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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: June 30, 2005 **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 ☑ No o

Indicate by check mark whether the registrant is an accelerated filer as defined in Exchange Act Rule 12b-2.
Yes ☑ No o

At July 25, 2005, there were 63,912,716 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, 2005 (unaudited)	December 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 36,395,545	$ 41,059,532
Receivables	146,153	180,963
Other current assets	546,659	209,074
Total current assets	37,088,357	41,449,569
Property, plant and equipment, net	3,175,176	3,424,294
Other assets, net	2,682,633	2,753,419
Total assets	$ 42,946,166	$ 47,627,282
Liabilities and stockholders' equity Current liabilities:		
Accounts payable	$ 424,433	$ 524,917
Accrued expenses	935,500	1,547,370
Accrued wind-down expenses, current portion	1,095,448	1,013,460
Capital lease obligations, current portion	55,001	52,843
Bonds payable, current portion	249,083	244,167
Total current liabilities	2,759,465	3,382,757
Capital lease obligations less current maturities	13,017	41,065
Bonds payable, less current maturities	1,480,752	1,605,417
Deposits & other long-term liabilities	533,185	610,126
Accrued wind-down expenses, non-current portion	5,578,922	4,514,569
Deferred rent	566,640	523,801
Total liabilities	10,931,981	10,677,735
Stockholders' equity:		
Common stock, $.01 par value; 125,000,000 shares authorized; 63,545,160 and 62,129,407 shares issued and outstanding at June 30, 2005 and December 31, 2004, respectively	635,451	621,293
Additional paid in capital	213,600,451	211,419,300
Accumulated deficit	(181,522,333)	(174,205,214)
Deferred compensation	(699,384)	(885,832)
Total stockholders' equity	32,014,185	36,949,547
Total liabilities and stockholders' equity	$ 42,946,166	$ 47,627,282

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,	
	2005	2004	2005	2004
Revenue:				
Revenue from grants	$ 26,092		$ 52,184	$ 92,593
Revenue from licensing agreements	10,677	$ 5,837	19,906	6,336
Total revenue	36,769	5,837	72,090	98,929
Operating expenses:				
Research and development	2,102,362	1,939,415	3,927,293	3,807,341
General and administrative	821,276	877,158	2,120,480	1,740,988
Wind-down expenses	1,197,226	467,574	1,718,200	598,143
Total operating expenses	4,120,864	3,284,147	7,765,973	6,146,472
Loss from operations	(4,084,095)	(3,278,310)	(7,693,883)	(6,047,543)
Other income (expense):				
Interest income	261,389	27,283	489,152	76,410
Interest expense	(45,345)	(49,436)	(91,756)	(98,931)
Other income (expense)	(235)	(2,184)	(20,632)	(3,195)
Total other income (expense)	215,809	(24,337)	376,764	(25,716)
Net loss applicable to common stockholders	(3,868,286)	($ 3,302,647)	(7,317,119)	($ 6,073,259)
Net loss per share applicable to common stockholders; basic and diluted	($ 0.06)	($ 0.08)	($ 0.12)	($ 0.14)
Weighted average shares used to compute net loss per share applicable to common stockholders; basic and diluted	63,072,873	43,066,807	62,741,639	42,038,437

See accompanying notes to condensed consolidated financial statements.

PART I — ITEM 1 — FINANCIAL STATEMENTS

STEMCELLS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Six months ended June 30,	
	2005	2004
Cash flows from operating activities:		
Net loss	($ 7,317,119)	($ 6,073,259)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	552,237	508,098
Amortization of deferred compensation	69,501	10,442
Stock-based compensation expense	65,280	134,966
Changes in operating assets and liabilities:		
Accrued interest receivable	(4,481)	(4,327)
Receivables	39,289	81,107
Other current assets	(337,584)	33,822
Other assets, net	52,947	—
Accounts payable and accrued expenses	(712,355)	(109,988)
Accrued wind-down expenses	1,146,341	18,919
Deposits received (refunded)	(76,941)	—
Deferred rent	42,839	(186,200)
Net cash used in operating activities	(6,480,046)	(5,586,420)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(235,280)	(63,380)
Acquisition of other assets	(50,000)	—
Net cash used in investing activities	(285,280)	(63,380)
Cash flows from financing activities:		
Proceeds from the exercise of stock options	309,026	—
Proceeds from the exercise of warrants	1,937,952	—
Proceeds from issuance of common stock, net	—	18,707,730
Repayments of capital lease obligations	(25,890)	—
Repayment of debt obligations	(119,749)	(117,500)
Net cash provided by financing activities	2,101,339	18,590,230
Increase (decrease) in cash and cash equivalents	(4,663,987)	12,940,430
Cash and cash equivalents, beginning of period	41,059,532	13,081,703
Cash and cash equivalents, end of period	$36,395,545	$26,022,133
Supplemental disclosure of cash flow information:		
Interest paid	$ 91,756	$ 98,931

See accompanying notes to condensed consolidated financial statements

PART I — ITEM 1. — FINANCIAL STATEMENTS

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
June 30, 2005 and 2004

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 six months ended June 30, 2005, are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 31, 2005.

The balance sheet at December 31, 2004 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, 2004, 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. 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.

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,	
	2005	2004	2005	2004
Net loss applicable to common stockholders	$ (3,868,286)	$ (3,302,647)	(7,317,119)	$ (6,073,259)
Weighted average shares used in computing net loss per share applicable to common stockholders, basic and diluted	63,072,873	43,066,807	62,741,639	42,038,437
Net loss per share applicable to common stockholders, basic and diluted	$ (0.06)	$ (0.08)	$ (0.12)	$ (0.14)

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,	
	2005	2004
Outstanding options	6,741,787	5,095,389
Outstanding warrants	4,187,439	6,038,430
Total	10,929,226	11,133,819

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 SFAS 123 to stock-based employee compensation:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net loss applicable to common stockholders – as reported	$ (3,868,286)	$ (3,302,647)	$ (7,317,119)	$ (6,073,259)
Add: Stock-based employee/director compensation expense included in reported net loss	—	—	—	38,728
Deduct: Total stock-based employee/director compensation expense under the fair value based method for all awards	(101,231)	(178,828)	(238,693)	(420,489)
Net loss applicable to common stockholders – pro forma	$ (3,969,517)	$ (3,481,475)	$ (7,555,812)	$ (6,455,020)
Basic and diluted net loss per share applicable to common stockholders as reported	$ (0.06)	$ (0.08)	$ (0.12)	$ (0.14)
Basic and diluted net loss per share applicable to common stockholders – pro forma	$ (0.06)	$ (0.08)	$ (0.12)	$ (0.15)
Shares used in basic and diluted loss per share applicable to common stockholder amounts	63,072,873	43,066,807	62,741,639	42,038,437

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.

In December 2004, FASB issued SFAS No. 123R (revised 2004*),"* *Share-Based Payment"* ("SFAS 123R"). This Statement is a revision of SFAS 123 and amends SFAS No. 95, *"Statement of Cash Flows"*. This Statement supersedes APB Opinion No. 25, *"Accounting for Stock Issued to Employees"*, and its related implementation guidance. SFAS 123R covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The new standard is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. Based on the aforementioned effective date, the Company will begin expensing stock options granted to its employees in its Statement of Operations using a fair-value based method effective the period beginning January 1, 2006. Adoption of the expensing requirements will increase the Company's operating expenses.

