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: June 30, 2004

Commission File Number: 0-19871

STEMCELLS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	94-3078125
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer identification No)

3155 PORTER DRIVE
PALO ALTO, CA 94304

(Address of principal executive offices including zip code)

(650) 475-3100

(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 is an accelerated filer as defined in Exchange Act Rule 12b-2. Yes | | No | X |

At July 23, 2004, there were 54,230,152 shares of Common Stock, $.01 par value, issued and outstanding.

STEMCELLS, INC.

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PART I — ITEM 1 — FINANCIAL STATEMENTS

STEMCELLS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2004	December 31, 2003
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 26,022,133	$ 13,081,703
Receivables	68,683	145,463
Other current assets	146,226	180,048
Total current assets	26,237,042	13,407,214
Property, plant and equipment, net	3,215,226	3,611,402
Other assets, net	2,719,254	2,767,798
Total assets	$ 32,171,522	$ 19,786,414
Liabilities, and stockholders' equity		
Current liabilities:		
Accounts payable	$ 531,851	$ 454,434
Accrued expenses	853,745	1,041,150
Accrued wind-down expenses, current portion	993,265	789,000
Current maturities of capital lease obligations	239,583	237,084
Total current liabilities	2,618,444	2,521,668
Capital lease obligations, less current maturities	1,729,583	1,849,583
Deposits & other long-term liabilities	521,420	521,420
Accrued wind-down expenses, non-current portion	2,848,638	3,033,984
Deferred rent	710,001	896,201
Total liabilities	8,428,086	8,822,856
Stockholders' equity:		
Common stock, $.01 par value; 125,000,000 shares authorized; 54,216,455 and 40,998,858 shares issued and outstanding at June 30, 2004 and December 31, 2003, respectively	542,164	409,988
Additional paid in capital	189,042,458	170,406,393
Accumulated deficit	(164,948,174)	(158,874,915)
Deferred compensation	(893,012)	(977,908)
Total stockholders' equity	23,743,436	10,963,558
Total liabilities and stockholders' equity	$ 32,171,522	$ 19,786,414

See accompanying notes to condensed consolidated financial statements.

PART I — ITEM 1 — FINANCIAL STATEMENTS

STEMCELLS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Revenue:				
Revenue from grants	—	$ 56,250	$ 92,593	$ 112,500
Revenue from licensing agreements	$ 5,837	4,047	6,336	6,750
Total revenue	5,837	60,297	98,929	119,250
Operating expenses:				
Research and development	1,939,415	1,740,102	3,807,341	3,079,896
General and administrative	877,158	781,753	1,740,988	1,598,030
Wind-down expenses	467,574	220,878	598,143	473,603
Total operating expenses	3,284,147	2,742,733	6,146,472	5,151,529
Loss from operations	(3,278,310)	(2,682,436)	(6,047,543)	(5,032,279)
Other income (expense):				
Interest income	27,283	9,103	76,410	11,211
Interest expense	(49,436)	(53,724)	(98,931)	(107,303)
Other income (expense)	(2,184)	14,397	(3,195)	6,219
Total other income (expense)	(24,337)	(30,224)	(25,716)	(89,873)
Net loss	(3,302,647)	(2,712,660)	(6,073,259)	(5,122,152)
Dividend to preferred stockholders	—	46,833	—	46,833
Deemed dividend	—	1,168,301	—	1,488,302
Net loss applicable to common stockholders	($ 3,302,647)	($ 3,927,794)	($ 6,073,259)	($ 6,657,287)
Net loss per share applicable to common stockholders; basic and diluted	($ 0.08)	($ 0.13)	($ 0.14)	($ 0.23)
Weighted average shares used to compute net loss per share applicable to common stockholders; basic and diluted	43,066,807	31,157,909	42,038,437	29,062,107

See accompanying notes to condensed consolidated financial statements.

PART I — ITEM 1 — FINANCIAL STATEMENTS

STEMCELLS, INC.

CONDENSED STATEMENTS OF CASH FLOWS

(unaudited)

	Six Months Ended June 30,	
	2004	2003
Cash flows from operating activities:		
Net loss	($ 6,073,259)	($ 5,122,152)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	508,098	504,402
Amortization of deferred compensation	10,442	186,413
Stock-based compensation expense	134,966	216,012
Changes in operating assets and liabilities:		
Accrued interest receivable	(4,327)	(1,576)
Receivables	81,107	(55,059)
Other current assets	33,822	(70,783)
Other assets, net	—	(294,203)
Accounts payable and accrued expenses	(109,988)	349,304
Accrued wind-down expenses	18,919	—
Deferred rent	(186,200)	(27,128)
Net cash used in operating activities	(5,586,420)	(4,314,770)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(63,380)	(92,591)
Net cash used in investing activities	(63,380)	(92,591)
Cash flows from financing activities:		
Proceeds from the exercise of stock options		1,578
Proceeds from issuance of common stock, net	18,707,730	6,816,271
Principal payments under capital lease obligations	(117,500)	(112,500)
Net cash provided by financing activities	18,590,230	6,705,349
Increase in cash and cash equivalents	12,940,430	2,297,988
Cash and cash equivalents, beginning of period	13,081,703	4,236,367
Cash and cash equivalents, end of period	$26,022,133	$ 6,534,355
Supplemental disclosure of cash flow information:		
Interest paid	$ 98,931	$ 107,303

See accompanying notes to condensed consolidated financial statements

PART I — ITEM 1. — FINANCIAL STATEMENTS

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
June 30, 2004 and 2003

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The terms “StemCells”, the “Company”, “our”, “we” and “us” as used in this report refer to StemCells Inc. The accompanying unaudited, condensed consolidated financial statements have been prepared by the Company in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying financial statements include all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented. Results of operations for the three and six months ended June 30, 2004, are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 31, 2004.

The balance sheet at December 31, 2003 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required for complete financial statements in accordance with accounting principles generally accepted in the United States of America. For the complete financial statements, refer to the audited financial statements and footnotes thereto as of December 31, 2003, included on Form 10-K.

