current liabilities	8,062,346	5,097,132
Bonds payable, non-current		125,000
Capital lease obligations, non-current	34,896	12,646
Loan payable net of discount, non-current	9,865,375	
Fair value of warrant liability	8,420,954	9,265,365
Deposits and other long-term liabilities	512,320	216,439
Deferred rent, non-current	1,792,683	1,389,342
Deferred revenue, non-current	67,116	79,736
Total liabilities	28,755,690	16,185,660
Commitments and contingencies (Note 8)		
Stockholders equity:		

Common stock, $0.01 par value; 75,000,000 shares authorized; issued and outstanding 42,044,839 at September 30, 2013 and 37,506,305 at December 31, 2012	420,449	375,063
Additional paid-in capital	383,537,795	374,507,552
Accumulated deficit	(380,567,957)	(361,091,175)
Accumulated other comprehensive income	170,605	193,177
Total stockholders equity	3,560,892	13,984,617
Total liabilities and stockholders equity	$ 32,316,582	$ 30,170,277

See Notes to Condensed Consolidated Financial Statements.

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STEMCELLS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenue:				
Revenue from licensing agreements, grants and other	$ 52,798	$ 60,739	$ 159,773	$ 471,501
Revenue from product sales	271,994	203,256	730,916	685,364
Total revenue	324,792	263,995	890,689	1,156,865
Cost of product sales	85,743	71,891	230,157	208,127
Gross profit	239,049	192,104	660,532	948,738
Operating expenses:				
Research and development	5,184,365	3,478,142	14,553,145	11,165,599
Selling, general and administrative	1,710,749	1,636,438	5,180,027	5,336,105
Wind-down expenses		154,742	61,837	199,799
Total operating expenses	6,895,114	5,269,322	19,795,009	16,701,503
Loss from operations	(6,656,065)	(5,077,218)	(19,134,477)	(15,752,765)
Other income (expense):				
Change in fair value of warrant liability	(143,511)	(11,239,465)	425,570	(9,974,685)
Interest income	136	2,372	8,772	9,393
Interest expense	(382,119)	(11,392)	(785,122)	(40,014)
Other income (expense), net	(10,094)	(11,087)	8,475	25,364
Total other expense, net	(535,588)	(11,259,572)	(342,305)	(9,979,942)
Net loss	$ (7,191,653)	$ (16,336,790)	$ (19,476,782)	$ (25,732,707)
Basic and diluted net loss per share	$ (0.17)	$ (0.54)	$ (0.49)	$ (0.99)
Weighted average number of common shares outstanding, basic and diluted	41,402,717	30,168,475	39,787,527	25,992,764

See Notes to Condensed Consolidated Financial Statements.

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STEMCELLS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net loss	$ (7,191,653)	$ (16,336,790)	$ (19,476,782)	$ (25,732,707)
Other comprehensive income (loss)				
Foreign currency translation adjustments	206,120	98,706	(23,928)	125,854
Unrealized gains (losses) on marketable securities	(425)	587	1,356	3,210
Other comprehensive income (loss)	205,695	99,293	(22,572)	129,064
Comprehensive loss	$ (6,985,958)	$ (16,237,497)	$ (19,499,354)	$ (25,603,643)

See Notes to Condensed Consolidated Financial Statements.

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STEMCELLS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Nine months ended September 30,	
	2013	**2012**
Cash flows from operating activities:		
Net loss	$ (19,476,782)	$ (25,732,707)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	730,504	759,527
Stock-based compensation	2,033,228	2,227,145
Amortization of debt discount and issuance costs	509,069	
Gain on disposal of fixed assets	(34,946)	
Change in fair value of warrant liability	(425,570)	9,974,685
Changes in operating assets and liabilities:		
Accrued interest and other receivables	(364,940)	19,432
Trade receivables	57,569	(40,584)
Prepaid and other current assets	782,745	170,667
Other assets, non-current	(52,474)	32,926
Accounts payable and accrued expenses	499,935	(1,613,123)
Accrued wind-down expenses	(1,102,762)	(817,110)
Deferred revenue	(19,146)	(665)
Deferred rent	431,390	69,997
Net cash used in operating activities	(16,432,180)	(14,949,810)
Cash flows from investing activities:		
Purchase of marketable securities	(527,967)	(8,109,933)
Proceeds from the maturity of marketable securities	14,430,000	5,362,000
Purchases of property, plant and equipment	(4,556,406)	(19,729)
Proceeds from sale of property, plant and equipment	38,500	
Acquisition of other assets	(100,000)	
Net cash provided by (used in) investing activities	9,284,127	(2,767,662)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of issuance costs	6,115,442	16,196,587
Proceeds from the exercise of stock options	2,809	
Proceeds from the exercise of warrants, net of issuance costs	460,097	4,153,584
Proceeds from loan payable, net of issuance costs	13,558,358	
Payments related to net share issuance of stock based awards	(342,366)	(59,090)
Repayment of capital lease obligations	(7,302)	(18,521)
Repayment of bonds payable	(152,500)	(141,250)
Net cash provided by financing activities	19,634,538	20,131,310
Increase in cash and cash equivalents	12,486,485	2,413,838
Effects of foreign exchange rate changes on cash	(2,467)	(12,411)
Cash and cash equivalents, beginning of period	8,471,275	13,311,261
Cash and cash equivalents, end of period	$ 20,955,293	$ 15,712,688
Supplemental disclosure of cash flow information:		

Interest paid	$	271,054	$	40,114
Supplemental schedule of non-cash investing and financing activities:				
Fair value of 329,131 shares issued as consideration under an equity financing agreement[1]	$	600,006	$	
Stock issued for an option agreement[2]	$		$	50,000
Equipment acquired under a capital lease[3]	$	43,600	$	21,721

See Notes to Condensed Consolidated Financial Statements.

[1] In June 2013, we entered into an agreement with an institutional investor, under which we have the right to sell up to $30.0 million of common stock to the institutional investor. In consideration for entering into the agreement, we issued 329,131 shares of our common stock to the institutional investor. We will not receive any cash proceeds from the issuance of these 329,131 shares. All shares sold or to be sold under this agreement are offered under our shelf registration statement previously filed with, and declared effective by, the SEC. In October 2013, we terminated the agreement without any cost or penalty.

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[2] In September 2012, we issued 24,753 shares of restricted common stock under the terms of an agreement with a developer of biological materials in return for certain product rights including an exclusive right of first offer to commercialize the developer s products as may be developed on or before April 18, 2017.

[3] Represents the present value of future minimum capital lease payments for equipment leased.

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Notes to Condensed Consolidated Financial Statements (Unaudited)

September 30, 2013 and 2012

Note 1. Summary of Significant Accounting Policies

Nature of Business.

StemCells, Inc., a Delaware corporation, is a biopharmaceutical company that operates in one segment, the research, development, and commercialization of stem cell therapeutics and related technologies.

The accompanying financial data as of September 30, 2013 and for the three and nine months ended September 30, 2013 and 2012 have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) have been condensed or omitted pursuant to these rules and regulations. The December 31, 2012 condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. However, we believe that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

We have incurred significant operating losses since inception. We expect to incur additional operating losses over the foreseeable future. We have very limited liquidity and capital resources and must obtain significant additional capital and other resources in order to provide funding for our product development efforts, the acquisition of technologies, businesses and intellectual property rights, preclinical and clinical testing of our products, pursuit of regulatory approvals, acquisition of capital equipment, laboratory and office facilities, establishment of production capabilities, selling, general and administrative expenses and other working capital requirements. We rely on our cash reserves, proceeds from equity and debt offerings, credit facilities, proceeds from the transfer or sale of intellectual property rights, equipment, facilities or investments, government grants and funding from collaborative arrangements, to fund our operations. If we exhaust our cash reserves and are unable to obtain adequate financing, we may be unable to meet our operating obligations and we may be required to initiate bankruptcy proceedings. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of StemCells, Inc., and our wholly-owned subsidiaries, including StemCells California, Inc., Stem Cell Sciences Holdings Ltd, and Stem Cell Sciences (UK) Ltd. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported in our condensed consolidated financial statements and accompanying notes. Actual results could differ materially from these estimates.

Significant estimates include the following:

- the grant date fair value of stock-based awards recognized as compensation expense (see Note 5, Stock-Based Compensation);
- the fair value of warrants recorded as a liability (see Note 9, Warrant Liability); and
- the fair value of goodwill and other intangible assets (see Note 4, Goodwill and Other Intangible Assets).

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Financial Instruments

Cash and Cash Equivalents

Cash equivalents are money market accounts, money market funds and investments with maturities of 90 days or less from the date of purchase.

Marketable Securities

Our existing marketable securities are designated as available-for-sale securities. These securities are carried at fair value (see Note 2, Financial Instruments), with the unrealized gains and losses reported as a component of stockholders equity. Management determines the appropriate designation of its investments (current or non-current) in marketable securities at the time of purchase and reevaluates such designation as of each balance sheet date. The cost of securities sold is based upon the specific identification method.

If the estimated fair value of a security is below its carrying value, we evaluate whether we have the intent and ability to retain our investment for a period of time sufficient to allow for any anticipated recovery to the cost of the investment, and whether evidence indicating that the cost of the investment is recoverable within a reasonable period of time outweighs evidence to the contrary. Other-than-temporary declines in estimated fair value of all marketable securities are charged to Other income (expense), net in the accompanying condensed consolidated statements of operations. No such impairment was recognized during the three and nine months ended September 30, 2013 or 2012.

Trade and Other Receivables

Our receivables generally consist of interest income on our financial instruments, revenue from licensing agreements and grants, and revenue from product sales.

Warrant Liability

We account for our warrants in accordance with U.S. GAAP which defines how freestanding contracts that are indexed to and potentially settled in a company s own stock should be measured and classified. Authoritative accounting guidance prescribes that only warrants issued by us under contracts that cannot be net-cash settled, and are both indexed to and settled in our common stock, can be classified as equity. As part of both our November 2008 and November 2009 financings, we issued warrants with five year terms to purchase 1,034,483 and 400,000 shares of our common stock at $23.00 and $15.00 per share, respectively. As part of our December 2011 financing, we issued Series A Warrants with a five year term to purchase 8,000,000 shares at $1.40 per share and Series B Warrants with a ninety trading day term to purchase 8,000,000 units at $1.25 per unit. Each unit underlying the Series B Warrants consisted of one share of our common stock and one Series A Warrant. In the first and second quarter of 2012, an aggregate of 2,700,000 Series B Warrants were exercised. For the exercise of these warrants, we issued 2,700,000 shares of our common stock and 2,700,000 Series A Warrants. The remaining 5,300,000 Series B Warrants expired unexercised by their terms on May 2, 2012. As terms of the warrants issued in 2008 and 2009, as well as the Series A and Series B Warrants, do not meet the specific conditions for equity classification, we are required to classify the fair value of these warrants as a liability, with subsequent changes in fair value to be recorded as income (loss) due to change in fair value of warrant liability. The fair value of the warrants issued in the 2008 and 2009 financings is determined using the Black-Scholes-Merton (Black-Scholes) option pricing model and the fair value of the Series A and Series B Warrants is determined using a Monte Carlo simulation model (see Note 9, Warrant Liability). The fair value is affected by changes in inputs to these models including our stock price, expected stock price volatility, the contractual term, and the risk-free interest rate. The use of a Monte Carlo simulation model requires input of additional assumptions including the progress of our R&D programs and its affect on potential future financings. We will continue to classify the fair value of the warrants as a liability until the warrants are exercised, expire or are amended in a way that would no longer require these warrants to be classified as a liability. The estimated fair value of our warrant liability at September 30, 2013, was approximately $8,421,000.