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.

Recent Accounting Pronouncements

In June 2005, the FASB issued Statement of Financial Accounting Standards No. 154, Accounting Changes and Error Corrections ("SFAS 154"). SFAS 154 replaces APB Opinion No. 20, *"Accounting Changes"* and SFAS No. 3, *"Reporting Accounting Changes in Interim Financial Statements"*. SFAS 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle. SFAS 154 also requires that a change in method of depreciating or amortizing a long-lived nonfinancial asset be accounted for prospectively as a change in estimate, and correction of errors in previously issued financial statements should be termed a restatement. SFAS 154 is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. The implementation of FAS 154 is not expected to have a material impact on the Company's consolidated financial statements.

In March 2005, Staff Accounting Bulletin No. 107 ("SAB 107") was issued which expressed views of the Securities and Exchange Commission (SEC) regarding the interaction between SFAS 123R, and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. FASB issued SFAS No. 123R in December 2004. This Statement is a revision of SFAS No. 123,

Accounting for Stock-Based Compensation and amends SFAS No. 95, *"Statement of Cash Flows"*. This Statement supersedes APB Opinion No. 25, *"Accounting for Stock Issued to Employees"*, and its related implementation guidance. SFAS 123R covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The new standard is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. Based on the aforementioned effective date, the Company will begin expensing stock options granted to its employees in its Statement of Operations using a fair-value based method effective the period beginning January 1, 2006. Adoption of the expensing requirements will reduce the Company's reported earnings. See "Stock-based Compensation" above in this Note 1 for disclosures regarding the effect on net earnings and earnings per share if we had applied the fair value recognition provisions of the exposure draft and SFAS 123. Depending on the model used to calculate stock-based compensation expense in the future, that disclosure may not prove indicative of the stock-based compensation expense to be recognized in future financial statements.

NOTE 2. LEASES

The Company, which was originally resident in Rhode Island, 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 currently from 8.1% to 9.5%. The outstanding principal at June 30, 2005 was approximately $1,730,000. 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, 2004 and June 30, 2005, the Company had deferred rent liability for this facility of $1,177,000 and $1,192,000 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. 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. The Company negotiated an amendment to the lease effective April 1, 2005, which extends the term of the lease through March 31, 2010, includes an immediate reduction in the rent per square foot, and provides for an expansion of the leased premises by approximately 28,000 additional square feet effective July 1, 2006. In addition, the Company has sublet some of the additional space for the period from April 1, 2005 through June 30, 2006. The average annual rent for the period commencing April 1, 2005 to March 31, 2010 will be approximately $2 million before subtenant income. As the lease involves escalating rent payments, the Company is recognizing rent expense on a straight-line basis. At December 31, 2004 and June 30, 2005, the Company had deferred rent liability for this facility of $524,000 and $567,000 respectively. At June 30, 2005 the Company has space-sharing agreements covering in total approximately 13,000 square feet of the 40,000 square foot facility. The Company receives 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. RELOCATION TO CALIFORNIA FROM RHODE ISLAND

In October 1999 the Company relocated to California from Rhode Island and established a wind down reserve for the estimated lease payments and operating costs of the Rhode Island facilities through an expected disposal date of June 30, 2000. The Company did not fully sublet the Rhode Island facilities in 2000. Even though it is the intent of the Company to dispose the facility at the earliest possible time, it cannot determine with certainty a fixed date by which such disposal will occur. In light of this uncertainty, based on estimates, the Company periodically re-evaluates and adjusts the reserve. The Company considers various factors such as the Company's lease payments through to the end of the lease, operating expenses, the current real estate market in Rhode Island, and estimated subtenant income based on occupancy both actual and projected. At December 31, 2004 the reserve was $4,350,000. The Company incurred $586,000 in operating expenses for the six month period ending June 30, 2005, which was recorded against the reserve. After evaluating the afore-mentioned factors the Company re-evaluated its estimate to $4,568,000 and $5,482,000 at March 31, 2005 and June 30, 2005 respectively, by booking an additional $521,000 and $1,197,000 respectively as wind-down expenses.

Wind-down reserve

	January to March 31, 2005	April to June 30, 2005	January to June 30, 2005
Accrued wind-down reserve at beginning of period	$4,350,000	$4,568,000	$4,350,000
Less actual expenses recorded against estimated reserve during the period	(303,000)	(283,000)	(586,000)
Additional expense recorded to revise estimated reserve at period-end	521,000	1,197,000	1,718,000
Revised reserve at period-end	4,568,000	5,482,000	5,482,000
Add deferred rent at period end (Note 2)	1,185,000	1,192,000	1,192,000
Total accrued wind-down expenses at period-end (current and non current portion)	$5,753,000	$6,674,000	$6,674,000
Accrued wind-down expenses			
Current portion	$1,034,000	$1,095,000	$1,095,000
Non current portion	4,719,000	5,579,000	5,579,000
Total accrued wind-down expenses	$5,753,000	$6,674,000	$6,674,000

NOTE 4. GRANTS

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 $93,000 in 2004. No revenue from this grant was recognized in 2005 as the remaining $107,000 was paid to a subcontractor. In September 2004, the National Institutes of Health (NIH) awarded the Company a Small Business Technology Transfer grant of $464,000 for studies in Alzheimer's disease, consisting of $308,000 for the first year and $156,000 for the remainder of the grant term, September 2005 through March 2006. The studies will be conducted by Dr. George A. Carlson of the McLaughlin Research Institute (MRI) in Great Falls, Montana, which will receive approximately $222,000 of the total award. The balance will be recognized by the Company as grant revenue as and when resources are expended for this study. The Company recognized $26,000 in the last quarter of 2004 and $52,000 for the six month period ended June 30, 2005.

NOTE 5. STOCKHOLDERS' EQUITY

During the six-month period ended June 30, 2005, warrants issued as part of the June 16, 2004 financing arrangement were exercised to purchase an aggregate of 258,342 shares of the Company's common stock at $1.90 per share. The Company issued 258,342 shares of its common stock and received proceeds of $490,850. In May 2005, warrants issued as part of a Stock Purchase Agreement dated May 7, 2003, were exercised to purchase an aggregate of 800,000 shares of the Company's common stock at $1.50 per share. The Company issued 800,000 shares of its common stock and received proceeds of $1,200,000. Also in January 2005, 79,899 shares of unregistered stock (which the Company has no obligation to register) were issued upon the cashless exercise by the holder of a warrant acquired as partial compensation for services to the Company.

On April 13, 2000 the Company issued 1,500 shares of 6% cumulative convertible preferred stock plus adjustable warrants to two members of its Board of Directors. The preferred shares were converted into common shares in 2002. In March 2005, one of the members exercised his adjustable warrant in full for 72,252 shares at $3.42 per share. The Company issued 72,252 shares and received proceeds of $247,000. In May 2005 the other member through a cashless exercise, exercised in full, his adjustable warrant for 72,252 shares for which, the Company issued 10,784 shares.