The Company has incurred significant operating losses and negative cash flows since inception. It has not achieved profitability and may not be able to realize sufficient revenues to achieve or sustain profitability in the future. While the Company’s available cash and cash equivalents are expected to finance currently planned activities into fiscal year 2006, the Company has limited capital resources and it will need to raise additional capital from time to time to sustain its product development efforts, acquisition of technologies and intellectual property rights, preclinical and clinical testing of anticipated products, pursuit of regulatory approvals, acquisition of capital equipment, laboratory and office facilities, establishment of production capabilities, general and administrative expenses and other working capital requirements. To fund its operations, the Company relies on cash balances, proceeds from equity and debt offerings, proceeds from the transfer or sale of intellectual property rights, equipment, facilities or investments, and on government grants and collaborative arrangements. The Company cannot be certain that such funding will be available when needed. 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.

Reclassifications

Certain amounts reported in previous periods have been reclassified to conform to the 2004 presentation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Actual results could differ from these estimates. Significant estimates include the accrued wind-down expenses.

Net Loss Per Share

The Company has computed net loss per common share according to the Financial Accounting Standards Board Statement ("SFAS") No. 128, "Earnings Per Share," which requires disclosure of basic and diluted earnings per share. Basic earnings per share excludes any dilutive effects of options, warrants and convertible securities, and is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share includes the impact of potentially dilutive securities and is computed using the weighted average of common and diluted equivalent stock options, warrants and convertible securities outstanding during the period. Stock options, warrants and convertible securities that are antidilutive are excluded from the calculation of diluted loss per common share.

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Net loss applicable to common stockholders	$ (3,302,647)	$ (3,927,794)	$ (6,073,259)	$ (6,657,287)
Weighted average shares used in computing net loss per share applicable to common stockholders, basic and diluted.	43,066,807	31,157,909	42,038,437	29,062,107
Net loss per share applicable to common stockholders, basic and diluted.	$ (0.08)	$ (0.13)	$ (0.14)	$ (0.23)

The Company has excluded outstanding stock options, warrants and convertible securities from the calculation of diluted loss per common share because all such securities are anti-dilutive for all applicable periods presented. These outstanding securities consist of the following potential common shares:

	Outstanding at June 30,	
	2004	2003
Convertible preferred stock	—	1,000,000
Outstanding options	5,095,389	4,604,578
Outstanding warrants	6,038,430	3,180,238
Total	11,133,819	8,784,816

Stock-Based Compensation

The Company's employee stock option plan is accounted for under Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." The Company grants qualified stock options for a fixed number of shares to employees with an exercise price equal to the fair market value of the shares at the date of grant. In these circumstances in accordance with APB 25, the Company recognizes no compensation expense for qualified stock option grants. The Company also issues non-qualified stock options for a fixed number of shares to employees with an exercise price less than the fair market value of the shares at the date of grant. When such options vest, the Company recognizes the difference between the exercise price and fair market value as compensation expense in accordance with APB 25.

For purposes of disclosures pursuant to Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," (SFAS 123) as amended by Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure," (SFAS 148), the estimated fair value of options is amortized to expense over the options' vesting period. The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of FAS 123 to stock-based employee compensation:

	Three months ended June 30,		Six months ended June 30,	
	2004	2004	2004	2003
Net loss applicable to common stockholders – as reported	$ (3,302,647)	$ (3,927,794)	$ (6,073,259)	$ (6,657,287)
Add: Stock-based employee/director compensation expense included in reported net loss		63,250	38,728	130,500
Deduct: Total stock-based employee/director compensation expense under the fair value based method for all awards	(178,828)	(212,110)	(420,489)	(457,318)
Net loss applicable to common stockholders – proforma	$ (3,481,475)	$ (4,076,654)	$ (6,455,020)	$ (6,984,105)
Basic and diluted net loss per share applicable to common stockholders as reported	$ (0.08)	$ (0.13)	$ (0.14)	$ (0.23)
Basic and diluted net loss per share applicable to common stockholders – pro forma	$ (0.08)	$ (0.13)	$ (0.15)	$ (0.24)
Shares used in basic and diluted loss per share applicable to common stockholder amounts	43,066,807	31,157,909	42,038,437	29,062,107

The effects on pro forma net loss and net loss per share of expensing the estimated fair value of stock options are not necessarily representative of the effects on reporting the results of operations for future years. As required by SFAS 123, the Company has used the Black-Scholes model for option valuation, which method may not accurately value the options described.

The Company accounts for stock options granted to non-employees in accordance with SFAS 123 and Emerging Issues Task Force (EITF) 96-18 — “Accounting For Equity Instruments That Are Issued To Other Than Employees For Acquiring, Or In Conjunction With Selling, Goods Or Services”, and accordingly, recognizes as expense the estimated fair value of such options as calculated using the Black-Scholes valuation model. The fair value is remeasured during the service period and is amortized over the vesting period of each option or the recipient’s contractual arrangement, if shorter.

Revenue Recognition

Revenues from collaborative agreements and grants 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 collaborative agreement. Payments received in advance of research performed are designated as deferred revenue. Fees associated with substantive at risk, performance-based milestones are recognized as revenue upon their completion, as defined in the respective agreements. Incidental assignment of technology rights is recognized as revenue at the time of receipt.

NOTE 2. LEASES

The Company had undertaken 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 a pilot manufacturing facility related to its former encapsulated cell technology. The related leases are structured such that lease payments will fully fund all semiannual interest payments and annual principal payments through maturity in August 2014. Interest rates vary with the respective bonds’ maturities, ranging from 5.1% to 9.5%. The outstanding principal at June 30, 2004 was approximately $1,969,000. The bonds contain certain restrictive covenants, which limit among other things, the payment of cash dividends and the sale of the related assets.

The Company entered into a fifteen-year lease for a laboratory facility in connection with a sale and leaseback arrangement in 1997. The lease has escalating rent payments and accordingly, the Company is recognizing rent expense on a straight-line basis. At December 31, 2003 and June 30, 2004, the Company had deferred rent liability for this facility of $1,147,000 and $1,162,000 respectively; the deferred rent liability is presented as part of the wind-down accrual.