Goodwill and Other Intangible Assets

Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to annual impairment tests. If the assumptions and estimates used to allocate the purchase price are not correct, or if business conditions change, purchase price adjustments or future asset impairment charges could be required. We test goodwill for impairment on an annual basis or more frequently if we believe indicators of impairment exist. Impairment evaluations involve management estimates of asset useful lives and future cash flows. Significant management judgment is required in the forecasts of future operating results that are used in the evaluations, and it is possible, even likely, that the plans and estimates used may be incorrect. If our actual results, or the plans and estimates used in future impairment analysis are lower than the original estimates used to assess the recoverability of these assets, we could incur additional impairment charges in a future period. We completed our annual impairment testing during the fourth quarter of 2012, and determined that there was no impairment of goodwill.

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Prior to fiscal year 2001, we capitalized certain patent costs, which are being amortized over the estimated life of the patent and would be expensed at the time such patents are deemed to have no continuing value. Since 2001, all patent costs are expensed as incurred. License costs are capitalized and amortized over the estimated life of the related license agreement.

Revenue Recognition

We currently recognize revenue resulting from the licensing and use of our technology and intellectual property, from government grants, from services provided to third parties, and from product sales. Licensing agreements may contain multiple elements, such as upfront fees, payments related to the achievement of particular milestones and royalties. Revenue from upfront fees for licensing agreements that contain multiple elements are generally deferred and recognized on a straight-line basis over the term of the agreement. Fees associated with substantive at risk performance-based milestones are recognized as revenue upon completion of the scientific or regulatory event specified in the agreement, and royalties received are recognized as earned. Revenue from licensing agreements is recognized net of a fixed percentage due to licensors as royalties. Grant revenue from government agencies are funds received to cover specific expenses and are recognized as earned upon either the incurring of reimbursable expenses directly related to the particular research plan or the completion of certain development milestones as defined within the terms of the relevant collaborative agreement or grant. Revenue from services to third parties is recognized when we have provided the agreed upon services. Revenue from product sales are recognized when the product is shipped and the order fulfilled.

Stock-Based Compensation

Compensation expense for stock-based payment awards to employees is based on their grant date fair value as calculated and amortized over their vesting period. See Note 5, Stock-Based Compensation for further information.

We use the Black-Scholes model to calculate the fair value of stock-based awards.

Per Share Data

Basic net income or loss per share is computed by dividing net income or loss by the weighted average number of shares of common stock outstanding during the period. Diluted net income or loss per share is computed based on the weighted average number of shares of common stock and other dilutive securities. To the extent these securities are anti-dilutive, they are excluded from the calculation of diluted earnings per share.

The following is a reconciliation of the numerators and denominators of the basic and diluted net loss per share computations:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net loss	$ (7,191,653)	$ (16,336,790)	$ (19,476,782)	$ (25,732,707)
Weighted average shares outstanding used to compute basic and diluted net income or loss per share	41,402,717	30,168,475	39,787,527	25,992,764
Basic and diluted net loss per share	$ (0.17)	$ (0.54)	$ (0.49)	$ (0.99)

The following outstanding potentially dilutive securities were excluded from the computation of diluted net income or loss per share because the effect would have been anti-dilutive as of September 30:

	2013	2012
Options	431,558	474,917
Restricted stock units	3,336,282	1,516,199
Warrants	9,894,909	10,689,083
Total	13,662,749	12,680,199

Comprehensive Income (Loss)

Comprehensive income (loss) is comprised of net income or loss and other comprehensive income or loss (OCL). OCL includes certain changes in stockholders equity that are excluded from net income or loss. Specifically, we include in OCL changes in unrealized gains and losses on our marketable securities and unrealized gains and losses on foreign currency translations. Accumulated other comprehensive income was $170,605, as of September 30, 2013, and accumulated other comprehensive income was $193,177, as of December 31, 2012.

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Note 2. Financial Instruments

The following table summarizes the fair value of our cash, cash equivalents and available-for-sale marketable securities held in our current investment portfolio:

	Amortized Cost	Gross Unrealized (Losses)	Fair Value
September 30, 2013			
Cash	$ 377,695	$	$ 377,695
Cash equivalents	20,577,598		20,577,598
Total cash, cash equivalents, and marketable securities	$ 20,955,293	$	$ 20,955,293
December 31, 2012			
Cash	$ 254,267	$	$ 254,267
Cash equivalents	8,217,259	(252)	8,217,007
Marketable debt securities, current	13,901,782	(1,104)	13,900,678
Total cash, cash equivalents, and marketable securities	$ 22,373,308	$ (1,356)	$ 22,371,952

At September 30, 2013, our investments in money market accounts are through a money market fund that invests in high quality, short-term money market instruments which are classified as cash equivalents in the accompanying Consolidated Balance Sheet due to their short maturities. The investment seeks to provide the highest possible level of current income while still maintaining liquidity and preserving capital. From time to time, we carry cash balances in excess of federally insured limits. Our cash balance at September 30, 2013 includes approximately $114,000 held by our U.K. subsidiary.

Note 3. Fair Value Measurement

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, we are required to apply a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value. The three levels of the fair value hierarchy are:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Directly or indirectly observable inputs other than in Level 1, that include quoted prices for similar assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3 Unobservable inputs which are supported by little or no market activity that reflects the reporting entity s own assumptions about the assumptions that market participants would use in pricing the asset or liability.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Assets measured at fair value are classified below based on the three fair value hierarchy tiers described above.

Our cash equivalents are classified as Level 1 because they are valued primarily using quoted market prices.

Our bonds payable, marketable securities, and liability for warrants issued in our 2008 and 2009 financing, are classified as Level 2 as they are valued using alternative pricing sources and models utilizing market observable inputs.

We estimated the fair value of our loan payable using the net present value of the payments discounted at an effective interest rate. We believe the estimates used to measure the fair value of our loan payable constitute Level 3 inputs.

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Our liability for warrants issued in our 2011 financing is classified as Level 3 as the liability is valued using a Monte Carlo simulation model. Some of the significant inputs used to calculate the fair value of warrant liability include our stock price on the valuation date, expected volatility of our common stock as traded on NASDAQ, and risk-free interest rates that are derived from the yield on U.S. Treasury debt securities, all of which are observable from active markets. However, the use of a Monte Carlo simulation model requires the input of additional subjective assumptions including management s assumptions regarding the likelihood of a re-pricing of these warrants pursuant to anti-dilution provisions and the progress of our R&D programs and its affect on potential future financings.

The following table presents financial assets and liabilities measured at fair value as of September 30, 2013:

	Fair Value Measurement at Report Date Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	As of September 30, 2013
Financial assets:				
Cash equivalents:				
Money market funds	$ 377,695	$	$	$ 377,695
U.S. Treasury debt obligations	20,577,598			20,577,598
Total financial assets	$ 20,955,293	$	$	$ 20,955,293
Financial liabilities:				
Bond obligation	$	$ 178,750	$	$ 178,750
Loan payable net of discounts			13,468,348	13,468,348
Warrant liabilities		15,260	8,405,694	8,420,954
Total financial liabilities	$	$ 194,010	$ 21,874,042	$ 22,068,052

Level 2 Reconciliation

The following table presents a roll forward for financial assets and liabilities measured at fair value using significant other observable inputs (Level 2) for 2013:

	Level 2 Beginning Balance 12/31/12 $	Net transfers (to) from Level 1 $	Change included in earnings $	Settled $	Level 2 Ending Balance 09/30/13 $
Marketable securities	13,900,678	(13,900,678)			
Bond obligation	331,250			(152,500)	178,750
Warrant liabilities	107,968		(92,708)		15,260

Transfers from Level 2 to Level 1 are maturities of short term marketable debt securities into cash and cash equivalents.

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Level 3 Reconciliation

The following table presents a roll forward for liabilities measured at fair value using significant unobservable inputs (Level 3) for 2013.

	Warrant Liabilities
Balance at December 31, 2012	$ 9,157,397
Less fair value of warrants exercised	(418,841)
Add change in fair value of warrants	(332,862)
Balance at September 30, 2013	$ 8,405,694

	Loan payable net of discounts	
Loan proceeds	$	13,820,264
Less discount		(487,576)
Add amortization of discount		135,660
Balance at September 30, 2013	$	13,468,348

Note 4. Goodwill and Other Intangible Assets

On April 1, 2009, we acquired the operations of Stem Cell Sciences Plc (SCS) for an aggregate purchase price of approximately $5,135,000. The acquired operations includes proprietary cell technologies relating to embryonic stem cells, induced pluripotent stem (iPS) cells, and tissue-derived (adult) stem cells; expertise and infrastructure for providing cell-based assays for drug discovery; a cell culture products business; and an intellectual property portfolio with claims relevant to cell processing, reprogramming and manipulation, as well as to gene targeting and insertion.

The purchase price was allocated as follows:

	Allocated purchase Price	Estimated life of intangible assets in years
Net tangible assets	$ 36,000	
Intangible assets:		
Customer relationships and developed technology	1,310,000	6 to 9
In-process research and development	1,340,000	N/A
Trade name	310,000	15
Goodwill	2,139,000	N/A
Total	$ 5,135,000	

In-process research and development assets relate to: 1) the acquisition of certain intellectual property rights not expected to expire until 2027 related to our program focused on developing genetically engineered rat models of human disease (our Transgenic Rat Program); and 2) the acquisition of certain technology related to the commercialization of our SC Proven cell culture products and the development and commercialization of cell-based assay platforms for use in drug discovery and development (our Assay Development Program).

At the time of valuation (April 2009), our Transgenic Rat Program was in its nascent stage and our Assay Development Program was expected to achieve proof of concept by 2012. Neither program was expected to begin generating revenue until 2011-2012. In December 2011, in part because of management s decision to focus on our therapeutic product development programs and not to allocate time and resources to the assays

technology, we determined that we could not predict the future cash flows from the intangible IPR&D asset related to the Assay Development Program. Therefore, at December 31, 2011, we determined that the intangible asset was impaired and wrote off the approximately $655,000 carrying value of the asset.

Trade name relates to the SC Proven trademark of our cell culture products which we expect to market for 15 years from the date of acquisition, based on which, we estimated a remaining useful life of 15 years from the valuation date.

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The following table presents changes in goodwill:

Balance as of December 31, 2012	$ 1,983,426
Foreign currency translation	(10,124)
Balance as of September 30, 2013	$ 1,973,302

The components of our other intangible assets at September 30, 2013 are summarized below:

Other Intangible Asset Class	Cost	Additions	Impairment	Accumulated Amortization	Foreign Currency Translation	Net Carrying Amount	Weighted-Average Amortization Period
Customer relationships and developed technology	$ 1,310,000	$	$	$ (829,204)	$ 142,683	$ 623,479	8.0 years
In-process research and development	1,340,000		(654,961)	(270,687)	133,300	547,652	Indefinite
Trade name	310,000			(102,118)	35,913	243,795	15.0 years
Patents	979,612	64,000		(785,487)		258,125	16.0 years
Total other intangible assets	$ 3,939,612	$ 64,000	$ (654,961)	$ (1,987,496)	$ 311,896	$ 1,673,051	12.2 years

Amortization expense was approximately $66,000 in the third quarter of 2013.

The expected future annual amortization expense for each of the next five years based on current balances of our intangible assets is approximately as follows:

For the year ending December 31:	
2013	$ 289,000
2014	$ 275,000
2015	$ 275,000
2016	$ 267,000
2017	$ 247,000

Note 5. Stock-Based Compensation

We currently grant stock-based compensation under two equity incentive plans approved by the Company s stockholders and one plan adopted in 2012 pursuant to NASDAQ Listing Rule 5635(c)(4) concerning inducement grants for new employees (our 2012 Commencement Incentive Plan). As of September 30, 2013, we had 2,601,389 shares available to grant under the above mentioned plans. At our annual stockholders meeting held on June 12, 2007, our stockholders approved an amendment to our 2006 Equity Incentive Plan to provide for an annual increase in the number of shares of common stock available for issuance under the plan each January 1 (beginning January 1, 2008) equal to 4% of the outstanding common shares as of that date. The amendment further provided an aggregate limit of 3,000,000 shares issuable pursuant to incentive stock option awards under the plan. Under the two stockholder-approved plans we may grant incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, 401(k) Plan employer match in form of shares and performance-based shares to our employees, directors and consultants, at prices determined by our Board of Directors. Incentive stock options may only be granted to employees under these plans with a grant price not less than the fair market value on the date of grant. Under our 2012 Commencement Inducement Plan, we may only award options, restricted stock units and other equity awards to newly hired employees and newly engaged directors, in each case as allowed by NASDAQ listing requirements.