For the six month period ended June 30, 2005, the Company issued 194,475 shares from activity related to its stock option plans. The following table presents the activity of the Company's stock option plans for the six month period ended June 30, 2005:

	2005	
	Options	Weighted Average Exercise Price
Outstanding at January 1	6,682,201	$2.67
Granted	384,895	$4.08
Exercised	(194,475)	$1.62
Canceled	(130,834)	$2.27
Outstanding at June 30	6,741,787	$2.79
Options exercisable at June 30	3,687,643	$2.97

NOTE 6. SUBSEQUENT EVENTS

On July 1, 2005, the Company entered a license agreement with ReNeuron Limited, a privately-owned UK biotech corporation, permitting ReNeuron to use the Company's neural stem cell technology only in connection with ReNeuron's "c-mycER" conditionally immortalized adult human neural stem cell technology. In return for the license, StemCells received an equity interest in ReNeuron and a cross-license to the exclusive use of ReNeuron'sc-mycER technology for certain diseases and conditions, including lysosomal storage diseases, spinal cord injury, cerebral palsy and multiple sclerosis. ReNeuron will supply cells for StemCells use under the cross-license. The agreement also provides for royalties and milestone payments by each party on the achievement of various goals under the license and cross-license. The agreement is attached as an exhibit to this Report.

In July 2005, warrants issued as part of the June 16, 2004 financing arrangement, were exercised to purchase an aggregate of 351,710 of the Company's common stock at $1.90 per share. The Company issued 351,710 shares of its common stock and received proceeds of $668,249.

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, 2005 and 2004 should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and the related footnotes thereto.

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, expectations regarding ReNeuron's technology, the Company's ability to develop products using the ReNeuron technology, the likelihood of obtaining milestone or royalty payments from ReNeuron under the license agreement, the likelihood of any future collaborations with ReNeuron, and the value of the Company's equity interest in ReNeuron. Our actual results may vary materially from those contained in such forward-looking statements because of risks to which we are subject, including uncertainty as to whether the U.S. Food and Drug Administration will remove the clinical hold on our proposed initial clinical trial and permit us to proceed to clinical testing despite the novel and unproven nature of the Company's technology; the risk that, even if approved, our initial clinical trial could be substantially delayed beyond its expected dates or cause us to incur substantial unanticipated costs; uncertainties regarding the 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 risk of failure to obtain a corporate partner or partners to support the development of our stem cell programs, the uncertainty regarding the outcome of the Phase I clinical trial and any other trials the Company may conduct in the future; the uncertainty regarding the validity and enforceability of issued patents; the uncertainty whether any products that may be generated in the Company's stem cell programs will prove clinically effective and not cause tumors or other side effects; the uncertainty whether the Company will achieve revenues from product sales or become profitable; uncertainties regarding the Company's obligations in regard to its former facilities in Rhode Island; obsolescence of our technology; competition from third parties; intellectual property rights of third parties; litigation and other risks to which we are subject. 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, 2004 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. Since the second half of 1999, our sole focus has been on our stem cell technology. In the last quarter of 2004 we filed the first in a planned series of INDs (Investigational New Drug Applications) for CNS (Central Nervous System) diseases or conditions with the FDA (U.S. Food and Drug Administration). This IND, which is for a Phase I clinical trial of our human neural stem cells in Batten disease, is currently on clinical hold until questions and issues raised by the FDA have been resolved. Batten disease is included among the neuronal ceroid lipofuscinoses (NCLs), 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. The NCLs primarily affect infants and young children, and are always fatal. There can be no assurance that the FDA will lift the clinical hold and permit the trial to go forward.

We have not derived any revenues from the sale of any products apart from license revenue for the research use of our human neural stem cells and other patented cells and media, 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 had expenditures for toxicology and other studies

in preparation for submitting the Batten disease IND to the FDA, and will incur more such expenditures for any future INDs. 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 in 2004, two financing arrangements for gross proceeds of $20 million and $22.5 million in June and October respectively. (See “Liquidity and Capital Resources” below for further detail on each of these transactions.

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 related to our Rhode Island facilities.

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 9 of the Notes to the Consolidated Financial Statements, included in our 2004 Annual Report on Form 10-K, 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, 2005 and 2004 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 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.

In December 2004, FASB issued SFAS 123R (revised 2004)," *Share-Based Payment*". This Statement is a revision of SFAS 123, "*Accounting for Stock-Based Compensation*" and amends SFAS No. 95, "*Statement of Cash Flows*". This Statement supersedes APB Opinion No. 25, "*Accounting for Stock Issued to Employees*", and its related implementation guidance. SFAS 123R covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The new standard is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. Based on the afore mentioned effective date, we will begin expensing stock options granted to our employees in our Statement of Operations using a fair-value based method effective the period beginning January 1, 2006. Adoption of the expensing requirements will reduce the Company's reported earnings.

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 operations in Lincoln, Rhode Island, and the relocation of our activities and corporate headquarters to California, in October 1999, we provided a reserve for our 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 our former research facility in Rhode Island terminates in 2013, we will adjust our reserve on an ongoing basis by reevaluating our 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, if at all.

RESULTS OF OPERATIONS

Three months ended June 30, 2005 and 2004

	2005	2004	Change from previous year	
			$	%
Revenue:				
Revenue from grants	$26,092	—	$26,092	
Revenue from licensing agreements	10,677	$5,837	4,840	83%
Total revenue	$36,769	$5,837	$30,932	530%

For the three months ended June 30, 2005 revenue from grants and licensing agreements totaled approximately $37,000 of which $26,000 was part of a $464,000 Small Business Technology Transfer grant for studies in Alzheimer's disease and approximately $11,000 in licensing revenue. For the three months ended June 30, 2004, no revenue from grants was recognized and revenue from licensing agreements totaled approximately $6,000.

	2005	2004	Change from previous year	
			$	%
Operating expenses:				
Research and development	$2,102,362	$1,939,415	$162,947	8%
General and administrative	821,276	877,158	(55,882)	(6)%
Wind-down expenses	1,197,226	467,574	729,652	156%
Total operating expenses	$4,120,864	$3,284,147	$836,717	25%

Research and development expenses totaled approximately $2,102,000 for the three months ended June 30, 2005, compared with approximately $1,939,000 for the same period in 2004. The increase of $163,000 or approximately 8% from 2004 to 2005 was primarily attributable to the costs associated with a higher head count in the three-month period ended June 30, 2005 as compared to the same period in 2004. At June 30, 2005, we had thirty full-time employees working in research and development and laboratory support services as compared to twenty-four at June 30, 2004. The increase in expenses was offset by a decrease in expenses for external services in 2005 as compared to 2004. In 2004, our external services included required toxicology studies and other outside services in preparing the submission of our first IND to the FDA, to evaluate the safety and efficacy of our human neural stem cells as a treatment for Batten disease.