Although the Company previously discontinued activities relating to encapsulated cell technology, the Company remains obligated under the leases for the pilot manufacturing facility and the laboratory facility. The Company has succeeded in subleasing the pilot manufacturing facility and part of the laboratory facility. The aggregate income received by the Company is significantly less than the Company's aggregate obligations under the leases, and the Company's continued receipt of rental income is dependent on the financial ability of the occupants to comply with their obligations under the subleases. As part of a subleasing agreement for the laboratory facility, the Company was required to provide the landlord with two letters of credit: one for $106,560, which expired on March 31, 2003, and the other for $159,000 which will automatically decrease to $106,053 on March 15, 2005 and $52,947 on March 15, 2006, with a final expiration date of March 31, 2007. The Company continues to seek to sublet the vacant portions of the Rhode Island facilities, to assign or sell its interests in all of these properties, or to otherwise arrange for the termination of its obligations under the lease obligations on these facilities. There can be no assurance, however, that the Company will be able to dispose of these properties in a reasonable time, if at all, or to terminate its lease obligations without the payment of substantial consideration.

As of February 1, 2001, the Company entered into a 5-year lease for a 40,000 square foot facility located in the Stanford Research Park in Palo Alto, CA. The facility includes space for animals, laboratories, offices, and a GMP (Good Manufacturing Practices) suite. GMP facilities can be used to manufacture materials for clinical trials. On December 19, 2002 the Company negotiated an amendment to the lease, which resulted in reducing the average annual rent over the remaining term of the lease from approximately $3.7 million to $2.0 million. As part of the amendment the Company issued a letter of credit on January 2, 2003 for $503,079, which was an addition to the letter of credit in the amount of $275,000 issued at commencement of the lease, to serve as a deposit for the duration of the lease. As the lease involved an upfront payment as well as escalating rent payments, the Company is recognizing rent expense on a straight-line basis. At June 30, 2004, the Company had $710,000 in deferred rent liability for this facility. In 2001 and 2002, the Company entered into space-sharing agreements currently covering in total approximately 15,000 square feet of the 40,000 square foot facility. The Company expects to receive the amount of base rent plus the proportionate share of the operating expenses that it pays for such space over the term of these agreements.

NOTE 3. WIND-DOWN OF ENCAPSULATED CELL TECHNOLOGY RESEARCH AND DEVELOPMENT PROGRAM

In 1999, in connection with exiting its former corporate headquarters and encapsulated cell technology facilities, the Company created a reserve for the estimated lease payments and operating expenses of the Rhode Island facilities through June 30, 2000, when it expected to fully sublease, assign or sell its remaining interests in the property. The Company did not fully sublet the Rhode Island facilities as expected and therefore made a change in estimate in June 2000 to accrue additional expenses of $3,327,000 to cover operating lease payments and operating expenses (including utilities, taxes, insurance, maintenance, interest and other non-employee expenses) through 2001. At December 31, 2001, the $3,327,000 reserve was exhausted and the Company recorded an additional reserve of $575,000. This reserve was based on information provided by the Company's broker/realtor that estimated, based on assumptions relevant to the real estate market conditions as of the end of 2001, the time it would be likely to take until the facility would be fully sub-leased. In 2002, the Company incurred $964,000 in lease payments and operating expenses, net of subtenant income for this facility, of which $575,000 was recorded against the reserve created at the end of 2001 and the remainder recorded as wind-down expenses. At the end of December 2002, based on an analysis of the real estate market conditions at that time, the Company revised the reserve to $775,000. In 2003 the Company incurred $984,000 in lease payments and operating expenses, net of subtenant income for this facility of which $775,000 was recorded against the reserve and the remainder recorded as wind-down expenses. After considering various factors such as the Company's experience in subleasing the facility since exiting the facility in 1999, its lease payments through to the end of the lease, facility operating expenses, the current real estate market in Rhode Island, and estimated subtenant income based on both actual and projected occupancy, the Company revised the reserve at December 31, 2003 to $2,676,000. For the December 31, 2003 financial statement presentation, the deferred rent of $1,147,000 (see NOTE 2) related to this facility was included in the wind-down accrual shown on the balance sheet. For the six months ending June 30, 2004 the Company recorded $594,000 against the reserve. At March 31, 2004 and June 30, 2004 the Company re-evaluated its estimate and adjusted the reserve to $2,510,000 and $2,680,000 respectively, by recording an additional $130,000 at March 31, 2004 and $ 468,000 at June 30, 2004 as wind-down expenses. For the June 30, 2004 financial statement presentation, the total accrued wind-down expenses (current portion and non-current portion) of $3,842,000,

represents the total of the deferred rent related to this facility of $1,162,000 and the reserve of $2,680,000. Even though it is the intent of the Company to sublease, assign or sell its interests in the facility at the earliest possible time, it cannot determine with certainty a fixed date by which such events will occur. In light of this uncertainty, based on estimates, the Company will periodically re-evaluate and adjust the reserve, as necessary.

Wind-down reserve

	Period covered	
	January to March 31, 2004	**April to June 30, 2004**
Accrued wind-down reserve at beginning of period	$2,676,000	$2,510,000
Less actual expenses recorded against estimated reserve for the period	(296,000)	(298,000)
Additional expense recorded to revise estimated reserve at period-end	130,000	468,000
Revised reserve at period-end	2,510,000	2,680,000
Add deferred rent at period end	1,155,000	1,162,000
Total accrued wind-down expenses at period-end (current and non current portion)	$3,665,000	$3,842,000

NOTE 4. GRANTS

On September 30, 2001, the Company was awarded a four-year, $225,000 per year grant from the National Institute of Diabetes & Digestive & Kidney Disorders of the National Institutes of Health for the Company's liver stem cell program which focuses on identifying liver stem and progenitor cells for the treatment of liver diseases. The grant is subject to the availability of funds and satisfactory progress of the project. For this award, the Company has recognized revenue of $56,250 in 2001, $225,000 for 2002 and $112,500 for 2003. The Company does not intend to draw further funds from this grant since it will no longer pursue the particular research it covered. In September 2003 the Company was awarded a one year, $342,000, Small Business Innovation Research grant from the National Institute of Neurological Disease and Stroke (NINDS), to further its work in the treatment of spinal cord injuries. For this award, the Company has recognized revenue of $143,000 in 2003, and $92,000 for the six months ended June 30, 2004. The remaining $107,000 will go towards reimbursing a subcontractor.