Our stock-based compensation expense for the three and nine months ended September 30 was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Research and development expense	$ 346,938	$ 314,393	$ 1,064,301	$ 966,570
Selling, general and administrative expense	250,067	452,760	968,927	1,260,575
Total stock-based compensation	$ 597,005	$ 767,153	$ 2,033,228	$ 2,227,145
Effect on basic and diluted net loss per share	$ (0.01)	$ (0.03)	$ (0.05)	$ (0.09)

As of September 30, 2013, we had approximately $4,767,000 of total unrecognized compensation expense related to unvested awards of stock options and restricted stock units granted under our various equity incentive plans that we expect to recognize over a weighted-average vesting period of 3.2 years.

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Stock Options

Generally, stock options granted to employees have a maximum term of ten years, and vest over a four year period from the date of grant; 25% vest at the end of one year, and 75% vest monthly over the remaining three-year service period. We may grant options with different vesting terms from time to time. Upon employee termination of service, any unexercised vested option will be forfeited three months following termination or the expiration of the option, whichever is earlier. Unvested options are forfeited on termination.

A summary of our stock option activity for the three months ended September 30, 2013 is as follows:

	Number of options	Weighted-average exercise price ($) per share
Balance at June 30, 2013	440,126	19.85
Granted		
Exercised	(723)	1.00
Cancelled	(7,845)	18.87
Outstanding options at September 30, 2013	431,558	19.90

A summary of changes in unvested options for the three months ended September 30, 2013 is as follows:

	Number of options	Weighted-average exercise price ($) per share	Weighted-average grant date fair value ($) per option
Unvested options at June 30, 2013	39,097	10.37	8.25
Granted			
Vested	(10,374)	10.55	8.38
Cancelled			
Unvested options at September 30, 2013	28,723	10.31	8.20

The estimated fair value of options vested was approximately $87,000 in the three months ended September 30, 2013.

Restricted Stock Units

We have granted restricted stock units (RSUs) to certain employees and members of the Board of Directors which entitle the holders to receive shares of our common stock upon vesting of the RSUs. The fair value of restricted stock units granted is based upon the market price of the underlying common stock as if it were vested and issued on the date of grant.

A summary of changes in our restricted stock units for the three months ended September 30, 2013 is as follows:

	Number of RSUs	Weighted-average grant date fair value ($) per RSU
Outstanding restricted stock units at June 30, 2013	3,350,616	1.70
Granted(1)	60,000	1.73
Vested and exercised	(30,334)	3.26
Cancelled	(44,000)	2.01
Outstanding restricted stock units at September 30, 2013	3,336,282	1.68

(1) 10,000 of these restricted stock units vest and convert into shares of our common stock after one year from the date of grant. 50,000 of these restricted stock units will vest and convert into shares of our common stock over a four year period from the date of grant; one-fourth of the award will vest on each grant date anniversary following the grant.

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Stock Appreciation Rights

In July 2006, we granted cash-settled Stock Appreciation Rights (SARs) to certain employees that give the holder the right, upon exercise, to the difference between the price per share of our common stock at the time of exercise and the exercise price of the SARs.

The SARs have a maximum term of ten years with an exercise price of $20.00, which is equal to the market price of our common stock at the date of grant. The SARs vest 25% on the first anniversary of the grant date and 75% vest monthly over the remaining three-year service period. All of the outstanding SARs as of September 30, 2013 are fully vested. Compensation expense is based on the fair value of SARs which is calculated using the Black-Scholes option pricing model.

The stock-based compensation expense and liability are re-measured at each reporting date through the earlier of date of settlement or forfeiture of the SARs.

A summary of the changes in SARs for the three months ended September 30, 2013 is as follows:

	Number of SARs
Outstanding at June 30, 2013	110,593
Granted	
Exercised	
Forfeited and expired	
Outstanding SARs at September 30, 2013	110,593
SARs exercisable at September 30, 2013	110,593

For the three months ended September 30, 2013 and 2012, the re-measured liability and expense for the respective periods related to the SARs were not significant.

The compensation expense related to the SARs recognized for the three months ended September 30, 2013 may not be representative of compensation expense for future periods and its resulting effect on net loss and net loss per share attributable to common stockholders, due to changes in the fair value calculation which is dependent on the stock price, volatility, interest and forfeiture rates, additional grants and subsequent periods of vesting. We will continue to recognize compensation cost each period, which will be the change in fair value from the previous period through the earlier date of settlement or forfeiture of the SARs.

Note 6. Wind-Down Expenses

Rhode Island

In connection with our wind-down of our research and manufacturing operations in Lincoln, Rhode Island, and the relocation of our corporate headquarters and remaining research laboratories to California in October 1999, we provided a reserve for our exit cost obligation. The reserve was for the estimated costs of our former research and administrative facility in Lincoln, which we held on a lease that terminated on June 30, 2013. We periodically re-evaluated and adjusted the reserve after considering various factors such as our lease payments through to the end of the lease, operating expenses, the real estate market in Rhode Island, and estimated subtenant income based on actual and projected occupancy. The reserve was approximately $505,000 at March 31, 2013. In the second quarter of 2013, payments net of subtenant income of approximately $505,000 were recorded against this reserve and approximately $39,000 as additional wind-down expenses. We have closed this reserve as the lease and our obligations related to it terminated on June 30, 2013.

The summary of the changes to our wind-down reserve related to this facility for 2013 and 2012 were as follows:

	January 1 to March 31, 2013	April 1 to June 30, 2013	January 1 to June 30, 2013	January 1 to December 31, 2012

Accrued wind-down reserve at beginning of period	$ 854,000	$ 505,000	$ 854,000	$ 1,683,000
Less actual expenses recorded against estimated reserve during the period	(372,000)	(505,000)	(877,000)	(1,185,000)
Additional expense recorded to revise estimated reserve at period-end	23,000		23,000	356,000
Revised reserve at period-end	505,000			854,000
Add deferred rent at period-end	124,000			249,000
Total accrued wind-down expenses at period-end, current	$ 629,000	$	$	$ 1,103,000

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Note 7. Loan Payable

Loan Agreement with Silicon Valley Bank

In April 2013, we entered into a Loan Agreement with Silicon Valley Bank (SVB) and received loan proceeds of $9,900,000, net of a $100,000 cash discount. The loan proceeds will be used for research and development and general corporate purposes. The loan has a three-year term and bears interest at an annual rate of 6%. The loan obligations are secured by a first priority security interest on substantially all of our assets excluding intellectual property. For the first six months, payments will be interest only followed by repayment of principal and interest over a period of 30 months. There is also a final $1,000,000 fee payable at the end of the term which is being expensed over the term of the loan using the effective interest method. In conjunction with the Loan Agreement, we issued to SVB a ten year warrant to acquire 293,531 shares of common stock at an exercise price of $1.7034 per share. The warrant is immediately exercisable and expires in April 2023. We estimated the fair value of the warrant to be approximately $388,000 using the Black-Scholes option pricing model with the following assumptions:

Expected life (years)	10
Risk-free interest rate	1.9%
Expected volatility	88.1%
Expected dividend yield	0%

We applied the relative fair value method to allocate the $9,900,000 net proceeds between the loan and warrant. The approximately $388,000 fair value allocated to the warrant was recorded as an increase to additional paid-in capital and as a discount to loan payable. Approximately $9,512,000 was assigned to the loan and was recorded as the initial carrying amount of the loan payable, net of discount. The approximately $388,000 fair value of the warrant and the $100,000 cash discount are both being amortized as additional interest expense over the term of the loan using the effective interest rate method.

We also incurred loan issuance costs of approximately $117,000, which are recorded as deferred financing costs on the accompanying condensed consolidated balance sheet and are being amortized to interest expense over the term of the Loan Agreement using the effective interest rate method.

The effective interest rate used to amortize the deferred financing costs and the discount (including the fair value of the warrant and the cash discount), and for the accretion of the final payment, is 9.0%.

Loan Agreement with California Institute for Regenerative Medicine

In April 2013, we entered into an agreement with the California Institute for Regenerative Medicine (CIRM) (the CIRM Loan Agreement) under which CIRM will provide up to approximately $19.3 million to help fund preclinical development and IND-enabling activities of our HuCNS-SC cells for Alzheimer s disease. This funding was awarded in September 2012 under CIRM s Disease Team Therapy Development Award program (RFA 10-05), and the goal of the research is to file an Investigational New Drug application with the U.S. Food and Drug Administration within four years. The funding is in the form of a forgivable loan, in accordance with mutually agreed upon terms and conditions and CIRM regulations, and is expected to be disbursed periodically by CIRM over the four-year project period subject to a number of preconditions, including the achievement of certain progress milestones and compliance with certain financial covenants. The loan is unsecured and the term of the loan is ten years and may be extended under certain circumstances. Initially, the loan will bear interest at the one year LIBOR rate plus two percent and will increase by 1% each year after year five. Interest will accrue with the first disbursement of loan funds, but we will not begin paying interest until year six. Repayment of the principal and any accrued and unpaid interest will be due and payable at the end of the term. We can prepay the CIRM loan at our election, either in whole or in part at any time and without a prepayment fee. In addition, the loan is forgivable so that our obligation to repay will be contingent upon the success of our HuCNS-SC cells as a treatment for Alzheimer s disease. In July 2013, we received approximately $3.8 million as the initial disbursement of the loan provided under the CIRM Loan Agreement.

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Note 8. Commitments and Contingencies

Leases

Capital Leases

We entered into direct financing transactions with the State of Rhode Island and received proceeds from the issuance of industrial revenue bonds totaling $5,000,000 to finance the construction of our pilot manufacturing facility in Rhode Island. The related lease agreements are structured such that lease payments fully fund all semiannual interest payments and annual principal payments through maturity in August 2014. The interest rate for the remaining bond series is 9.5%. The bond contains certain restrictive covenants which limit, among other things, the payment of cash dividends and the sale of the related assets. The outstanding principal was approximately $179,000 at September 30, 2013 and $331,000 at December 31, 2012.

Operating Leases

We lease various real properties under operating leases that generally require us to pay taxes, insurance, maintenance, and minimum lease payments. Some of our leases have options to renew.

Operating Leases California

In September 2010, we entered into a two-year sublease agreement with Caliper Life Sciences, Inc., for office and research space in a facility located in Mountain View, California. In June 2012, the sublease term was extended to and expired on September 30, 2013. We paid approximately $1,081,000 in aggregate as rent over the term of the lease.

In December 2010, we entered into a commercial lease agreement with BMR-Gateway Boulevard LLC (BMR), as landlord, for office and research space at BMR s Pacific Research Center in Newark, California. The initial term of the lease is approximately eleven and one-half years and includes escalating rent payments which we recognize as lease operating expense on a straight-line basis. We will pay approximately $17,869,000 in aggregate as rent over the term of the lease to BMR. Deferred rent for this facility was approximately $1,432,000 as of September 30, 2013, and approximately $1,389,000 as of December 31, 2012.