General and administrative expenses were approximately $821,000 for the three months ended June 30, 2005, compared with approximately $877,000 for the same period in 2004. The decrease of $56,000 or approximately 6%, from 2004 to 2005 was primarily attributable to a credit received in the current quarter for the cost of external services incurred in the evaluation and testing of our internal financial control systems, offset by higher costs attributable to an increase in head count required in part, to meet the requirements of and be in compliance with the new Securities and Exchange Commission rules issued under section 404 of the Sarbanes-Oxley Act.

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, 2005 the reserve was $4,568,000. For the three months ended June 30, 2005, expenses of $283,000 net of subtenant income was recorded against this reserve. At June 30, 2005 we re-evaluated the estimate and adjusted the reserve to $5,482,000 by recording an additional $1,197,000 as wind-down expenses. Wind-down expenses for the same period in 2004 were $468,000. 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, if at all. In light of this uncertainty, based on estimates, we will periodically re-evaluate and adjust the reserve, as necessary.

	2005	2004	Change from previous year	
			$	%
Other income (expense):				
Interest income	$261,389	$ 27,283	$234,106	858%
Interest expense	(45,345)	(49,436)	4,091	8%
Other income (expense)	(235)	(2,184)	1,949	89%
Total other income (expense)	$215,809	$(24,337)	$240,146	987%

Interest income for the three months ended June 30, 2005 and 2004 was approximately $261,000 and $27,000 respectively. The increase in interest income in 2005 was primarily attributable to a higher average investment balance. Interest expense for the three months ended June 30, 2005 and 2004 was approximately $45,000 and $49,000 respectively. The decrease in interest expense in 2005 was attributable to lower outstanding debt and capital lease balances in 2005 compared to 2004. Other expenses include state franchise taxes paid.

Six months ended June 30, 2005 and 2004

	2005	2004	Change from previous year	
			$	%
Revenue:				
Revenue from grants	$52,184	$92,593	$(40,409)	(44)%
Revenue from licensing agreements	19,906	6,336	13,570	214%
Total revenue	$72,090	$98,929	$(26,839)	(27)%

For the six months ended June 30, 2005 revenue from grants and licensing agreements totaled approximately $72,000 of which $52,000 was part of a $464,000 Small Business Technology Transfer grant for studies in Alzheimer's disease and approximately $20,000 in licensing revenue. For the six months ended June 30, 2004, revenue from grants and licensing agreements totaled approximately $99,000 of which $93,000 was 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.

	2005	2004	Change from previous year	
			$	%
Operating expenses:				
Research and development	$3,927,293	$3,807,341	$ 119,952	3%
General and administrative	2,120,480	1,740,988	379,492	22%
Wind-down expenses	1,718,200	598,143	1,120,057	187%
Total operating expenses	$7,765,973	$6,146,472	$1,619,501	26%

Research and development expenses totaled approximately $3,927,000 for the six months ended June 30, 2005, compared with approximately $3,807,000 for the same period in 2004. The increase of $120,000 or approximately 3% from 2004 to 2005 was primarily attributable to the costs associated with a higher head count in the six-month period ended June 30, 2005 as compared to the same period in 2004. At June 30, 2005, we had thirty full-time employees working in research and development and laboratory support services as compared to twenty-four at June 30, 2004. The increase in expenses was offset by a decrease in expenses for external services in 2005 as compared to 2004. In 2004, our external services included required toxicology studies and other outside services in preparing the submission of our first IND to the FDA, to evaluate the safety and efficacy of our human neural stem cells as a treatment for Batten disease.

General and administrative expenses were approximately $2,120,000 for the six months ended June 30, 2005, compared with approximately $1,740,000 for the same period in 2004. The increase of $379,000 or approximately 22%, from 2004 to 2005 was primarily attributable to the cost of external services incurred in the evaluation and testing of our internal financial control systems so as to meet the requirements of and be in compliance with the new Securities and Exchange Commission rules issued under section 404 of the Sarbanes-Oxley Act. The increase in general and administrative expenses was also attributable to costs related to an increase in head count and recruiting.

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, 2004 the reserve was $4,350,000. For the six month period ended June 30, 2005, expenses of $586,000 net of subtenant income were recorded against this reserve. At March 31, 2005 and June 30, 2005, we re-evaluated the estimate and adjusted the reserve to $4,568,000 and $5,482,000, respectively, by recording an additional $521,000 at March 31, 2005 and $ 1,197,000 at June 30, 2005 for an aggregate of $1,718,000 as wind-down expenses. Aggregate wind-down expenses for the same six-month period ended June 30, 2004 were $598,000. 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, if at all. In light of this uncertainty, based on estimates, we will periodically re-evaluate and adjust the reserve, as necessary.

	2005	2004	Change from previous year	
			$	%
Other income (expense):				
Interest income	$489,152	$ 76,410	$412,742	540%
Interest expense	(91,756)	(98,931)	7,175	7%
Other income (expense)	(20,632)	(3,195)	(17,437)	(546)%
Total other income (expense)	$376,764	$(25,716)	$402,480	1,565%

Interest income for the six months ended June 30, 2005 and 2004 was approximately $489,000 and $76,000 respectively. The increase in interest income in 2005 was primarily attributable to a higher average investment balance. Interest expense for the six months ended June 30, 2005 and 2004 was approximately $92,000 and $99,000 respectively. The decrease in interest expense in 2005 was attributable to lower outstanding debt and capital lease balances in 2005 compared to 2004. Increase in other expense from approximately $3,000 to $26,000 was primarily attributable to an increase in franchise tax paid to the State of Delaware as a result of a higher total value of assets in 2005 as compared to 2004.

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 $36,396,000 at June 30, 2005. Cash equivalents are invested in US Treasuries with maturities of less than 90 days. The table below summarizes our cash flows for the respective six month periods.

	2005	2004	Change from previous year	
			$	%
Net cash used in operating activities	$(6,480,046)	$ (5,586,420)	$ (893,626)	(16)%
Net cash used in investing activities	(285,280)	(63,380)	(221,900)	(350)%
Net cash provided (used) by financing activities	2,101,339	18,590,230	(16,488,891)	(89)%
Increase (decrease) in cash and cash equivalents	$(4,663,987)	$12,940,430	$(17,604,417)	(136)%

We used $6,480,000 and $5,586,000 of cash in operating activities for the six months ended June 30, 2005 and 2004 respectively. The increase in cash used in operating activities in 2005 in comparison to the same period in 2004 was primarily attributable to the increase in operating expenses attributable to the costs associated with a higher head count including recruiting fees, the cost of external services incurred in the evaluation and testing of our internal financial control systems so as to meet the requirements of and be in compliance with the new Securities and Exchange Commission rules issued under section 404 of the Sarbanes-Oxley Act, prepayment of our Directors and Officers Insurance Policy and the payout of higher bonus and external service accruals in 2005 as compared to 2004. The increase in expenses was offset by a decrease in expenses for our external services related to toxicology studies and other outside services required in preparing the submission of our first IND to the FDA, to evaluate the safety and efficacy of our human neural stem cells as a treatment for Batten disease.