NOTE 5. STOCKHOLDERS' EQUITY

On June 16, 2004, the Company entered into a definitive agreement with institutional and other accredited investors with respect to the private placement of approximately 13,160,000 shares of its common stock at a purchase price of $1.52 per share, for gross proceeds of approximately $20,000,000. Investors also received warrants exercisable for five years to purchase approximately 3,290,000 shares of common stock at an exercise price of $1.90 per share. C.E. Unterberg, Towbin LLC (Unterberg) served as placement agent for the transaction. For acting as the Company's placement agent, Unterberg received fees totaling $1,200,192, expense reimbursement of approximately $25,000 and a five year warrant to purchase 526,400 shares of the Company's common stock at an exercise price of $1.89 per share.

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

The following discussion of our financial condition and the results of our operations for the three and six-month periods ended June 30, 2004 and 2003 should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and the related footnotes thereto.

This report includes forward-looking statements. You can identify these statements by forward-looking words such as "may," "could," "will," "possibly," "expect," "anticipate," "project," "promising," "believe," "estimate," "continue" or similar words. You should read statements that contain these words carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial condition, or state other "forward-looking" information. These forward-looking statements include, for example, 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. We believe that it is important to communicate our future expectations to our investors. However, there will be events in the future that we have not been able to accurately predict or control and that may cause our actual results to differ materially from those discussed. For example, failure to obtain a corporate partner or partners to support the development of our stem cell programs, inability to sell, assign or sublease our interest in our facilities related to our former encapsulated cell technology program, risks of delays in, or adverse results from, our research, development and clinical testing programs, obsolescence of our technology, lack of available funding, contaminations at our facilities, changes in the pharmaceutical or biotechnology industries, competition from third parties, intellectual property rights of third parties, failure of our collaborators to perform, regulatory constraints, litigation, changes in government regulations or general economic or market conditions and other risks could all have significant effects on our results. These factors should be considered carefully and readers should not place undue reliance on our forward-looking statements. Before you invest in our common stock, you should be aware that the occurrence of the events described in the "Cautionary Factors Relevant to Forward Looking Information" and "Business" sections included in our Form 10-K report as of December 31, 2003 could harm our business, operating results and financial condition. 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 contained or referred to herein.

OVERVIEW

Since our inception in 1988, we have been primarily engaged in research and development of human therapeutic products. As a result of the acquisition of StemCells California Inc. in 1997 and restructuring in the second half of 1999, our sole focus is now on our stem cell technology.

We have not derived any revenues from the sale of any products, and we do not expect to receive revenues from product sales for at least several years. We have not commercialized any product and in order to do so we must, among other things, substantially increase our research and development expenditures as research and product development efforts accelerate and clinical trials are initiated. We have incurred annual operating losses since inception and expect to incur substantial operating losses in the future. As a result, we are dependent upon external financing from equity and debt offerings and revenues from collaborative research arrangements with corporate sponsors to finance our operations. There are no such collaborative research arrangements at this time and there can be no assurance that such financing or partnering revenues will be available when needed or on terms acceptable to us.

Since 2001, we have entered into a number of financing arrangements including an equity line (which has now expired) from which we drew $4.6 million; sale of 1 million shares of common stock for $1.1 million; sale of 4 million shares of common stock for $6.5 million; issuance of convertible preferred stock for $5 million (all of which has now been converted), sale of 5 million shares of common stock for a total of $9.5 million, and on June 16 2004, in our latest financing arrangement, the sale of 13.2 million shares for a total of $20 million before financing costs. (See "Liquidity and Capital Resources" below for further detail on each of these transactions.)

We are concentrating all our resources on our primary goal, which is to evaluate the potential of using our stem and progenitor cells to treat or even cure some of the world's most debilitating diseases. In 2003, studies were conducted at the Stanford University laboratory of Dr. William Mobley and at our own laboratories in mice designed to model Batten Disease, a set of several closely related genetic lysosomal storage disorders caused by a deficiency of specific enzymes required for normal cell metabolism. The deficiency results in storage of toxic waste materials and the death of certain neurons. Batten Disease primarily affects infants and young children, and is fatal. In the studies, our proprietary human neural stem cells were transplanted into the mice, resulting in widespread engraftment, persistent production of the enzyme that is deficient in the disease, reduction in the toxic waste material and preliminary indications of improved neuronal survival. Based on these results, we embarked upon a plan to file our first IND (Investigational New Drug filing) with the Food and Drug Administration in the first quarter of 2005, in order to begin a clinical trial in Batten Disease. This will entail an increase in expenditures for both internal and external resources and will require the acquisition of additional capital in order to carry out the clinical trial. Filing the IND will require a well-tested process for manufacturing the cell therapy product. Prior to IND filing, the Company is required to complete safety testing of the cell bank, pharmacology analysis, safety toxicology studies, and definitive arrangements with the clinical programs through which the trial will be conducted. We are proceeding on schedule with all of these.

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 licensing payments, the initiation or termination of research collaborations, the changes in the sublease income and rental and other expenses to lease and maintain our facilities in Rhode Island and changes in the costs associated with our move to a larger facility in California. To expand and provide high quality systems and support to our research and development programs, we would need to hire more personnel, which would lead to higher operating expenses.

CRITICAL ACCOUNTING POLICIES

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Actual results could differ from these estimates. The significant estimates include the accrued wind-down expenses.