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In March 2013, we entered into a commercial lease agreement with Prologis, L.P. (Prologis), as landlord, for office and research space in Sunnyvale, California. The facility is for operations that support our clinical development activities. The initial term of the lease is ten years and includes escalating rent payments which we recognize as lease operating expense on a straight-line basis. We will pay approximately $3,497,000 in aggregate rent over the term of the lease. As part of the lease, Prologis has agreed to provide us financial allowances to build initial tenant improvements, subject to customary terms and conditions relating to landlord-funded tenant improvements. The tenant improvements are recorded as leasehold improvement assets and amortized over the term of the lease. The financial allowances are treated as a lease incentive and recorded as deferred rent which is amortized as reductions to lease expense over the lease term. Deferred rent for this facility was approximately $389,000 as of September 30, 2013.

Operating Leases Rhode Island

We entered into a fifteen-year lease agreement for a scientific and administrative facility (SAF) in Rhode Island in connection with a sale and leaseback arrangement in 1997. The lease term expired on June 30, 2013. For the year 2013, we paid approximately $1,165,000 in operating lease payments and operating expenses net of sub-tenant income.

Operating Leases United Kingdom

In January 2011, we amended the existing lease agreements of our wholly-owned subsidiary, Stem Cell Sciences (U.K.) Ltd, effectively reducing our leased office and lab space. The lease by its terms was extended to September 30, 2013. In October 2013, we signed a new three-year lease agreement for the leased space and expect to pay rent of approximately GBP 53,000 per annum. StemCells, Inc. is the guarantor of Stem Cell Sciences (U.K.) Ltd s obligations under the existing lease.

With the exception of the operating leases discussed above, we have not entered into any significant off balance sheet financial arrangements and have not established any special purpose entities. We have not guaranteed any debts or commitments of other entities or entered into any options on non-financial assets.

Contingencies

In July 2006, we filed suit against Neuralstem, Inc. in the Federal District Court for the District of Maryland, alleging that Neuralstem s activities violate claims in four of the patents we exclusively licensed from NeuroSpheres Holdings Ltd. and NeuroSpheres Ltd. (NeuroSpheres), specifically U.S. Patent No. 6,294,346 (claiming the use of human neural stem cells for drug screening), U.S. Patent No. 7,101,709 (claiming the use of human neural stem cells for screening biological agents), U.S. Patent No. 5,851,832 (claiming methods for proliferating human neural stem cells), and U.S. Patent No. 6,497,872 (claiming methods for transplanting human neural stem cells). In May 2008, we filed a second patent infringement suit against Neuralstem and its two founders, Karl Johe and Richard Garr. In this suit, which we filed in the Federal District Court for the Northern District of California, we allege that Neuralstem s activities infringe claims in two patents we exclusively license from NeuroSpheres, specifically U.S. Patent No. 7,361,505 (claiming composition of matter of human neural stem cells derived from any source material) and U.S. Patent No. 7,115,418 (claiming methods for proliferating human neural stem cells). In addition, we allege various state law causes of action against Neuralstem arising out of its repeated derogatory statements to the public about our patent portfolio. Also in May 2008, Neuralstem filed suit against us and NeuroSpheres in the Federal District Court for the District of Maryland seeking a declaratory judgment that the 505 and 418 patents are either invalid or are not infringed by Neuralstem and that Neuralstem has not violated California state law. In August 2008, the California court transferred our lawsuit against Neuralstem to Maryland for resolution on the merits. In July 2009, the Maryland District Court granted our motion to consolidate these two cases with the litigation we initiated against Neuralstem in 2006. Discovery is ongoing in these cases and we anticipate a trial date in 2014.

In October, 2013, we acquired from NeuroSpheres a patent portfolio consisting of the patents we licensed from NeuroSpheres on an exclusive worldwide basis, including the six patents that are the subject of our patent infringement litigation against Neuralstem. As consideration for the patents, we will issue 139,548 shares of unregistered common stock to NeuroSpheres. In connection with the patent acquisition, all preexisting agreements were terminated. The acquisition relieves us from further milestone and royalty payments to NeuroSpheres.

Note 9. Warrant Liability

We use various option pricing models, such as the Black-Scholes option pricing model and a Monte Carlo simulation model, to estimate fair value of warrants issued. In using these models, we make certain assumptions about risk-free interest rates, dividend yields, volatility, expected term of the warrants and other assumptions. Risk-free interest rates are derived from the yield on U.S. Treasury debt securities. Dividend yields are based on our historical dividend payments, which have been zero to date. Volatility is estimated from the historical volatility of our common stock as traded on NASDAQ. The expected term of the warrants is based on the time to expiration of the warrants from the date of measurement.

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In November 2008, we sold 1,379,310 units to institutional investors at a price of $14.50 per unit, for gross proceeds of $20,000,000. The units, each of which consisted of one share of common stock and a warrant to purchase 0.75 shares of common stock at an exercise price of $23.00 per share, were offered as a registered direct offering under a shelf registration statement previously filed with, and declared effective by, the SEC. We received total proceeds, net of offering expenses and placement agency fees, of approximately $18,637,000. We recorded the fair value of the warrants to purchase 1,034,483 shares of our common stock as a liability. The fair value of the warrant liability is revalued at the end of each reporting period, with the change in fair value of the warrant liability recorded as a gain or loss in our condensed consolidated statements of operations. The fair value of the warrants will continue to be classified as a liability until such time as the warrants are exercised, expire or an amendment of the warrant agreement renders these warrants to be no longer classified as a liability.

The assumptions used for the Black-Scholes option pricing model are as follows:

	To Calculate Fair Value of Warrant Liability at	
	September 30, 2013	December 31, 2012
Expected life (years)	0.6	1.4
Risk-free interest rate	0.1%	0.2%
Expected volatility	40.2%	108.2%
Expected dividend yield	0%	0%

	At September 30, 2013	At December 31, 2012	Change in Fair Value of Warrant Liability
Fair value of liability for warrants issued in 2008	$ 0	$ 44,628	$ (44,628)

In November 2009, we sold 1,000,000 units to institutional investors at a price of $12.50 per unit, for gross proceeds of $12,500,000. The units, each of which consisted of one share of common stock and a warrant to purchase 0.40 shares of common stock at an exercise price of $15.00 per share, were offered as a registered direct offering under a shelf registration statement previously filed with, and declared effective by, the SEC. We received total proceeds, net of offering expenses and placement agency fees, of approximately $11,985,000. We recorded the fair value of the warrants to purchase 400,000 shares of our common stock as a liability. The fair value of the warrant liability is revalued at the end of each reporting period, with the change in fair value of the warrant liability recorded as a gain or loss in our condensed consolidated statements of operations. The fair value of the warrants will continue to be classified as a liability until such time as the warrants are exercised, expire or an amendment of the warrant agreement renders these warrants to be no longer classified as a liability.

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The assumptions used for the Black-Scholes option pricing model are as follows:

	To Calculate Fair Value of Warrant Liability at	
	September 30, 2013	December 31, 2012
Expected life (years)	1.6	2.3
Risk-free interest rate	0.3%	0.3%
Expected volatility	86.1%	94.5%
Expected dividend yield	0%	0%

	At September 30, 2013	At December 31, 2012	Change in Fair Value of Warrant Liability
Fair value of liability for warrants issued in 2009	$ 15,260	$ 63,340	$ (48,080)

In December 2011, we raised gross proceeds of $10,000,000 through a public offering of 8,000,000 units and 8,000,000 Series B Warrants. The combination of units and Series B Warrants were sold at a public offering price of $1.25 per unit. Each Series B Warrant gave the holder the right to purchase one unit at an exercise price of $1.25 per unit and was exercisable until May 2, 2012, the 90th trading day after the date of issuance. Each unit consists of one share of our common stock and one Series A Warrant. Each Series A Warrant gives the holder the right to purchase one share of our common stock at an initial exercise price of $1.40 per share. The Series A Warrants are immediately exercisable upon issuance and will expire in December 2016. In 2012, an aggregate of 2,700,000 Series B Warrants were exercised. For the exercise of these warrants, we issued 2,700,000 shares of our common stock and 2,700,000 Series A Warrants. The remaining 5,300,000 Series B Warrants expired unexercised by their terms on May 2, 2012. In 2012, an aggregate of 2,198,571 Series A Warrants were exercised. For the exercise of these warrants, we issued 2,198,571 shares of our common stock. In the first quarter of 2013, an aggregate of 334,534 Series A Warrants were exercised. For the exercise of these warrants, we issued 334,534 shares of our common stock and received gross proceeds of approximately $468,000. The shares were offered under our shelf registration statement previously filed with previously filed with, and declared effective by, the SEC.

The assumptions used for the Monte Carlo simulation model to value the Series A Warrants at September 30, 2013 are as follows:

Risk-free interest rate per year	0.7%
Expected volatility per year	83.6%
Expected dividend yield	0%
Expected life in years	3.2

The use of a Monte Carlo simulation model requires the input of additional subjective assumptions including the progress of our R&D programs and its affect on potential future financings.

The following table is a summary of the changes in fair value of warrant liability for the Series A Warrants for the nine-month period ended September 30, 2013:

	Series A	
	Number of Warrants	Fair value $
Balance at December 31, 2012	8,501,429	$ 9,157,397
Less exercised	(334,534)	(418,841)
Changes in fair value		(332,862)
Balance at September 30, 2013	8,166,895	$ 8,405,694

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The following table is a summary of our warrant liability as of September 30, 2013:

Warrants	Number Outstanding	Exercise Price ($) per share	Fair value
Warrants issued in 2008	1,034,483	23.00	$
Warrants issued in 2009	400,000	15.00	15,260
Series A Warrants	8,166,895	1.40	8,405,694
Total	9,601,378		$ 8,420,954

The fair value of the warrant liability is revalued at the end of each reporting period, with the change in fair value of the warrant liability recorded as a gain or loss in our condensed consolidated statements of operations. The fair value of the warrants will continue to be classified as a liability until such time as the warrants are exercised, expire or an amendment of the warrant agreement renders these warrants to be no longer classified as a liability.

Note 10. Common Stock

In June 2009, we entered into a sales agreement (2009 sales agreement) pursuant to which we had the option to sell up to $30 million of our common stock, from time to time, in at-the-market offerings. Between June 2009 and November 2012, we sold common stock under the 2009 sales agreement worth approximately $26.7 million. In December 2012, we amended the 2009 sales agreement (2012 amended sales agreement) to, among other provisions, raise the dollar amount of shares available to sell under the agreement back to $30 million. The sales agent is paid compensation of up to 3% of gross proceeds pursuant to the terms of the agreement. The sales agreement, as amended, has been filed with the SEC. During the nine-month period ended September 30, 2013, we sold a total of 1,733,771 shares of our common stock at an average price per share of $1.91 for gross proceeds of approximately $3,317,000. The shares were sold under the 2012 amended sales agreement. The shares were offered under our shelf registration statement previously filed with, and declared effective by, the SEC.

In the first quarter of 2013, an aggregate of 334,534 Series A Warrants were exercised. For the exercise of these warrants, we issued 334,534 shares of our common stock and received gross proceeds of approximately $468,000.

In June 2013, we entered into an agreement with an institutional investor, under which we have the right to sell up to $30.0 million of our common stock to the institutional investor. Proceeds from the sale of our common stock will be used for general corporate purposes. Under the terms of the agreement, we immediately sold 1,645,639 in shares of our common stock to the institutional investor at a purchase price of $1.823 per share, which was the volume-weighted average price of the prior ten trading days, and received gross proceeds of $3.0 million. In consideration for entering into the agreement, we issued 329,131 shares of our common stock to the institutional investor. We did not receive any cash proceeds from the issuance of these 329,131 shares. Under this agreement, we have the right for a period of three years and at our sole discretion, to sell additional amounts up to $27.0 million of our common stock to the institutional investor subject to certain limitations. No warrants were issued in connection with this transaction. All shares were sold under our shelf registration statement previously filed with, and declared effective by, the SEC. In October 2013, we terminated the agreement without any cost or penalty.