We used $285,000 and $63,000 of cash in investing activities for the six months ended June 30, 2005 and 2004 respectively. The increase in cash used in investing activities in 2005 in comparison to the same period in 2004 was primarily attributable to an increase in capital expenditures primarily for lab and support equipment and a payment towards a licensing agreement.

For the six-month period ended June 30, 2005 cash provided by financing activities was primarily attributable to the exercise of warrants. A total of 1,282,745 warrants were exercised for gross proceeds of $1,938,000 (See Note 5 to the financial statements for further details on these transactions). For the same period in 2004 cash provided by financing activities was primarily attributable to the June 16, 2004 financing in which we issued 13,160,000 shares for a net amount of approximately $19,000,000.

On October 26, 2004, the Company entered into an agreement with institutional investors with respect to the registered direct placement of 7,500,000 shares of its common stock at a purchase price of $3.00 per share, for gross proceeds of $22,500,000. C.E. Unterberg, Towbin LLC (Unterberg) and Shoreline Pacific, LLC (Shoreline) served as placement agents for the transaction. The Company sold these shares under a shelf registration statement

previously filed with and declared effective by the U.S. Securities and Exchange Commission. For acting as our placement agent Unterberg and Shoreline received fees of approximately $1,350,000 and expense reimbursement of approximately $40,000. No warrants were issued as part of this financing transaction.

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. 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, and expect to pay in 2005, based on past experience and current assumptions, approximately $1,000,000 in lease payments and other operating expenses net of subtenant income. 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 the remainder of fiscal (July to December) 2005	Payable in 2006	Payable in 2007	Payable in 2008	Payable in 2009	Payable in 2010 and beyond
Capital lease payments	$ 2,601,422	$ 234,297	$ 445,486	$ 332,545	$ 244,531	$ 244,572	$1,099,991
Operating lease payments	19,106,802	1,260,374	2,831,930	3,165,162	3,469,017	3,536,843	4,843,476
Total contractual cash obligations	$21,708,224	$1,494,671	$3,277,416	$3,497,707	$3,713,548	$3,781,415	$5,943,467

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. 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.

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 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. As reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2004, management was unable to conclude that the Company's internal controls over financial reporting were then effective, as a result of a material weakness resulting from a lack of segregation of duties. We are continuing to evaluate and test the operating effectiveness of our internal controls over financial reporting.

PART II — ITEM 1

LEGAL PROCEEDINGS

One party has 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

None

PART II – ITEM 3

DEFAULTS UPON SENIOR SECURITIES

None

PART II – ITEM 4

SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On May 10, 2005, we held our Annual Meeting of Shareholders. Irving Weissman, M.D., and Ricardo Levy, Ph.D., were re-elected to the Board as Class II directors, with terms expiring in 2008. The remaining members of the Board, whose terms continued after the Annual Meeting, are Eric Bjerkholt, MBA, Roger Perlmutter, M.D., Ph.D., John Schwartz, Ph.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, 2005.

The number of proxies finally tabulated represented 55,712,353 of the 62,498,244 eligible shares, or 89.14 percent of eligible shares. The votes on each of the proposals were as follows:

	For	Authority Withheld	Against	Abstain	No
Election of Irving Weissman, M.D., as director	55,399,776	312,577			
Election of Ricardo Levy, Ph.D., as director	55,363,833	348,520			
Ratification of Grant Thornton LLP as independent accountants for 2005	55,362,812		208,811	140,729	1

PART II — ITEM 5

OTHER INFORMATION

There were no matters required to be disclosed in a current report on Form 8-K during the fiscal quarter covered by this report that were not so disclosed.

PART II — ITEM 6

EXHIBITS

Exhibit 10.71 – License Agreement between StemCells, Inc. and ReNeuron Limited

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

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

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 28, 2005

/s/ Judi Lum
Judi Lum
Chief Financial Officer

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Exhibit 10.71

LICENSE AGREEMENT BETWEEN STEMCELLS, INC. AND RENEURON LIMITED

LICENSE AGREEMENT

THIS LICENSE AGREEMENT (the "Agreement"), effective as of the 1st day of July, 2005 (the "Effective Date"), is between **STEMCELLS, INC.**, a Delaware corporation having its principal place of business at 3155 Porter Drive Palo Alto CA, USA 94304 ("SCI") and RENEURON LIMITED (company no. 03375897) a corporation organized under the laws of the United Kingdom and having its principal place of business at 10 Nugent Road, Surrey Research Park, Guilford, Surrey GU27AF, UK ("ReN"). SCI and ReN are each individually referred to herein as a "Party" and are collectively referred to herein as the "Parties."

WHEREAS:

A. SCI owns or controls (with the right to sub-license) the SCI Patent Rights and ReN owns or controls (with the right to sub-license) the ReN Patent Rights, each as hereinafter defined;

B. SCI wishes to grant to ReN, and ReN wishes to secure from SCI, certain rights under the SCI Patent Rights within the ReN Field, as set forth herein;

C. ReN wishes to grant to SCI, and SCI wishes to secure from ReN, certain rights under ReN Patent Rights as well as certain rights with respect to the c-MycER Cells, as set forth herein.

D. Simultaneously with the execution of this Agreement the Parties, together with ReNeuron Group PLC, ReNeuron (UK) Limited and certain Existing Shareholders (as defined therein) have entered into the Subscription Agreement (as hereafter defined) in consideration of the entering into of this Agreement pursuant to which SCI is granted certain rights to be issued shares in ReNeuron Group PLC.

NOW, THEREFORE, THE PARTIES AGREE AS FOLLOWS:

1. **DEFINITIONS**

The following capitalized terms used in this Agreement shall have the meanings given below unless the context clearly requires otherwise.

1.01 "Affiliate" shall mean any corporation, company, partnership, joint venture and/or firm that controls, is controlled by, or is under common control with a party. For purposes of this definition, "control" shall mean (a) in the case of a corporate entity, possession, directly or indirectly, of the power to direct the management and policies of such corporate entity, whether through ownership of securities, by contract or agency or otherwise; and (b) in the case of non-corporate entities, direct or indirect ownership of

more than 50% of the equity interest with the power to direct the management and policies of such non-corporate entities.

1.02 "Cell Line" shall mean c-MycER Cells of clonal origin, differentiated by the integration site of the c-MycER Cell insert.

1.03 "Cells" shall mean cultures of neural Stem Cells to the full extent described or claimed in the SCI Patent Rights and shall include all progeny and derivatives of such stem cells (including Progenitor Cells and their progeny and Stem Cells and their progeny) and "Cell" shall mean one of such cells.

1.04 "c-MycER Cells" shall mean human neural Stem Cells and Progenitor Cells conditionally immortalized with the c-Myc oncogene with an estrogen response element under tamoxifen control. c-MycER Cells shall not include human neural Stem Cells or Progenitor Cells or their progeny or derivatives that are not conditionally immortalized with c-myc under the control of the estrogen response element.