Stock-Based Compensation

As permitted by the provisions of Statement of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure," and Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," our employee stock option plan is accounted for under Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." We grant qualified stock options for a fixed number of shares to employees with an exercise price equal to the fair market value of the shares at the date of grant. In these circumstances in accordance with APB 25, we recognize no compensation expense for qualified stock option grants. We also issue non-qualified stock options for a fixed number of shares to employees with an exercise price less than the fair market value of the shares at the date of grant. When such options vest, we recognize the difference between the exercise price and fair market value as compensation expense in accordance with APB 25. Note 11 of the Notes to the Consolidated Financial Statements, included in our Annual Report on Form 10K, describes our equity compensation plans, and Note 1 of the Notes to the Condensed Consolidated Financial Statements elsewhere in this report contains a summary of the pro forma effects to reported net loss and loss per share for the three and six months ended June 30, 2004 and 2003 as if we had elected to recognize compensation cost based on the fair value of the options granted at grant date, as prescribed by SFAS No. 123. We account for certain stock options granted to non-employees in accordance with SFAS No. 123 and Emerging Issues Task Force ("EITF") 96-18 — accounting for equity instruments that are issued

to other than employees for acquiring, or in conjunction with selling, goods or services, and accordingly, we recognize as expense the estimated fair value of such options as calculated using the Black-Scholes valuation model, and as re-measured during the service period. Fair value is determined using methodologies allowable by SFAS No. 123. The cost is amortized over the vesting period of each option or the recipient's contractual arrangement, if shorter.

Long-Lived Assets

We adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," at the beginning of 2002. As permitted by the transition rules of SFAS No. 144, long-lived assets classified as held for sale as a result of activities that were initiated prior to this Statement's initial application shall continue to be accounted for in accordance with SFAS No. 121. If, however, the criteria for classifying long-lived assets held for sale under SFAS No. 144 were not met by the end of the fiscal year in which this Statement is initially applied, the related long-lived assets were to be reclassified as held and used. At December 31, 2002, the criteria under SFAS No. 144 for classifying the Company's long-lived assets held for sale were not met and accordingly, such assets were reclassified as held and used on the balance sheet.

We routinely evaluate the carrying value of our long-lived assets. We record impairment losses on long-lived assets used in operations when events and circumstances indicate that assets may be impaired and the undiscounted cash flows estimated to be generated by the assets are less than the carrying amount of those assets. If an impairment exists, the charge to operations is measured as the excess of the carrying amount over the fair value of the assets.

Research and Development Costs

We expense all research and development costs as incurred. Research and Development costs include costs of personnel, external services, supplies, facilities and miscellaneous other costs.

Wind-down and Exit Costs

In connection with the wind-down of our former encapsulated cell technology operations, its research and manufacturing operations in Lincoln, Rhode Island, and the relocation of its remaining research and development activities and corporate headquarters to California, in October 1999, the Company provided a reserve for its estimate of the exit cost obligation in accordance with EITF 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity." As the lease for the Company's former research facility in Rhode Island terminates in 2013, the Company will adjust its reserve on an ongoing basis by reevaluating its estimated costs to exit this facility. The estimates are based on assumptions and experience relevant to the real estate market conditions for the facility. Such re-evaluation will include lease payments over the lease term, occupancy and sublease rental rates, and facility operating expenses. We are seeking to sublease, assign, sell or otherwise divest itself of our interest in the facility at the earliest possible time, but we cannot determine with certainty a fixed date by which such events will occur.

RESULTS OF OPERATIONS

Three months ended June 30, 2004 and 2003

For the three months ended June 30, 2004, revenue from licensing agreements totaled approximately $6,000. For the three months ended June 30, 2003, revenue from grants and licensing agreements totaled approximately $60,000, which included $56,000 that is a part of the grant awarded by the National Institute of Diabetes & Digestive & Kidney Disorders of the National Institutes of Health, and $4,000 in licensing revenue. Beginning the third quarter of 2003 we did not draw further funds from the National Institute of Diabetes & Digestive & Kidney Disorders grant since we were no longer pursuing the particular research it covered.

Research and development expenses totaled $1,939,000 for the three months ended June 30, 2004, compared with $1,740,000 for the same period in 2003. The increase of $199,000 or approximately 11% from 2003 to 2004 was primarily attributable to the expenditures required for toxicology studies, supplies, personnel and other external services in preparation for submitting our first IND (Investigational New Drug filing) to the FDA, to evaluate the safety and efficacy of our human neural stem cells as a treatment for Batten disease. At June 30, 2004, we had twenty-four full-time employees working in research and development and laboratory support services as compared to twenty at June 30, 2003.

General and administrative expenses were $877,000 for the three months ended June 30, 2004, compared with $782,000 for the same period in 2003. The increase of $95,000 or 12%, from 2003 to 2004 was primarily attributable to an increase in costs related to the printing, mailing and filing of our annual report (Form 10-K) and proxy statement in 2004 as compared to 2003. The increase in this cost was attributable to the separate printing of our proxy statement and our Form 10-K, the cost of sending the materials by first-class mail and the effect of a greater number of shareholders in 2004 when compared to 2003.

In 1999, in connection with exiting our former research facility in Rhode Island, we created a reserve for the estimated lease payments and operating expenses related to it. The reserve has been re-evaluated and adjusted based on assumptions relevant to real estate market conditions and the estimated time until we could either fully sublease, assign or sell our remaining interests in the property. At March 31, 2004 the reserve was $2,510,000. For the three months ending June 30, 2004, expenses of $298,000 net of subtenant income was recorded against this reserve. At June 30, 2004 we re-evaluated the estimate and adjusted the reserve to $2,680,000 by recording an additional $468,000 as wind-down expenses. Wind-down expenses for the same period in 2003 were $221,000. Expenses for this facility will fluctuate based on changes in tenant occupancy rates and other operating expenses related to the lease. Even though it is our intent to sublease, assign, sell or otherwise divest ourselves of our interests in the facility at the earliest possible time, we cannot determine with certainty a fixed date by which such events will occur. In light of this uncertainty, based on estimates, we will periodically re-evaluate and adjust the reserve, as necessary.