Note 11. Accumulated Other Comprehensive Income

The following table sets forth the changes in accumulated other comprehensive loss by component for the three months ended September 30, 2013:

	Unrealized Gain on Other Available-for-Sale Securities	Foreign Currency Translation	Total
Beginning balance	$ 425	$ (35,515)	$ (35,090)
Other comprehensive income before reclassifications	(425)	206,121	205,696
Amounts reclassified from accumulated other comprehensive loss			

Net current-period other comprehensive income (loss)		(425)	206,121	205,696
Ending balance	$		$ 170,606	$ 170,606

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Note 12. Subsequent Events

In October 2013, we sold a total of 12,845,500 units in an underwritten public offering at a price of $1.45 per unit and received total proceeds, net of offering expenses, underwriting discounts and commissions, of approximately $17.3 million. Each unit sold consisted of one share of common stock, par value $.01 per share, and a warrant to purchase one-half share of common stock. The warrants have an exercise price of $1.80 per share, are exercisable immediately, and will expire five years from the date of issuance.

Subsequent to the end of the third quarter, 50,000 Series A Warrants were exercised at an exercise price of $1.40 per share. We will receive gross proceeds of approximately $70,000 and issue 50,000 shares of our common stock.

In October, 2013, we acquired from NeuroSpheres a patent portfolio we licensed on an exclusive worldwide basis, including the six patents that are the subject of our patent infringement litigation against Neuralstem. As consideration for the patents, we will issue 139,548 shares of unregistered common stock to NeuroSpheres. In connection with the patent acquisition, all preexisting agreements were terminated. The acquisition relieves us from further milestone and royalty payments to NeuroSpheres.

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

This report contains forward looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act that involve substantial risks and uncertainties. Such statements include, without limitation, all statements as to expectation or belief and statements as to our future results of operations; the progress of our research, product development and clinical programs; the need for, and timing of, additional capital and capital expenditures; partnering prospects; costs of manufacture of products; the protection of, and the need for, additional intellectual property rights; effects of regulations; the need for additional facilities; and potential market opportunities. Our actual results may vary materially from those contained in such forward-looking statements because of risks to which we are subject, including the fact that additional trials will be required to confirm the safety and demonstrate the efficacy of our HuCNS-SC cells for the treatment of any disease or disorder; uncertainty as to whether the U.S. Food and Drug Administration (FDA), Swissmedic, Health Canada, or other regulatory authorities will permit us to proceed with clinical testing of proposed products despite the novel and unproven nature of our technologies; the risk that our clinical trials or studies could be substantially delayed beyond their expected dates or cause us to incur substantial unanticipated costs; uncertainties in our ability to obtain the capital resources needed to continue our current research and development operations and to conduct the research, preclinical development and clinical trials necessary for regulatory approvals; the uncertainty regarding our ability to obtain a corporate partner or partners, if needed, to support the development and commercialization of our potential cell-based therapeutics products; the uncertainty regarding the outcome of our clinical trials or studies we may conduct in the future; the uncertainty regarding the validity and enforceability of our issued patents; the risk that we may not be able to manufacture additional master and working cell banks when needed; the uncertainty whether any products that may be generated in our cell-based therapeutics programs will prove clinically safe and effective; the uncertainty whether we will achieve significant revenue from product sales or become profitable; obsolescence of our technologies; competition from third parties; intellectual property rights of third parties; litigation risks; and other risks to which we are subject. All forward-looking statements attributable to us or to persons acting on our behalf are expressly qualified in their entirety by the cautionary statements and risk factors set forth in Risk Factors in Part I, Item 1A of our Form 10-K for the year ended December 31, 2012.

Overview

The Company

We are engaged in researching, developing, and commercializing cell-based therapeutics and enabling tools and technologies for stem cell-based research and drug discovery and development. Our research and development (R&D) programs are primarily focused on identifying and developing potential cell-based therapeutics which can either restore or support organ function. In particular, since we relocated our corporate headquarters to California in 1999, our R&D efforts have been directed at refining our methods for identifying, isolating, culturing, and purifying the human neural stem cell and developing this cell as potential cell-based therapeutics for the central nervous system (CNS). Our HuCNS-SC® cells (purified human neural stem cells) are currently in clinical development for several indications chronic spinal cord injury, dry age-related macular degeneration (AMD) and Pelizeaus-Merzbacher disease (PMD), which is a myelination disorder in the brain. We are also conducting preclinical research to evaluate HuCNS-SC cells in Alzheimer s disease.

In October 2012, we published in *Science Translational Medicine*, a peer-reviewed journal, the data from our four-patient Phase I clinical trial in PMD, which showed preliminary evidence of durable and progressive donor-derived myelination in all four patients. In addition, there were measurable gains in neurological function in three of the four patients, with the fourth patient clinically stable. We are conducting a Phase I/II clinical trial for the treatment of chronic spinal cord injury, which represents the first time that neural stem cells have been transplanted as a potential therapeutic agent for spinal cord injury. This trial is being conducted in Switzerland, Canada, and the United States. Data from the first three patients demonstrated a favorable safety profile and multi-segment gains in sensory function in two of the three patients 12 months after transplantation of HuCNS-SC cells compared to pre-transplant baselines; the third patient remained stable. As of October 2013, a total of eight patients have been enrolled and dosed with our HuCNS-SC cells in this trial. We are also conducting a Phase I/II clinical trial in dry AMD at two trial sites in the United States, and as of October 2013, have dosed a total of six patients with our HuCNS-SC cells in this trial. We previously completed a Phase I clinical trial in infantile and late infantile neuronal ceroid lipofuscinosis (NCL), which showed that our HuCNS-SC cells were well tolerated and non-tumorigenic, and that there was evidence of engraftment and long-term survival of the transplanted HuCNS-SC cells. In October 2013, the results of a four-year, long-term follow up study of the patients from the initial Phase I study showed there were no long-term safety or tolerability issues associated with the cells up to five years post-transplantation.

In April 2013, we entered into an agreement with the California Institute for Regenerative Medicine (CIRM) under which CIRM will provide up to approximately $19.3 million as a forgivable loan, in accordance with mutually agreed upon terms and conditions

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and CIRM regulations. The CIRM loan will help fund preclinical development of our HuCNS-SC cells for Alzheimer s disease. In July 2013, we received an initial disbursement of $3.8 million under the CIRM Loan Agreement. For a brief description of our significant therapeutic research and development programs see Overview Research and Development Programs in the Business Section of Part I, Item 1 of our Form 10-K for the year ended December 31, 2012.

We are also engaged in developing and commercializing applications of our technologies to enable research, which we believe represent current and nearer-term commercial opportunities. Our portfolio of technologies includes cell technologies relating to embryonic stem cells, induced pluripotent stem (iPS) cells, and tissue-derived (adult) stem cells; expertise and infrastructure for providing cell-based assays for drug discovery; a cell culture products and antibody reagents business; and an intellectual property portfolio with claims relevant to cell processing, reprogramming and manipulation, as well as to gene targeting and insertion. Many of these enabling technologies were acquired in April 2009 as part of our acquisition of the operations of Stem Cell Sciences Plc (SCS).

We have not derived any revenue or cash flows from the sale or commercialization of any products except for license revenue for certain of our patented technologies and sales of products for use in stem cell research. As a result, we have incurred annual operating losses since inception and expect to incur substantial operating losses in the future. Therefore, we are dependent upon external financing, such as from equity and debt offerings, to finance our operations. Before we can derive revenue or cash inflows from the commercialization of any of our therapeutic product candidates, we will need to: (i) conduct substantial *in vitro* testing and characterization of our proprietary cell types, (ii) undertake preclinical and clinical testing for specific disease indications; (iii) develop, validate and scale-up manufacturing processes to produce these cell-based therapeutics, and (iv) obtain required regulatory approvals. These steps are risky, expensive and time consuming.

Overall, we expect our R&D expenses to be substantial and to increase for the foreseeable future as we continue the development and clinical investigation of our current and future product candidates. However, expenditures on R&D programs are subject to many uncertainties, including whether we develop our product candidates with a partner or independently. We cannot forecast with any degree of certainty which of our current product candidates will be subject to future collaboration, when such collaboration agreements will be secured, if at all, and to what degree such arrangements would affect our development plans and capital requirements. In addition, there are numerous factors associated with the successful commercialization of any of our cell-based therapeutics, including future trial design and regulatory requirements, many of which cannot be determined with accuracy at this time given the stage of our development and the novel nature of stem cell technologies. The regulatory pathways, both in the United States and internationally, are complex and fluid given the novel and, in general, clinically unproven nature of stem cell technologies. At this time, due to such uncertainties and inherent risks, we cannot estimate in a meaningful way the duration of, or the costs to complete, our R&D programs or whether, when or to what extent we will generate revenues or cash inflows from the commercialization and sale of any of our therapeutic product candidates. While we are currently focused on advancing each of our product development programs, our future R&D expenses will depend on the determinations we make as to the scientific and clinical prospects of each product candidate, as well as our ongoing assessment of the regulatory requirements and each product candidate s commercial potential.

Given the early stage of development of our therapeutic product candidates, any estimates of when we may be able to commercialize one or more of these products would not be meaningful. Moreover, any estimate of the time and investment required to develop potential products based upon our proprietary HuCNS-SC technologies will change depending on the ultimate approach or approaches we take to pursue them, the results of preclinical and clinical studies, and the content and timing of decisions made by the FDA, Swissmedic, Health Canada, and other regulatory authorities. There can be no assurance that we will be able to develop any product successfully, or that we will be able to recover our development costs, whether upon commercialization of a developed product or otherwise. We cannot provide assurance that any of these programs will result in products that can be marketed or marketed profitably. If certain of our development-stage programs do not result in commercially viable products, our results of operations could be materially adversely affected.

The research markets served by our tools and technologies products are highly competitive, complex and dynamic. Technological advances and scientific discoveries have accelerated the pace of change in biological research, and stem cell technologies have been evolving particularly fast. We compete mainly by focusing on specialty media and antibody reagent products and human cell lines where we believe our expertise, intellectual property and reputation give us competitive advantage. We believe that, in this particular market niche, our products and technologies offer customers specific advantages over those offered by our competitors. We compete by offering innovative, quality-controlled products, consistently made and designed to produce reproducible results. We continue to make investments in research and development, quality management, quality improvement, and product innovation. We cannot assure you that we will have sufficient resources to continue to make such investments. For the three-month period ended September 30, 2013, we generated revenues from the sale of specialty cell culture products of approximately $272,000. We can give no assurances that we will be able to continue to generate such revenues in the future.

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Significant Events

In July 2013, we formally launched our Alzheimer s disease program, which is being supported by CIRM. The goal of the project is to file, within four years, an Investigational New Drug (IND) application with the U.S. Food and Drug Administration to evaluate our HuCNS-SC cells as a potential therapeutic for Alzheimer s disease. CIRM has agreed to provide approximately $19.3 million in the form of a forgivable loan to help fund our preclinical development and IND-enabling activities, and in July we received an initial disbursement of $3.8 million from CIRM. The funding was awarded under CIRM s Disease Team Therapy Development Award program (RFA 10-05) in September 2012.

In August 2013, we presented data which show that, two years after transplantation of our HuCNS-SC cells into patients with PMD, the evidence of myelination, by magnetic resonance imaging (MRI), is more pronounced compared to one year post-transplantation, the gains in neurological function reported after one year were maintained, and there were no safety concerns. The neurological and MRI changes suggest a departure from the natural history of the disease and may represent signals of a clinical effect.

In September 2013, we published a comprehensive overview of the therapeutic potential and results from early clinical trials of our HuCNS-SC cells. The paper was published in *Stem Cell Research & Therapy*, an international peer-reviewed journal considered to be the major forum for translational research into stem cell therapies.