1.05 A "Change of Control" of a Party (or an the Affiliate of a Party to which assignment has occurred pursuant to Section 8.01, below), shall be deemed to have occurred at such time as any "person" or "group" (as such terms are used for purposes of Sections 13(d) and 14(d) of the Securities Exchange Act of 1934) that, on the Effective Date, is not the "beneficial owner" (as such term is used in Rule 13d-3 under the Securities Exchange Act of 1934) directly or indirectly, of more than fifty percent (50%) of the total securities of such Party entitled to vote for directors of such Party, becomes (except as the result of a Qualified Investment in such Party), directly or indirectly, in one or more transactions, the beneficial owner (as so defined), directly or indirectly, of more than fifty percent (50%) of the total securities of such Party entitled to vote for directors of such Party. For purposes of this definition a "Qualified Investment" shall mean a bona fide cash investment in the applicable Party by a financial institution, venture capitalist or similar entity (excluding a venture capital affiliate or similar financing arm of a collaborator or commercial partner of such Party).

1.06 "Confidential Information" shall mean any and all information disclosed by a Party (the "Discloser") to the other Party (the "Recipient") hereunder that is clearly marked or identified as "confidential" including all information relating to any technology, product, process, business information or other intellectual property of such Person (including, but not limited to, owned or license intellectual property rights, data, know-how, samples, technical and non-technical materials and specifications, as well as any business plan or other confidential commercial information of or about such Person). "Confidential Information" shall further include the terms and conditions of this Agreement not otherwise made public by agreement of the Parties or as required by law as well as information arising or disclosed pursuant to Section 2.03(c), 3.03 or 3.06 or Article 6 of this Agreement. Notwithstanding the foregoing, information shall not be considered "Confidential Information" to the extent that the Recipient can demonstrate by written record or other suitable physical evidence that:

(a) such specific information was lawfully in the Recipient's possession or control prior to the time such information was disclosed to the Recipient by the Discloser;

(b) such specific information was independently developed by one or more employees of the Recipient without the use of such Confidential Information;

(c) such specific information was lawfully obtained by the Recipient from a third party under no obligation of confidentiality to the Discloser; or

(d) such specific information was at the time it was disclosed or obtained by the Recipient, or thereafter became, publicly known otherwise than through a breach of the Recipient's obligations hereunder.

1.07 "Control" shall mean the possession by a Party of a license and the right to grant a sub-license thereunder to the other Party in accordance with this Agreement.

1.08 "Dollar(s)" (including the symbol "$") shall mean United States dollar(s).

1.09 "Field" shall mean the ReN Field or the SCI Field, as applicable.

1.10 "First Commercial Sale" shall mean, with respect to a Product and country, the first sale of such Product in such country after receipt of all applicable marketing and pricing approvals (if any) have been granted by the applicable governing health authority.

1.11 "Fully Diluted Share Capital" shall have the meaning set forth for such term in the Subscription Agreement.

1.12 "Gross Revenues" shall mean the gross revenues received by a Party, any Affiliate of a Party and any sub-licensee hereunder of a Party from the sale of any Product to, or the commercial use of any Product by, any Person other than that Party, its Affiliate or sub-licensee hereunder. Gross Revenues shall not include any revenues resulting from the use of Product by a Party or its Affiliates or sub-licensee hereunder solely for research and development (not done for third party compensation (which does not include expense reimbursement)), regulatory clearance, non-commercial product testing or quality control purposes.

1.13 "IND" shall mean an Investigational New Drug application filed with the United States Food and Drug Administration or equivalent application to the applicable governmental authority of another country, required to commence human clinical testing of a Product.

1.14 "Indication" shall mean a manifestation of a recognized disease or condition, one or more symptoms of a recognized disease or condition, or adjunctive therapy for a disease or condition.

1.15 "License," in the case of a license hereunder from one Party to the other Party shall include a sub-license to such of a Party's Patent Rights as have been in-licensed by from a third party. A Party may be referred to as "owner" of its Patent Rights even though some of such rights may have been in-licensed by from a third party.

1.16 "Net Sales" shall mean, with respect to any Product and any Party (including such Party's Affiliates and sub-licensees hereunder), the aggregate Dollar equivalent of such Party's Gross Revenues (including Gross Revenues of such Party's Affiliates and sub-licensees hereunder) with respect to such Product, less:

(a) credits, allowances or charge-backs, if any, granted on account of price adjustments, recalls, rejection, return or spoilage of such Product previously sold,

(b) excise, import and export taxes, sales, use, value added and other direct taxes incurred on the sale of such Product, customs duties, surcharges or other taxes imposed upon or paid with respect to any sale or use generating such Gross Revenues (excluding income or franchise taxes of any kind),

(c) the cost of insurance, packing and shipping Product in connection with such sale or use; and

(d) cash, quantity or other discounts, and credits, rebates or price reductions for such Product, given under price reduction programs that are consistent with industry practices.

1.17 "Ordinary Shares" shall mean "TopCo Shares" as such term is defined in the Subscription Agreement.

1.18 "Patent Rights" shall mean the SCI Patent Rights and/or the ReN Patent Rights, as the case may be.

1.19 "Person" shall mean any individual, corporation, governmental body or other legal entity.

1.20 "Phase I Clinical Trial" shall mean a human clinical trial in any country that is intended to evaluate the safety and/or pharmacological effect of a product in subjects, or that would otherwise satisfy the requirements of 21 CFR 312.21(a), or its foreign equivalent.

1.21 "Phase II Clinical Trial" shall mean a human clinical trial in any country that is intended to evaluate the safety and effectiveness of a product for a particular Indication or Indications in patients with the disease or Indication under study, or that would otherwise satisfy the requirements of 21 CFR 312.21(b), or its foreign equivalent.

1.22 "Product" shall mean an SCI Product, an ReN Product, an ReN NCT or an Unregulated Cells, as the case may be.

1.23 "Progenitor Cell" shall mean an undifferentiated Cell capable of limited proliferation and the production of differentiated functional progeny.

1.24 "ReN c-MycER Cell Technology" shall mean all know-how, data, biological materials, inventions and other proprietary information and technology owned or Controlled by ReN and relating to the manufacture, sale, use or manipulation of c-MycER Cells.

1.25 "ReN Discovery Field" shall mean use of c-MycER Cells for the research, discovery, screening and development of new non-cellular therapeutics for use in the treatment of any disease state or condition in humans.

1.26 "ReN Field" shall mean the ReN Transplantation Field, the ReN Discovery Field, and the ReN Reagents Field.

1.27 "ReN NCT" shall mean a non-cellular therapeutic molecule, i.e., a new chemical or biological molecule, identified or developed by ReN through the practice of inventions claimed in or covered by one or more of the SCI Patents or molecules derived therefrom, which identification or development occurred during the term of a Valid Claim of any such SCI Patent.

1.28 "ReN Patent Rights" shall mean:

(a) the patents and patent applications listed on Schedule 1.28 attached hereto (the "ReN Patents"),

(b) any and all United States or foreign patents and patent applications corresponding to any of the foregoing patents and patent applications, whether now existing of hereafter filed,

(c) any provisionals, substitutions, divisionals, reissues, renewals, continuations, continuations-in-part (but only to the extent not directed to new matter), extensions (including patent term extensions), substitute applications and inventors' certificates arising from, or based upon, any of the foregoing patents or patent applications, in respect of the foregoing;

(d) any patents issuing from any of the foregoing patent applications, and

(e) any issued patents now or hereafter owned or Controlled by ReN or an Affiliate of ReN to the extent necessary or useful for the manufacture, use or sale of any product or method utilizing c-MycER Cells or ReN c-MycER Cell Technology in the SCI Field.