Interest income for the three months ended June 30, 2004 and 2003 was $27,000 and $9,100 respectively. The increase in interest income in 2004 was primarily attributable to a higher average investment balance. Interest expense for the three months ended June 30, 2004 and 2003 was $49,000 and $54,000 respectively. The decrease in interest expense in 2004 was attributable to lower outstanding debt and capital lease balances in 2004 compared to 2003.

For the three months ended June 30, 2003, we recorded deemed dividends of $1,168,000. The deemed dividends were related to the 3% cumulative convertible preferred stock and included the accretion of common stock warrants, the beneficial conversion feature and the related issuance costs. For the three months ended June 30, 2003, we recorded dividends of $47,000 which was paid in the form of common stock to our 6% cumulative convertible preferred stock holders. There is no longer any preferred stock outstanding as all of the Company’s previously outstanding 3% and 6% cumulative convertible preferred stock, was converted to the Company’s common stock prior to the end of 2003.

Six months ended June 30, 2004 and 2003

For the six months ended June 30, 2004, revenue from grants and licensing agreements totaled approximately $99,000, which included $ 93,000 that is part of the $342,000 Small Business Innovation Research grant from the National Institute of Neurological Disease and Stroke, and $6,000 in licensing revenue. For the six months ended June 30, 2003, revenue from grants and licensing agreements totaled approximately $119,000, which included $112,000 that is a part of the grant awarded by the National Institute of Diabetes & Digestive & Kidney Disorders of the National Institutes of Health, and $7,000 in licensing revenue. Beginning the third quarter of 2003 we did not draw further funds from the National Institute of Diabetes & Digestive & Kidney Disorders grant since we were no longer pursuing the particular research it covered.

Research and development expenses totaled $3,807,000 for the six months ended June 30, 2004, compared with $3,080,000 for the same period in 2003. The increase of $727,000 or approximately 24% from 2003 to 2004 was primarily attributable to the expenditures required for toxicology studies, supplies, personnel and other external

services in preparation for submitting our first IND to the FDA, to evaluate the safety and efficacy of our human neural stem cells as a treatment for Batten disease. At June 30, 2004, we had twenty-four full-time employees working in research and development and laboratory support services as compared to twenty at June 30, 2003.

General and administrative expenses were $1,741,000 for the six months ended June 30, 2004, compared with $1,598,000 for the same period in 2003. The increase of $143,000 or 9%, from 2003 to 2004 was primarily attributable to an increase in costs related to the printing, mailing and filing of our annual report (Form 10-K) and proxy statement in 2004 as compared to 2003. The increase in cost was attributable to the separate printing of our proxy statement and our Form 10-K and the effect of a greater number of shareholders in 2004 when compared to 2003 on these costs. The increase in general and administrative expenses was also partly attributable to the external auditor fees and other external services fees incurred in the first quarter of 2004 as a result of the restatement of our prior year financials.

In 1999, in connection with exiting our former research facility in Rhode Island, we created a reserve for the estimated lease payments and operating expenses related to it. The reserve has been re-evaluated and adjusted based on assumptions relevant to real estate market conditions and the estimated time until we could either fully sublease, assign or sell our remaining interests in the property. At December 31, 2003 the reserve was $2,676,000. For the six months ending June 30, 2004, expenses of $594,000 net of subtenant income was recorded against this reserve. At June 30, 2004 we re-evaluated the estimate and adjusted the reserve to $2,680,000 by recording an additional $598,000 as wind-down expenses. Wind-down expenses for the same period in 2003 were $474,000. Expenses for this facility will fluctuate based on changes in tenant occupancy rates and other operating expenses related to the lease. Even though it is our intent to sublease, assign, sell or otherwise divest ourselves of our interests in the facility at the earliest possible time, we cannot determine with certainty a fixed date by which such events will occur. In light of this uncertainty, based on estimates, we will periodically re-evaluate and adjust the reserve, as necessary.

Interest income for the six months ended June 30, 2004 and 2003 was $76,000 and $11,000 respectively. The increase in interest income in 2004 was primarily attributable to a higher average investment balance. Interest expense for the six months ended June 30, 2004 and 2003 was $99,000 and $107,000 respectively. The decrease in interest expense in 2004 was attributable to lower outstanding debt and capital lease balances in 2004 compared to 2003.

For the six months ended June 30, 2003, we recorded deemed dividends of $1,488,000. The deemed dividends were related to the 3% cumulative convertible preferred stock and included the accretion of common stock warrants, the beneficial conversion feature and the related issuance costs. For the six months ended June 30, 2003, we recorded dividends of $47,000 which was paid in the form of common stock to our 6% cumulative convertible preferred stock holders. There is no longer any preferred stock outstanding as all of the Company’s previously outstanding 3% and 6% cumulative convertible preferred stock, was converted to the Company’s common stock prior to the end of 2003.

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, revenues from collaborative agreements, research grants and interest income.

We had cash and cash equivalents totaling $26,022,000 at June 30, 2004. Cash equivalents are invested in US Treasuries with maturities of less than 90 days. We used $5,586,000 and $4,315,000 of cash for the six months ended June 30, 2004 and 2003 respectively, in our operating activities. The increase in cash used in 2004 in comparison to the same period in 2003 was primarily attributable to the expenses incurred in preparing to submit our first IND to the FDA, to evaluate the safety and efficacy of our human neural stem cells as a treatment for Batten disease. These expenses will increase as we approach the anticipated filing date in the first quarter of 2005.

On June 16, 2004, we entered into a definitive agreement with institutional and other accredited investors with respect to the private placement of approximately 13,160,000 shares of our common stock at a purchase price of $1.52 per share, for gross proceeds of approximately $20,000,000. Investors also received warrants exercisable

for five years to purchase approximately 3,290,000 shares of common stock at an exercise price of $1.90 per share. C.E. Unterberg, Towbin LLC (Unterberg) served as placement agent for the transaction. For acting as our placement agent Unterberg, received fees totaling $1,200,192, expense reimbursement of approximately $25,000 and a five year warrant to purchase 526,400 shares of our common stock at an exercise price of $1.89 per share.