In September 2013, we dosed the first high-dose patient in our Phase I/II clinical trial in dry AMD. The patient, the fifth overall in the 16-patient trial, was transplanted with one million of our HuCNS-SC cells. The first four patients each received a dose of 200,000 cells. An independent Data Safety Monitoring Committee conducted a review of the trial data related to the first four patients, and found no safety issues to preclude the trial from proceeding to the high dose.

In September 2013, we published preclinical data confirming that our HuCNS-SC cells preserve photoreceptor cells and visual function in a widely used model of retinal degeneration. The data show not only that HuCNS-SC cells preserve the number of photoreceptors that would otherwise be lost, but also that the surviving photoreceptors appear healthy and normal, and maintain their synaptic connection to other important cells necessary for visual function. The study was published in *Investigative Ophthalmology and Visual Science (IVOS),* the peer-reviewed journal of the Association for Research in Vision and Ophthalmology.

In October 2013, the FDA authorized our IND application for clinical testing of our HuCNS-SC cells as a treatment for spinal cord injury. Under this IND, we are in the process of opening U.S. sites for our Phase I/II clinical trial for chronic spinal cord injury.

In October 2013, we sold a total of 12,845,500 units in an underwritten public offering at a price of $1.45 per unit and received total proceeds, net of offering expenses, underwriting discounts and commissions, of approximately $17.3 million. Each unit sold consisted of one share of common stock, par value $.01 per share, and a warrant to purchase one half share of common stock. The warrants have an exercise price of $1.80 per share, are exercisable immediately, and will expire five years from the date of issuance.

In October 2013, we presented the results of a four-year observation study in patients with NCL, who had been transplanted with our HuCNS-SC cells in the initial Phase I study. Key results include long-term evidence of safety, up to five years post transplantation, for the surgical transplantation of the HuCNS-SC cells into multiple sites in the brain and at doses of up to one billion cells. The study results represent the first, and thus far only, multi-year data set following transplantation of neural stem cells into human subjects, and supports the feasibility of our approach in multiple neurological disorders. The data was presented by our co-principal investigator in the studies, at the Congress of Neurological Surgeons Annual Meeting in San Francisco, California.

In October, 2013, we acquired from NeuroSpheres the patents we had licensed on an exclusive worldwide basis, including the six patents that are the subject of our patent infringement litigation against Neuralstem. As consideration for the patents, we will issue 139,548 shares of unregistered common stock to NeuroSpheres. In connection with the acquisition, all preexisting agreements were terminated, including the license agreements, which thereby relieves us of further milestone and royalty payments to NeuroSpheres.

Critical Accounting Policies and the Use of Estimates

The accompanying discussion and analysis of our financial condition and results of operations are based on our condensed consolidated financial statements and the related disclosures, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires management to make estimates, assumptions, and judgments that affect the reported amounts in our condensed consolidated financial statements and accompanying notes. These estimates form the basis for making judgments about the carrying values of assets and liabilities. We base our estimates and judgments on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, and we have established internal controls related to the preparation of these estimates. Actual results

and the timing of the results could differ materially from these estimates.

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Stock-Based Compensation

U.S. GAAP requires us to recognize expense related to the fair value of our stock-based payment awards, including employee stock options and restricted stock units. Under the provisions of U.S. GAAP, the fair value of our employee stock-based payment awards is estimated at the date of grant using the Black-Scholes-Merton (Black-Scholes) option-pricing model and is recognized as expense ratably over the requisite service period. The Black-Scholes option-pricing model requires the use of certain assumptions, the most significant of which are our estimates of the expected volatility of the market price of our stock and the expected term of the award. Our estimate of the expected volatility is based on historical volatility. The expected term represents our estimated period during which our stock-based awards remain outstanding. We estimate the expected term based on historical experience of similar awards, giving consideration to the contractual terms of the awards, vesting requirements, and expectation of future employee behavior, including post-vesting terminations.

We review our valuation assumptions at each grant date and, as a result, our assumptions in future periods may change. As of September 30, 2013, we expect to recognize approximately $4,767,000 of compensation expense related to unvested stock-based awards over a weighted-average period of 3.2 years. See also Note 5, Stock-Based Compensation, in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

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Wind-down expenses Rhode Island

In connection with exiting our research and manufacturing operations in Lincoln, Rhode Island, and the relocation of our corporate headquarters and remaining research laboratories to California in October 1999, we provided a reserve for our estimate of the exit cost obligation. The reserve was for the estimated costs of our former research and administrative facility in Lincoln, which we held on a lease that terminated on June 30, 2013. We periodically re-evaluated and adjusted the reserve after considering various factors such as our lease payments through to the end of the lease, operating expenses, the real estate market in Rhode Island, and estimated subtenant income based on actual and projected occupancy. We have closed this reserve as our lease and related obligations terminated on June 30, 2013. See Note 6 Wind-Down Expenses, in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Business Combinations

The operating results of acquired companies or operations are included in our consolidated financial statements starting on the date of acquisition. Goodwill is recorded at the time of an acquisition and is calculated as the difference between the aggregate consideration paid for an acquisition and the fair value of the net tangible and intangible assets acquired. Accounting for acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired, including in-process research and development. Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to annual impairment tests. If the assumptions and estimates used to allocate the purchase price are not correct, or if business conditions change, purchase price adjustments or future asset impairment charges could be required. We test goodwill for impairment on an annual basis or more frequently if we believe indicators of impairment exist. Impairment evaluations involve management estimates of asset useful lives and future cash flows. Significant management judgment is required in the forecasts of future operating results that are used in the evaluations. It is possible, however, that the plans and estimates used may be incorrect. If our actual results, or the plans and estimates used in future impairment analysis, are lower than the original estimates used to assess the recoverability of these assets, we could incur impairment charges in a future period.

Warrant Liability

We account for our warrants in accordance with U.S. GAAP which defines how freestanding contracts that are indexed to and potentially settled in a company s own stock should be measured and classified. Authoritative accounting guidance prescribes that only warrants issued by us under contracts that cannot be net-cash settled, and are both indexed to and settled in our common stock, can be classified as equity. As part of both our November 2008 and November 2009 financings, we issued warrants with five year terms to purchase 1,034,483 and 400,000 shares of our common stock at $23.00 and $15.00 per share, respectively. As part of our December 2011 financing, we issued Series A Warrants with a five year term to purchase 8,000,000 shares at $1.40 per share and Series B Warrants with a ninety trading day term to purchase 8,000,000 units at $1.25 per unit. Each unit underlying the Series B Warrants consisted of one share of our common stock and one Series A Warrant. In the first and second quarter of 2012, an aggregate of 2,700,000 Series B Warrants were exercised. For the exercise of these warrants, we issued 2,700,000 shares of our common stock and 2,700,000 Series A Warrants. The remaining 5,300,000 Series B Warrants expired unexercised by their terms on May 2, 2012. As terms of the warrants issued in 2008 and 2009, as well as the Series A and Series B Warrants, do not meet the specific conditions for equity classification, we are required to classify the fair value of these warrants as a liability, with subsequent changes in fair value to be recorded as income (loss) due to change in fair value of warrant liability. The fair value of the warrants issued in the 2008 and 2009 financings is determined using the Black-Scholes-Merton (Black-Scholes) option pricing model and the fair value of the Series A and Series B Warrants is determined using a Monte Carlo simulation model (see Note 9, Warrant Liability). The fair value is affected by changes in inputs to these models including our stock price, expected stock price volatility, the contractual term, and the risk-free interest rate. The use of a Monte Carlo simulation model requires input of additional assumptions including the progress of our R&D programs and its affect on potential future financings. We will continue to classify the fair value of the warrants as a liability until the warrants are exercised, expire or are amended in a way that would no longer require these warrants to be classified as a liability. The estimated fair value of our warrant liability at September 30, 2013, was approximately $8,421,000.

Revenue Recognition

We currently recognize revenue resulting from the licensing and use of our technology and intellectual property, from government grants, from services provided to third parties, and from product sales. Licensing agreements may contain multiple elements, such as upfront fees, payments related to the achievement of particular milestones and royalties. Revenue from upfront fees for licensing agreements that contain multiple elements are generally deferred and recognized on a straight-line basis over the term of the agreement. Fees associated with substantive at risk performance-based milestones are recognized as revenue upon completion of the scientific or regulatory event specified in the agreement, and royalties received are recognized as earned. Revenue from licensing agreements is recognized net of a fixed percentage due to licensors as royalties. Grant revenue from government agencies are funds received to cover specific expenses and are recognized as earned upon either the incurring of reimbursable expenses directly related to the particular research plan or the completion of certain development milestones as defined within the terms of the relevant collaborative agreement or grant. Revenue from services provided to third parties is recognized when we

have performed the agreed upon services. Revenue from product sales are recognized when the product is shipped and the order fulfilled.

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Results of Operations

Our results of operations have varied significantly from year to year and quarter to quarter and may vary significantly in the future due to the occurrence of material recurring and nonrecurring events, including without limitation the receipt and payment of recurring and nonrecurring licensing payments, the initiation or termination of clinical studies, research collaborations and development programs for both cell-based therapeutic products and research tools, unpredictable or unanticipated manufacturing and supply costs, unanticipated capital expenditures necessary to support our business, developments in on-going patent prosecution and litigation, the on-going expenses to lease and maintain our Rhode Island facilities, and the costs associated with operating our California and Cambridge, U.K. facilities.

We acquired the operations of SCS on April 1, 2009, and have consolidated such operations since that date.

Revenue and Cost of Product Sales

Revenue for the three and nine-month periods ended September 30, 2013, as compared with the same period in 2012, is summarized in the table below:

	Three months ended, September 30		Change in 2013 versus 2012		Nine months ended, September 30		Change in 2013 versus 2012	
	2013	2012	$	%	2013	2012	$	%
Revenue:								
Licensing agreements, grants and other	$ 52,798	$ 60,739	$ (7,941)	(13)%	$ 159,773	$ 471,501	$ (311,728)	(66)%
Product sales	271,994	203,256	68,738	34%	730,916	685,364	45,552	7%
Total revenue	324,792	263,995	60,797	23%	890,689	1,156,865	(266,176)	(23)%
Cost of product sales	85,743	71,891	13,852	19%	230,157	208,127	22,030	11%
Gross profit	$ 239,049	$ 192,104	$ 46,945	24%	$ 660,532	$ 948,738	$ (288,206)	(30)%

Third quarter ended September 30, 2013 versus third quarter ended September 30, 2012. Total revenue in the third quarter of 2013 was approximately $325,000, an increase of 23% compared to the third quarter of 2012. Revenue from product sales were 34% higher, at approximately $272,000, in the third quarter of 2013 compared to the same period in 2012. This increase was primarily attributable to increased unit volumes in our SC Proven line of media and reagents. Licensing, grant and other revenue in the third quarter of 2013 totaled approximately $53,000, which was a decline of 13% compared to the same period in 2012.

Nine-month period ended September 30, 2013 versus nine-month period ended September 30, 2012. Total revenue in the nine-month period ended September 30, 2013 was approximately $891,000, which was 23% lower than total revenue of approximately $1,157,000 for the same period of 2012. The decrease was primarily attributable to lower licensing revenue in 2013. The nine-month period of 2012 includes a one-time fee from a license agreement with genOway, under which we granted genOway a worldwide, exclusive license to our IRES technology for use in the development and commercialization of genetically engineered mice. In the nine-month period ended 2013, revenue from product sales was approximately $731,000, which was 7% higher compared to the same period in 2012. This increase from 2012 was primarily attributable to higher unit volumes in the third quarter of 2013 of our SC Proven line of media and reagents.