1.29 "ReN Product" shall mean a c-MycER Cell or a product utilizing a c-MycER Cell identified or developed, in whole or in part, through the practice by ReN or a sub-licensee of ReN of inventions claimed in or covered by one or more of the SCI Patents, which practice occurred during the term of a Valid Claim of any such SCI Patent.

1.30 "ReN Reagents Field" shall mean use of Unregulated Cells for research and other non-clinical and non-therapeutic purposes (not including administration to humans).

1.31 "ReN Transplantation Field" shall mean Transplantation of c-MycER Cells for the diagnosis, prevention and treatment of human diseases other than those in the SCI Field.

1.32 "Royalty Term" shall mean, with respect to an SCI Product or an Unregulated Cell, in each country of sale, the period ***. The Royalty Term for each Product shall be determined on a country-by-country basis. "Royalty Term" shall mean, with respect to an ReN Product or an ReN NCT, a period ***.

1.33 "SCI Field" shall mean the diagnosis, prevention and treatment of: (i) lysosomal storage diseases, (ii) spinal cord injury, or (iii) myelin-affected disorders including, without limitation, cerebral palsy and multiple sclerosis.

1.34 "SCI Patent Rights" shall mean:

(a) the patents and patent applications listed on Schedule 1.34 attached hereto (the "SCI Patents"),

(b) any and all United States or foreign patents and patent applications corresponding to any of the foregoing patents and patent applications, whether now existing of hereafter filed,

(c) any provisionals, substitutions, divisionals, reissues, renewals, continuations, continuations-in-part (but only to the extent not directed to new matter), extensions (including patent term extensions), substitute applications and inventors' certificates arising from, or based upon, any of the foregoing patents or patent applications, in respect of the foregoing;

(d) any patents issuing from any of the foregoing patent applications; and

(e) any issued patents now or hereafter owned or Controlled by SCI or an Affiliate of SCI to the extent necessary or useful for the manufacture, use or sale of:

(i) a c-MycER Cell (including without limitation a product utilizing a c-Myc-ER Cell) identified or developed, in whole or in part, through the practice by ReN or a sub-licensee of ReN of inventions claimed in or covered by one or more of the SCI Patents, or

(ii) a ReN NCT.

1.35 "SCI Product" shall mean any product or method utilizing c-MycER Cells, the manufacture, use, or sale of which, but for the license granted to SCI hereunder, would infringe any Valid Claim of the ReN Patent Rights.

1.36 "Stem Cell" shall mean an undifferentiated Cell capable of proliferation, self maintenance and the production of a large number of differentiated functional progeny.

1.37 "Sub-license Revenue" shall mean ***

1.38 "Subscription Agreement" shall mean an agreement entitled "Subscription and Share Exchange Agreement" of even date herewith among ReN, SCI and others.

1.39 "Third Party" shall mean any Person other than a Party or an Affiliate of a Party.

1.40 "Transplantation" shall mean the implantation of Cells, into a patient..

1.41 "Unregulated Cells" shall mean the ReN cell lines known as ReNcell CX and ReNcell VM and more particularly described on Schedule 1.41 hereto and, on notice from ReN to SCI, any alternative ReN cell line identified by ReN and substituted for either ReNcell CX or ReNcell VM as provided in Section 2.05, below.

1.42 "Valid Claim" shall mean a claim of an issued and unexpired patent included within the Patents Rights that has not been held permanently revoked, unenforceable or invalid by a decision of a court or other government agency of competent jurisdiction, unappealable or unappealed within the time allowed for appeal, and that has not been admitted to be invalid or unenforceable through release or disclaimer or otherwise.

2. LICENSES AND SUPPLY OF MATERIALS

2.01 Licenses from SCI to ReN

(a) SCI hereby grants to ReN a sole and exclusive (even as to SCI), royalty-bearing, worldwide license under the SCI Patent Rights to research, develop, make, have made, use, have used, sell, have sold, offer for sale and import ReN Products in the ReN Transplantation Field.

(b) SCI hereby grants to ReN a sole and exclusive (even as to SCI), royalty-bearing, worldwide license under the SCI Patent Rights to make and use c-MycER Cells to research, develop, make, have made, use, have used, sell, have sold, offer for sale and import ReN NCTs in the ReN Discovery Field.

(c) SCI hereby grants to ReN a non-exclusive, royalty-bearing, worldwide license, under the SCI Patent Rights to research, develop, make, have made, use, have used, sell, have sold, offer for sale and import, Unregulated Cells in the ReN Reagent Field.

Any sub-licenses included in any of the foregoing licenses under SCI Patent Rights are granted subject to the applicable terms and conditions of the agreement, if any, by which SCI is licensed under such SCI Patent Rights; provided, however, that SCI shall be responsible for the payment of royalties and other economic obligations to Third Parties under any such agreement that is in effect as of the Effective Date and ReN shall be responsible for the reimbursement to SCI of royalties calculated and due to Third Parties as the result of sale of a Product by ReN or an Affiliate or sub-licensee hereunder (but not any other economic obligations) under any such agreement that first comes into effect following the Effective Date. With respect to SCI Patent Rights derived as a result of a license to SCI from a Third Party that first comes into effect following the Effective Date, SCI shall first notify ReN as to the nature (including term and scope) of the Patent Rights in question and the royalty burden associated with the exercise of such rights by ReN pursuant to this Agreement. ReN shall have the right, at any time by notice to SCI, to decline (or, having first accepted thereafter to relinquish) its rights hereunder with respect to such Patent Rights, in whole or part, whereupon such Patent Rights, to the extent of such decline or relinquishment, shall be deleted from the grant of rights to ReN hereunder. The licenses granted in this Section 2.01 are subject to the terms and conditions of this Agreement.

2.02 License from ReN to SCI

ReN hereby grants to SCI a sole and exclusive (even as to ReN), royalty-bearing, worldwide license under the ReN Patent Rights and ReN c-MycER Cell Technology, to research, develop, make, have made, use, have used, sell, have sold, and offer for sale SCI Products in the SCI Field and to use the c-MycER Cells in order to make, use or sell an SCI Product in the SCI Field.

Any sub-licenses included in any of the foregoing licenses under ReN Patent Rights are granted subject to the applicable terms and conditions of the agreement by which ReN is licensed under such ReN Patent Rights; provided, however, that ReN shall be responsible for the payment of royalties and other economic obligations to Third Parties under any such agreement that is in effect as of the Effective Date and SCI shall be responsible for the reimbursement to ReN of royalties calculated and due to Third Parties as the result of sale of a Product by SCI or any Affiliate or sub-licensee hereunder (but not any other economic obligations) under any such agreement that first comes into effect following the Effective Date. With respect to ReN Patent Rights derived as a result of a license to ReN from a Third Party that first comes into effect following the Effective Date, ReN shall first notify SCI as to the nature (including term and scope) of the Patent Rights in question and the royalty burden associated with the exercise of such rights by SCI within the SCI Field. SCI shall have the right, at any time by notice to ReN, to decline (or, having first accepted thereafter to relinquish) its rights hereunder with respect to such

Patent Rights, in whole or part, whereupon such Patent Rights, to the extent of such decline or relinquishment, shall be deleted from the grant of rights to SCI hereunder. The license granted in this Section 2.02 is subject to the terms and conditions of this Agreement.