On December 10, 2003 we completed a $9.5 million financing transaction with Riverview Group L.L.C. (Riverview), through the sale of 5 million shares of common stock at a price of $1.90 per share. The closing price of our common stock on that date was $2.00 per share.

Pursuant to a Stock Purchase Agreement dated May 7, 2003, we issued 4 million shares of our common stock to Riverview for $6.5 million, or $1.625 per share. On the date of the agreement, the price was above the trading price of our common stock, which closed at $1.43 per share on that date. We also agreed to issue a 2-year warrant to Riverview to purchase 1,898,000 shares of common stock at $1.50 per share. The exercise price is subject to adjustment for stock splits, dividends, distributions, reclassifications and similar events. The exercise price may be below the trading market price at the time of the exercise. In the event that certain conditions are met, including the closing sale price of the Common Stock remaining at or above $2.50 per share for 10 consecutive trading days, we may require Riverview to exercise the warrant with respect to any remaining warrant shares or relinquish the right to do so. We registered the resale of the purchased shares and the shares to be issued on exercise of the warrants. On November 7, 2003 and November 11, 2003 Riverview exercised a total of 1,098,000 of these warrants at $1.50 by which, we received gross proceeds of $1,647,000.

On August 23, 2002, pursuant to an agreement with Triton West Group, Inc. (Triton), we sold 1,028,038 shares of common stock for aggregate proceeds of $1,100,000, or approximately $1.07 per share.

On December 4, 2001, we issued 5,000 shares of 3% Cumulative Convertible Preferred Stock to Riverview. We received total proceeds of $4,727,515 net of applicable fees and other associated costs. Riverview converted 1,000 of the preferred shares on December 7, 2001, at a conversion price of $2.00 per share of common stock, receiving 500,125 shares of common stock; 2,000 of the preferred shares on April 9, 2003, at $0.80 per share, receiving 2,521,042 shares of common stock; and the remaining 2,000 preferred shares on November 11, 2003, for 1,010,833 shares of the Company’s common stock, all inclusive of accrued dividends. As a result of the above transactions all of the 3% cumulative convertible preferred stock was fully converted into our common stock before the mandatory redemption date of December 4, 2003.

On May 10, 2001, we entered into a common stock purchase agreement with Sativum Investments Limited for the potential future issuance and sale of up to $30,000,000 of our common stock, at our discretion and subject to restrictions and other obligations. We drew down $4,000,000, $118,000 and $441,000 before applicable fees in 2001, 2002 and 2003 respectively. The equity line terminated in January of 2004.

We continue to have outstanding obligations in regard to our former facilities in Lincoln, Rhode Island, including lease payments and operating costs of approximately $1,235,000 for 2004, net of subtenant income of $735,000. We have subleased a portion of these facilities and are actively seeking to sublease, assign or sell our remaining interests in these facilities. Failure to do so within a reasonable period of time will have a material adverse effect on our liquidity and capital resources.

The following table summarizes our future contractual cash obligations (including both Rhode Island and California leases, but excluding interest income and sub-lease income):

	Total	Payable in 2004	Payable in 2005	Payable in 2006	Payable in 2007	Payable in 2008	Payable in 2009 and beyond
Capital lease payments	$ 2,933,153	$ 208,991	$ 412,587	$ 401,289	$ 330,643	$ 243,507	$1,336,136
Operating lease payments	13,125,780	1,473,667	3,007,630	1,115,186	937,500	1,171,875	5,419,922
Total contractual cash obligations	$16,058,933	$1,682,658	$3,420,217	$1,516,475	$1,268,143	$1,415,382	$6,756,058

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 revenues to achieve or sustain profitability in the future. While our available cash and cash equivalents are expected to finance currently planned activities into fiscal year 2006, we have limited capital resources and we will need to raise additional capital from to time to time to sustain our product development efforts, acquisition of technologies and intellectual property rights, preclinical and clinical testing of anticipated products, pursuit of regulatory approvals, acquisition of capital equipment, laboratory and office facilities, establishment of production capabilities, general and administrative expenses and other working capital requirements. To fund our operations, we rely on cash balances, proceeds from equity and debt offerings, proceeds from the transfer or sale of intellectual property rights, equipment, facilities or investments, and on government grants and collaborative arrangements. We cannot be certain that such funding will be available when needed. 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.

We intend to pursue opportunities to obtain additional financing in the future through equity and debt financings, grants and collaborative research arrangements. 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. . Lack of necessary funds may require us to delay, scale back or eliminate some or all of our research and product development programs and/or our capital expenditures or to license our potential products or technologies to third parties.

With the exception of operating leases for facilities, 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.

Nasdaq Listing Issues

Our common stock is quoted on the Nasdaq SmallCap Market (the SmallCap Market). The Nasdaq Stock Market, Inc. (Nasdaq) may delist our common stock from the SmallCap Market if we fail to meet their continued listing requirements. The continued listing requirements of the SmallCap Market that are most significant to us are a minimum bid price of $1.00 per share and a minimum of $2,500,000 in stockholders' equity. Our closing price per share and stockholders' equity at June 30, 2004 were $1.53 and $23,743,436 respectively. The delisting of our common stock from the SmallCap Market could adversely affect the market price and market liquidity of our common stock. If we were delisted from the SmallCap Market, trading, if any, of our common stock would thereafter have to be conducted in the over-the-counter market on the "pink sheets" or, if available, the National Association of Securities Dealers "Electronic Bulletin Board." In such an event, an investor could find it more difficult to dispose of, or to obtain accurate quotations as to the market value of, our common stock, which could further severely limit the market liquidity of our common stock and the ability of investors to trade our common stock.

If we are delisted from, or trading in our stock is suspended on, the SmallCap Market or other exchange or principal market for our Common Stock, under certain circumstances we would then be in breach of certain registration rights agreements that we entered into with certain investors and may be required to pay liquidated or other damages to those investors.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

No significant changes in our quantitative and qualitative disclosures from the Form 10-K.