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Operating Expenses

Operating expenses for the three and nine-month periods ended September 30, 2013, as compared with the same period in 2012, is summarized in the table below:

	Three months ended, September 30		Change in 2013 versus 2012		Nine months ended, September 30		Change in 2013 versus 2012	
	2013	2012	$	%	2013	2012	$	%
Operating expenses:								
Research & development	$ 5,184,365	$ 3,478,142	$ 1,706,223	49%	$ 14,553,145	$ 11,165,599	$ 3,387,546	30%
Selling, general & administrative	1,710,749	1,636,438	74,311	5%	5,180,027	5,336,105	(156,078)	(3)%
Wind-down expenses		154,742	(154,742)	(100)%	61,837	199,799	(137,962)	(69)%
Total operating expenses	$ 6,895,114	$ 5,269,322	$ 1,625,792	31%	$ 19,795,009	$ 16,701,503	$ 3,093,506	19%

Research and Development Expenses

Our R&D expenses consist primarily of salaries and related personnel expenses, costs associated with clinical trials and regulatory submissions, costs associated with preclinical activities such as toxicology studies, costs associated with cell processing and process development, certain patent-related costs such as licensing, facilities related costs such as allocated rent and operating expenses, depreciation, lab equipment and supplies. Clinical trial expenses include payments to vendors such as clinical research organizations, contract manufacturers, clinical trial sites, laboratories for testing clinical samples and consultants. Cumulative R&D costs incurred since we refocused our activities on developing cell-based therapeutics (fiscal years 2000 through the nine months ended September 30, 2013) were approximately $182 million. Over this period, the majority of these cumulative costs were related to: (i) characterization of our proprietary HuCNS-SC cells, (ii) expenditures for toxicology and other preclinical studies, preparation and submission of applications to regulatory agencies to conduct clinical trials and obtaining regulatory clearance to initiate such trials, all with respect to our HuCNS-SC cells, (iii) preclinical studies and development of our human liver engrafting cells, (iv) costs associated with cell processing and process development, and (v) costs associated with our clinical studies.

We use and manage our R&D resources, including our employees and facilities, across various projects rather than on a project-by-project basis for the following reasons. The allocations of time and resources change as the needs and priorities of individual projects and programs change, and many of our researchers are assigned to more than one project at any given time. Furthermore, we are exploring multiple possible uses for each of our proprietary cell types, so much of our R&D effort is complementary to and supportive of each of these projects. Lastly, much of our R&D effort is focused on manufacturing processes, which can result in process improvements useful across cell types. We also use external service providers to assist in the conduct of our clinical trials, to manufacture certain of our product candidates and to provide various other R&D related products and services. Many of these costs and expenses are complementary to and supportive of each of our programs. Because we do not have a development collaborator for any of our product programs, we are currently responsible for all costs incurred with respect to our product candidates.

Third quarter ended September 30, 2013 versus third quarter ended September 30, 2012. R&D expenses totaled approximately $5,184,000 in the third quarter of 2013 compared with $3,478,000 in the third quarter of 2012. The increase of approximately $1,706,000, or 49%,in 2013 compared to 2012, was primarily attributable to (i) an increase of approximately $489,000 in expenses related to our clinical studies,(ii) an increase in personnel costs of approximately $489,000 due to the addition of key personnel to strengthen our product development capabilities, (iii) an increase of approximately $390,000 in external services primarily related to preclinical studies of our HuCNS-SC cells, (iv) an increase of approximately $152,000 in supplies and validation expenses primarily related to manufacturing, quality control and process development activities to support our ongoing clinical trials, and (v) an increase in other expenses of approximately $186,000.

Nine-month period ended September 30, 2013 versus nine-month period ended September 30, 2012. R&D expenses totaled approximately $14,553,000 in the nine-month period ended September 30, 2013 compared with $11,166,000 for the same period in 2012. The increase of approximately $3,388,000, or 30%, in 2013 compared to 2012, was primarily attributable (i) an increase of approximately $572,000 in expenses related to our clinical studies, (ii) an increase in personnel costs of approximately $534,000 due to the addition of key personnel to strengthen our product development capabilities, (iii) an increase of approximately $1,540,000 in external services primarily related to preclinical studies of our HuCNS-SC cells, (iv) an increase of approximately $581,000 in supplies and validation expenses primarily related to manufacturing, quality control and process development activities to support our ongoing clinical trials, and (v) an increase in other expenses of approximately

$161,000.

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Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses are primarily comprised of salaries, benefits and other staff related costs associated with sales and marketing, finance, legal, human resources, information technology, and other administrative personnel, allocated facilities and overhead costs, external legal and other external general and administrative services.

Third quarter ended September 30, 2013 versus third quarter ended September 30, 2012. SG&A expenses totaled approximately $1,711,000 in the third quarter of 2013 which was a modest increase when compared with approximately $1,636,000 in the same period of 2012.

Nine-month period ended September 30, 2013 versus nine-month period ended September 30, 2012. SG&A expenses totaled approximately $5,180,000 in the nine-month period ended September 30, compared with approximately $5,336,000 in the same period of 2012. The decrease of approximately $156,000, or 3%, in 2013 compared to 2012, was primarily attributable to a decrease in external services.

Wind-down Expenses

In connection with our wind-down of our research and manufacturing operations in Lincoln, Rhode Island, and the relocation of our corporate headquarters and remaining research laboratories to California in October 1999, we provided a reserve for our exit cost obligation. The reserve was for the estimated costs of our former research and administrative facility in Lincoln, which we held on a lease that terminated on June 30, 2013. We periodically re-evaluated and adjusted the reserve after considering various factors such as our lease payments through to the end of the lease, operating expenses, the real estate market in Rhode Island, and estimated subtenant income based on actual and projected occupancy. The reserve was approximately $854,000 at December 31, 2012. In the first and second quarter of 2013, payments net of subtenant income of approximately $372,000 and $505,000 respectively were recorded against this reserve and approximately $23,000 and $39,000 respectively were expensed as additional wind-down expenses. We have closed this reserve as the lease and our related obligations terminated on June 30, 2013. See Note 6 Wind-down expenses, in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

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Other Income (Expense)

Other expense totaled approximately $536,000 in the third quarter of 2013 compared with other expense of approximately $11,260,000 in the same period of 2012, and other expense of approximately $342,000 for the nine-month period ended September 30, 2013 compared with other expense of approximately $9,980,000 for the nine-month period ended September 30, 2012.

	Three months ended, September 30		Change in 2013 versus 2012		Nine months ended, September 30		Change in 2013 versus 2012	
	2013	2012	$	%	2013	2012	$	%
Other income (expense):								
Change in fair value of warrant liability	$ (143,511)	$ (11,239,465)	$ 11,095,954	(99)%	$ 425,570	$ (9,974,685)	$ 10,400,255	(104)%
Interest income	136	2,372	(2,236)	(94)%	8,772	9,393	(621)	(7)%
Interest expense	(382,119)	(11,392)	(370,727)	3,254%	(785,122)	(40,014)	(745,108)	1,862%
Other income (expense), net	(10,094)	(11,087)	993	(9)%	8,475	25,364	(16,889)	(67)%
Total other income (expense), net	$ (535,588)	$ (11,259,572)	$ 10,723,984	(95)%	$ (342,305)	$ (9,979,942)	$ (9,637,637)	(97)%

Change in Fair Value of Warrant Liability

We record changes in fair value of warrant liability as income or loss in our Consolidated Statements of Operations. We have warrants outstanding which were issued as part of several transactions since 2008 and have classified all these warrants as a liability. The fair value of the outstanding warrants is determined using various option pricing models, such as the Black-Scholes-Merton (Black-Scholes) option pricing model and a Monte Carlo simulation model, and is affected by changes in inputs to the various models, including our stock price, expected stock price volatility, the contractual term and the risk-free interest rate. The use of a Monte Carlo simulation model requires input of additional subjective assumptions including the progress of our R&D programs and its affect on potential future financings. The fair value of the warrant liability is revalued at the end of each reporting period. See Note 9 Warrant Liability in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Interest Income

Interest income in the three and nine-month period ended September 30, 2013 and 2012 were not significant due to low average yields.

Interest Expense

Interest expense increased by approximately $371,000 in the third quarter of 2013, and $745,000 for the nine-month period ended September 30, 2013, when compared to the same periods in 2012. The increase is primarily attributable to interest due under a Loan Agreement with SVB. See Note 7 Loan Payable, in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Other income (expense), net

Other expense for the third quarter of 2013 was relatively flat when compared to other expense for the same period in 2012. Other income for the nine-month period ended September 30, 2013, is primarily from a gain on sale of equipment of approximately $35,000. Other income for the similar period in 2012 includes approximately $63,000 of R&D tax credits received by our wholly-owned subsidiary Stem Cell Sciences (U.K.) Ltd. The above income was offset by other expenses primarily related to state franchise taxes.

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Liquidity and Capital Resources

Since our inception, we have financed our operations through the sale of common and preferred stock, the issuance of long-term debt and capitalized lease obligations, credit facilities, revenue from collaborative agreements, research grants, license fees, and interest income.

	September 30, 2013	December 31, 2012	Change $	Change %
Cash and cash equivalents	$ 20,955,293	$ 8,471,275	$ 12,484,018	147%

In summary, our cash flows were:

	Nine months ended September 30, 2013	Nine months ended September 30, 2012	Change in 2013 versus 2012 $	Change in 2013 versus 2012 %
Net cash used in operating activities	$ (16,432,180)	$ (14,949,810)	$ (1,482,370)	10%
Net cash provided by (used in) investing activities	$ 9,284,127	$ (2,767,662)	$ 12,051,789	435%
Net cash provided by financing activities	$ 19,634,538	$ 20,131,310	$ (496,772)	2%

Net Cash Used in Operating Activities

Net cash used in operating activities in the nine-month period ended September 30, 2013 increased by approximately $1,482,000, or 10%, when compared to the same period of 2012. Cash used in operating activities is primarily driven by our net loss as adjusted for non-cash charges and differences in the timing of operating cash flows.

Net Cash Provided by (Used in) Investing Activities

Net cash provided by investing activities increased by approximately $12,052,000, or 435%, from 2012 to 2013. The increase was primarily attributable to an increase in net maturities of short-term marketable debt securities of approximately $16,650,000 offset by an increase in net capital expenditures of approximately $4,598,000. The increase in capital expenditures was primarily attributable to leasehold improvements related to our new leased facility in Sunnyvale, California.

Net Cash Provided by Financing Activities

Net cash provided by financing activities in the nine-month period ended September 30, 2013 decreased by approximately $497,000, or 2%, compared to the same period in 2012.

For the nine months ended September 30, 2013, we had the following significant financing transactions:

In April 2013, we entered into a Loan Agreement with SVB and received loan proceeds of $9,900,000, net of a $100,000 cash discount. The loan has a three-year term and bears interest at an annual rate of 6%. We incurred loan issuance costs of approximately $117,000 and there is also a final $1,000,000 fee payment at the end of the term.

In July 2013, we received approximately $3.8 million as the initial disbursement of the loan provided under the CIRM Loan Agreement. See Note 7, Loan Payable in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Sale of 1,733,771 shares of our common stock at an average price of $1.9134 per share for gross proceeds of approximately $3,317,000. These sales were made under the 2012 amended sales agreement and the sales agent is paid compensation up to 3% of gross proceeds pursuant to the terms of the agreement. The shares were offered under our shelf registration statement previously filed

with, and declared effective by, the SEC.

In June 2013, we entered into an agreement with an institutional investor, under which we have the right to sell up to $30.0 million of common stock to the institutional investor. Under the terms of the agreement, we immediately sold 1,645,639 in shares of our common stock to the institutional investor at a purchase price of $1.823 per share, and received gross proceeds of $3.0 million. In consideration for entering into the agreement, we issued 329,131 shares of our common stock to the institutional investor. We did not receive any cash proceeds from the issuance of these 329,131 shares. Under this agreement, we have the right for a period of three years and at our sole discretion, to sell additional amounts up to $27.0 million of our common stock to the institutional investor subject to certain limitations. No warrants were issued in connection with this transaction. All shares sold were offered under our shelf registration statement previously filed with, and declared effective by, the SEC. The agreement was terminated by us in October 2013.