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 (acting) 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 acting 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, and no corrective actions were undertaken.

PART II - ITEM 1

LEGAL PROCEEDINGS

One party has recently opposed two of our issued European patent cases. While we are confident that we will overcome the opposition, there is no guarantee that we will prevail. If we are unsuccessful in our defense of the opposed patents, all claimed rights in the opposed patents will be lost in Europe.

PART II – ITEM 2

CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

On June 16, 2004, StemCells, Inc. entered into a definitive agreement with institutional and other accredited investors with respect to the private placement of 13,160,000 shares of its common stock at a purchase price of $1.52 per share, for gross proceeds of approximately $20,000,000. Investors also received warrants exercisable for five years to purchase 3,290,000 shares of common stock at an exercise price of $1.90 per share. C.E. Unterberg, Towbin LLC served as placement agent for the transaction, and received a five year warrant to purchase 526,400 shares of common stock at an exercise price of $1.89 per share and cash equal to 6% of the gross proceeds as its placement fee. The transaction described above was effected in reliance upon the exemption from the registration requirements of the Securities Act of 1933 provided by Section 4(2) on the basis that such transaction did not involve any public offering

The Company intends to apply the net proceeds from the sale of the securities sold under the June 16, 2004 agreement for working capital and general corporate purposes, as well as in connection with selected acquisitions that may be considered in the future to expand its product and service offerings or for other strategic purposes.

PART II – ITEM 3

DEFAULTS UPON SENIOR SECURITIES

None

PART II – ITEM 4

SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On May 11, 2004, we held our Annual Meeting of Shareholders. John Schwartz, Ph.D. and Eric Bjerkholt, MBA, were re-elected to the Board as Class I directors, with terms expiring in 2007. The remaining members of the Board, whose terms continued after the Annual Meeting, are Ricardo Levy, Ph.D., Roger Perlmutter, M.D., Ph.D., Irving Weissman, M.D., and Martin McGlynn, President and CEO of StemCells. The shareholders also ratified the selection of Grant Thornton LLP as StemCells' independent public accountants for the fiscal year ending December 31, 2004. In addition, the shareholders approved the amendment of the Company's Certificate of Incorporation to increase the number of shares of Common Stock that the Company is authorized to issue from 75,000,000 to 125,000,000 shares; adopted the 2004 Equity Incentive Plan as set out in the Proxy Statement; and authorized the Company to issue, in connection with one or more capital raising transactions to finance the company, up to 30,000,000 shares of StemCells common stock, subject to the terms, conditions and limitations set out in the Proxy Statement.

The number of proxies finally tabulated represented 37,108,686 of the 41,032,924 eligible shares, or 90.436 percent of eligible shares. The votes on each of the proposals were as follows:

	For	Authority Withheld	Against	Abstain
Election of John Schwartz, Ph.D., as director	36,418,060	690,626		
Election of Eric Bjerkholt, as director	36,530,707	577,979		
Ratification of Grant Thornton LLP as independent accountants for 2004	36,851,511		101,911	155,264
Increasing the number of authorized shares of common stock	35,655,325		1,371,537	81,824
Adoption of the 2004 Equity Incentive Plan	7,108,074		1,250,726	126,030
Authorization to issue shares in connection with raising capital	5,762,184		2,604,822	117,824

PART II - ITEM 5

OTHER INFORMATION

None

PART II - ITEM 6

EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

Exhibit 31.1 - Certification of Martin McGlynn under Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 - Certification of George Koshy 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 George Koshy Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) REPORTS ON FORM 8-K

During the quarter ended June 30, 2004 we submitted the following reports on Form 8-K:

1) On April 6, 2004 we filed a report on Form 8-K (Item 12) with respect to our results of operations for the quarter and fiscal year ended December 31, 2003, attaching a copy of a press release containing financial statements for such periods.

2) On May 4, 2004 we filed a report on Form 8-K (Items 7 and 12) with respect to our results of operations for the quarter ended March 31, 2004, attaching a copy of a press release containing financial statements for such period.

3) On June 17, 2004 we filed a report on Form 8-K (Items 5 and 7) to report that we had entered into a securities purchase agreement with a limited number of accredited investors pursuant to which we agreed to issue approximately 13,160,000 shares of common stock, together with warrants to purchase an additional 3,260,000 shares of common stock, for an aggregate purchase price of approximately $20,000,000, attaching a related press release.

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)

July 29, 2004

/s/ George Koshy

George Koshy
Controller and Acting Chief Financial Officer (Duly authorized officer and principal accounting officer)

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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 George Koshy Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
UNDER SECTION 302 OF THE SARBANES-OXLEY ACT

I, Martin McGlynn, certify that:

(1) I have reviewed this quarterly report on Form 10-Q of StemCells, Inc.;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2004

/s/ Martin McGlynn
- ------------------------------------
Martin McGlynn
President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF ACTING CHIEF FINANCIAL OFFICER
UNDER SECTION 302 OF THE SARBANES-OXLEY ACT

I, George Koshy, certify that:

(1) I have reviewed this quarterly report on Form 10-Q of StemCells, Inc.;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2004

/s/ George Koshy
- --
George Koshy
Controller and Acting Chief Financial Officer

Exhibit 32.1

Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the StemCells, Inc. (the "Company") Quarterly on Form 10-Q for the period ending June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Martin McGlynn, President and Chief Executive Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1). The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2). The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to StemCells, Inc. and will be retained by StemCells, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

Date: July 29, 2004

/s/ Martin McGlynn
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Martin McGlynn
President and Chief Executive Officer

Exhibit 32.2

Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the StemCells, Inc. (the "Company") Quarterly on Form 10-Q for the period ending June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, George Koshy, Controller and Acting Chief Financial Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1). The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2). The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to StemCells, Inc. and will be retained by StemCells, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

Date: July 29, 2004

/s/ George Koshy
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George Koshy
Controller and Acting Chief Financial Officer