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In October 2013, we sold a total of 12,845,500 units in an underwritten public offering at a price of $1.45 per unit and received total proceeds, net of offering expenses, underwriting discounts and commissions, of approximately $17.3 million. Each unit sold consisted of one share of common stock, par value $.01 per share, and a warrant to purchase one half share of common stock. The warrants have an exercise price of $1.80 per share, are exercisable immediately, and will expire five years from the date of issuance.

We have incurred significant operating losses and negative cash flows since inception. We have not achieved profitability and may not be able to realize sufficient revenue to achieve or sustain profitability in the future. We do not expect to be profitable in the next several years, but rather expect to incur additional operating losses. We have limited liquidity and capital resources and must obtain significant additional capital resources in order to sustain our product development efforts, for acquisition of technologies and intellectual property rights, for preclinical and clinical testing of our therapeutic products, pursuit of regulatory approvals, acquisition of capital equipment, laboratory and office facilities, establishment of production capabilities, for selling, general and administrative expenses and other working capital requirements. We rely on cash balances and proceeds from equity and debt offerings, proceeds from the transfer or sale of our intellectual property rights, equipment, facilities or investments, government grants, and funding from collaborative arrangements, if obtainable, to fund our operations.

We intend to pursue opportunities to obtain additional financing in the future through equity and debt financings, grants and collaborative research arrangements. In November 2010, we filed with the SEC, and the SEC declared effective, a universal shelf registration statement which permits us to issue up to $100 million worth of registered debt and equity securities. As of October 31, 2013, we had approximately $3 million under this universal shelf registration statement available for issuing debt or equity securities. Under this effective shelf registration, we have the flexibility to issue registered securities, from time to time, in one or more separate offerings or other transactions with the size, price and terms to be determined at the time of issuance. Registered securities issued using this shelf may be used to raise additional capital to fund our working capital and other corporate needs, for future acquisitions of assets, programs or businesses, and for other corporate purposes.

In June 2009, we entered into the 2009 sales agreement pursuant to which we had the option to sell up to $30 million of our common stock, from time to time, in at-the-market offerings. Between June 2009 and November 2012, we sold common stock under the sales agreement worth approximately $26.7 million. In December 2012, we amended the 2009 sales agreement (2012 amended sales agreement) to, among other things, raise the dollar amount of shares available to sell under the agreement back to $30 million. As of October 31, 2013, we sold common stock worth approximately $3,317,000 under the 2012 amended sales agreement. The sales agreement, as amended, has been filed with the SEC.

The source, timing and availability of any future financing will depend principally upon market conditions, interest rates and, more specifically, on our progress in our exploratory, preclinical and future clinical development programs. Funding may not be available when needed at all, or on terms acceptable to us. Lack of necessary funds may require us, among other things, to delay, scale back or eliminate some or all of our research and product development programs, planned clinical trials, and/or our capital expenditures or to license our potential products or technologies to third parties. In addition, any decline in economic activity or deterioration of the credit and capital markets, could have an adverse impact on potential sources of future financing.

Commitments

See Note 8, Commitments and Contingencies in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Off-Balance Sheet Arrangements

We have certain contractual arrangements that create potential risk for us and are not recognized in our Consolidated Balance Sheets. Discussed below are those off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.

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Operating Leases

We lease various real properties under operating leases that generally require us to pay taxes, insurance, maintenance, and minimum lease payments. Some of our leases have options to renew.

Operating Leases California

In September 2010, we entered into a two-year sublease agreement with Caliper Life Sciences, Inc., for office and research space in a facility located in Mountain View, California. In June 2012, the sublease term was extended to and expired on September 30, 2013. We paid approximately $1,081,000 in aggregate as rent over the term of the lease.

In December 2010, we entered into a commercial lease agreement with BMR-Gateway Boulevard LLC (BMR), as landlord, for office and research space at BMR s Pacific Research Center in Newark, California. The initial term of the lease is approximately eleven and one-half years and includes escalating rent payments which we recognize as lease operating expense on a straight-line basis. We will pay approximately $17,869,000 in aggregate as rent over the term of the lease to BMR. Deferred rent for this facility was approximately $1,432,000 as of September 30, 2013, and approximately $1,389,000 as of December 31, 2012.

In March 2013, we entered into a commercial lease agreement with Prologis, L.P. (Prologis), as landlord, for office and research space in Sunnyvale, California. The facility is for operations that support our clinical development activities. The initial term of the lease is ten years and includes escalating rent payments which we recognize as lease operating expense on a straight-line basis. We will pay approximately $3,497,000 in aggregate rent over the term of the lease. As part of the lease, Prologis has agreed to provide us financial allowances to build initial tenant improvements, subject to customary terms and conditions relating to landlord-funded tenant improvements. The tenant improvements are recorded as leasehold improvement assets and amortized over the term of the lease. The financial allowances are treated as a lease incentive and recorded as deferred rent which is amortized as reductions to lease expense over the lease term. Deferred rent for this facility was approximately $389,000 as of September 30, 2013.

Operating Leases Rhode Island

We entered into a fifteen-year lease agreement for a scientific and administrative facility (SAF) in Rhode Island in connection with a sale and leaseback arrangement in 1997. The lease term expired on June 30, 2013. For the year 2013, we paid approximately $1,165,000 in operating lease payments and operating expenses net of sub-tenant income.

Operating Leases United Kingdom

In January 2011, we amended the existing lease agreements of our wholly-owned subsidiary, Stem Cell Sciences (U.K.) Ltd, effectively reducing our leased office and lab space. The lease by its terms was extended to September 30, 2013. In October 2013, we signed a new three-year lease agreement for the leased space and expect to pay rent of approximately GBP 53,000 per annum. StemCells, Inc. is the guarantor of Stem Cell Sciences (U.K.) Ltd s obligations under the existing lease.

With the exception of the leases discussed above, we have not entered into any off balance sheet financial arrangements and have not established any special purpose entities. We have not guaranteed any debts or commitments of other entities or entered into any options on non-financial assets.

Contractual Obligations

In the table below, we set forth our legally binding and enforceable contractual cash obligations at September 30, 2013:

	Total Obligations at September 30, 2013	Payable in (October to December) 2013	Payable in 2014	Payable in 2015	Payable in 2016	Payable in 2017	Payable in 2018 and Beyond
Operating lease payments(1)	$ 18,461,394	$ 456,724	$ 1,851,118	$ 1,912,217	$ 1,968,459	$ 2,014,706	$ 10,258,170
	61,400	6,071	24,284	21,591	9,454		

Capital lease payment (equipment)							
Loan Payable (principal & interest)(2)	10,855,087	770,339	4,322,035	4,322,035	1,440,678		
Bonds Payable (principal & interest)(3)	195,681	58,829	136,852				
Total contractual cash obligations	$ 29,573,562	$ 1,291,963	$ 6,334,289	$ 6,255,843	$ 3,418,591	$ 2,014,706	$ 10,258,170

(1) See Note 8, Commitments and Contingencies in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

(2) See Note 7, Loan Payable in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

(3) See Note 8, Commitments and Contingencies in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

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Under license agreements with NeuroSpheres, we obtained an exclusive patent license covering all uses of certain neural stem cell technology. We made up-front payments to NeuroSpheres of 6,500 shares of our common stock and $50,000, and are required to make additional cash payments as stated milestones are achieved. Effective in 2004, we were obligated to pay annual payments of $50,000, creditable against certain royalties. Effective in 2008, as part of an indemnification agreement with NeuroSpheres, we offset the annual $50,000 obligation against litigation costs incurred under that agreement. In October, 2013, we acquired from NeuroSpheres the patents we had previously licensed on an exclusive worldwide basis, including the six patents that are the subject of our patent infringement litigation against Neuralstem. As consideration for the patents, we will issue 139,548 shares of unregistered common stock to NeuroSpheres. In connection with the acquisition, all preexisting agreements were terminated, including the license agreements, which thereby relieves us of further milestone and royalty payments to NeuroSpheres.

We periodically enter into licensing agreements with third parties to obtain exclusive or non-exclusive licenses for certain technologies. The terms of certain of these agreements require us to pay future milestone payments based upon achievement of certain developmental, regulatory or commercial milestones. We do not anticipate making any milestone payments under any of our licensing agreements for 2013. Milestone payments beyond fiscal year 2013 cannot be predicted or estimated, due to the uncertainty of achieving the required developmental, regulatory or commercial milestones.

We do not have any material unconditional purchase obligations or commercial commitments related to capital expenditures, clinical development, clinical manufacturing, or other external services contracts at September 30, 2013.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risks at September 30, 2013 have not changed materially from those discussed in Item 7A of our Form 10-K for the year ended December 31, 2012 on file with the U.S. Securities and Exchange Commission.

See also Note 2, Financial Assets, in the notes to condensed consolidated financial statements in Part I, Item 1 of this Form 10-Q.

ITEM 4. CONTROLS AND PROCEDURES

In response to the requirement of the Sarbanes-Oxley Act of 2002, as of the end of the period covered by this report, our chief executive officer and chief financial officer, along with other members of management, reviewed the effectiveness of the design and operation of our disclosure controls and procedures. Such controls and procedures are designed to ensure that information required to be disclosed in the Company s Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to management, including the chief executive officer and the chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, the chief executive officer and chief financial officer have concluded that the Company s disclosure controls and procedures are effective.

During the most recent quarter, there were no changes in internal controls over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, these controls of the Company.

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PART II-OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In July 2006, we filed suit against Neuralstem, Inc. in the Federal District Court for the District of Maryland, alleging that Neuralstem s activities violate claims in four of the patents we exclusively licensed from NeuroSpheres, specifically U.S. Patent No. 6,294,346 (claiming the use of human neural stem cells for drug screening), U.S. Patent No. 7,101,709 (claiming the use of human neural stem cells for screening biological agents), U.S. Patent No. 5,851,832 (claiming methods for proliferating human neural stem cells), and U.S. Patent No. 6,497,872 (claiming methods for transplanting human neural stem cells). In May 2008, we filed a second patent infringement suit against Neuralstem and its two founders, Karl Johe and Richard Garr. In this suit, which we filed in the Federal District Court for the Northern District of California, we allege that Neuralstem s activities infringe claims in two patents we exclusively license from NeuroSpheres, specifically U.S. Patent No. 7,361,505 (claiming composition of matter of human neural stem cells derived from any source material) and U.S. Patent No. 7,115,418 (claiming methods for proliferating human neural stem cells). In addition, we allege various state law causes of action against Neuralstem arising out of its repeated derogatory statements to the public about our patent portfolio. Also in May 2008, Neuralstem filed suit against us and NeuroSpheres in the Federal District Court for the District of Maryland seeking a declaratory judgment that the 505 and 418 patents are either invalid or are not infringed by Neuralstem and that Neuralstem has not violated California state law. In August 2008, the California court transferred our lawsuit against Neuralstem to Maryland for resolution on the merits. In July 2009, the Maryland District Court granted our motion to consolidate these two cases with the litigation we initiated against Neuralstem in 2006. Discovery is ongoing in these cases and we anticipate a trial date in 2014.

ITEM 1A. RISK FACTORS

There have been no material change from the risk factors disclosed in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit 10.1	Letter Agreement, dated June 5, 2013, between the Registrant and Eliseo Salinas, M.D.
Exhibit 31.1	Certification of Martin McGlynn under Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of Rodney K. B. Young under Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification of Martin McGlynn Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	Certification of Rodney K. B. Young Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101.1	The following materials from the Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 are formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Comprehensive Income, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements. (****)

**** Pursuant to Rule 406T of Regulation S-T, the XBRL files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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SIGNATURE

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.

STEMCELLS, INC.

(name of Registrant)

November 5, 2013

/s/ Rodney K. B. Young
Rodney K. B. Young
Chief Financial Officer

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