2.03 Sub-licensing

(a) ReN shall have the right to sub-license its rights under Sections 2.01(a), (b) or (c), above, to an Affiliate of ReN on prior notice to SCI. Any such sub-license shall remain in effect only for so long as such Affiliate remains as Affiliate of ReN. ReN shall have the right to sub-license its rights under Sections 2.01(a) and (b), above, to a Third Party only with the prior consent of SCI, which consent shall not be unreasonably withheld or delayed. ReN shall have no right to sub-license its rights under Section 2.01 (c), above, to a Third Party; provided, however, that ReN shall have: (i) the right to contract with one or more distributors (including catalog reagent companies) with respect to the manufacture and/or sale of Unregulated Cells in the ReN Reagent Field, (ii) the right to contract with a Third Party to manufacture Products for sale in the ReN Reagent Field, and (iii) the right to pass through implied sub-licenses (without the right further to sub-license or assign) to end users of Unregulated Cells.

(b) SCI shall have the right to sub-license its rights under Section 2.02, above, to an Affiliate of SCI on prior notice to ReN. Any such sub-license shall remain in effect only for so long as such Affiliate remains an Affiliate of SCI. SCI shall have the right to sub-license its rights under Section 2.02, above, to a Third Party only with the prior consent of ReN, which consent shall not be unreasonably withheld or delayed.

(c) At least thirty (30) business prior to the proposed grant by a Party to a sub-licensee of any of its rights hereunder, the granting Party shall provide to the other Party a summary of the material terms and conditions (including the identity of the prospective sub-licensee) of such proposed sub-license. In the event that a Party (the “Controlling Party”) objects to the proposed sub-licensing of its Patent Rights by the other Party (the “Licensing Party”) to a Third Party, the Controlling Party shall so notify the Licensing Party within ten (10) days following its receipt of the proposed sub-license terms and conditions stating, with reasonable specificity, the reasons for such objection. If no such notice of objection is provided within such ten (10) day period, a sub-license consistent with such proposed terms and conditions to the prospective sub-licensee previously identified shall be deemed to have been approved by the Controlling Party, provide that such sub-license enters into effect during the following one hundred and eighty (180) days. If notice of objection is provided, at the request of the Licensing Party, the Parties shall promptly meet to discuss in good faith the objections raised by the Controlling Party. If the Controlling Party does not give its approval to the proposed sub-license terms and conditions within five (5) business days following the date of the Licensing Party’s initial receipt of the Controlling Party’s objection to the proposed sublicense, the reasonableness of such objection shall, at the request of the Licensing Party, be resolvable by binding arbitration as provided in Section 2.03(d), below.

(d) ***

2.04 Supply of Materials

(a) From time to time during the period commencing on the Effective Date and ending upon the expiration of the Royalty Term SCI shall have the right to nominate one or more Cell Lines either from among Cell Lines already in ReN's possession as of the Effective Date or for creation by ReN according to reasonable specifications provided by SCI. ***

Following the nomination of an Approved Cell Line, the Parties shall establish a time-line on which ReN, using reasonable diligence, shall establish the capacity (or have a sub-contractor establish such capacity) to supply SCI pursuant to this Section 2.04. In accordance with the agreed-upon time table, SCI shall notify ReN in advance of its projected requirements of such Approved Cell Line and shall place firm orders for such Approved Cell Line sufficiently in advance of the date proposed for delivery (as determined in the agreed time line). SCI shall reimburse ReN for the *** of Approved Cell Lines nominated and ordered by SCI, determined in accordance with United Kingdom GAAP.

With respect to Approved Cell Lines isolated, produced and supplied by ReN pursuant to this Section 2.04, SCI shall have the right, no more than once in any 12 month period, during ordinary working hours and with no fewer that 10 days' prior written notice to ReN, to conduct reasonable quality assurance audits of ReN's production and testing facilities.

(b) During the ninety (90) day period following the Effective Date the Parties shall, diligently and in good faith, endeavor to reach agreement on a "Supply Agreement" pursuant to which ReN shall supply (directly and/or through sub-contractors) to SCI Approved Cell Lines for which SCI has reached the Trigger Point prior to ReN pursuant to subsection (a), above, in cGMP and GMP form, for clinical and commercial use by SCI within the SCI Field. The Supply Agreement shall provide, inter alia, for:

(i) reasonable and customary representations and warranties with respect to the specifications of the materials delivered, with commercially reasonable rights to inspect and reject non-conforming goods (subject to reasonable and customary limitations on remedies and liability with respect thereto);

(ii) the establishment of a Quality Agreement covering such Approved Cell Line, the assurance that SCI and all responsible governmental bodies have the right to inspect and conduct audits (including quality assurance audits) of the ReN facilities used in the testing and production of such Approved Cell Line and ReN records related thereto including, without limitation, batch records, stability reports, and the results of internal and regulatory audits and inspections;

(iii) the right to audit such ReN facilities under special circumstances (e.g. in response to a serious adverse event or in connection with a governmental inspection);

(iv) the right for SCI to reference ReN's drug master file and the acquisition of appropriate manufacturing permits and licensure from regulatory authorities with respect to such Approved Cell Line and the facilities used for the testing or manufacture of such Approved Cell Line;

(v) procedures applicable in the event of complaints, adverse events or recalls with respect to materials supplied by ReN;

(vi) the forecasting of supply of materials and the timing of firm orders to be placed by SCI with respect to materials to be produced and supplied by ReN;

(vii) a purchase price for such materials equal to ***;

(viii) quality control and terms and conditions for changes in manufacturing or testing specifications;

(ix) reasonable advance notice and lead time to be given prior to initial production of any Cell Lines under the Supply Agreement to allow for ReN to establish the capacity, process and scale-up to manufacture and supply thereunder; and

(x) such other terms and conditions as are typical and reasonable for an agreement providing for the supply of FDA regulated pharmaceutical products and the use of such products for human clinical trials and commercial sale.

To the extent that the Parties are unable to reach agreement on all of the terms and conditions of the Supply Agreement within such ninety (90) day period, either Party shall have the right submit any open questions to binding arbitration using the procedure specified in Section 2.03(d), above.

2.05 Substitution of Unregulated Cells.

At any time during the term of this Agreement ReN shall have the right, by notice to SCI, to nominate an ReN cell line identified on Schedule 1.41 other than those identified as ReNcell CX or ReNcell VM as a substitute for ReNcell CX or ReNcell VM such that ReN will, at all times have rights to two Unregulated Cells. SCI shall not enter into any license or other agreement with a Third Party inconsistent with the foregoing.

2.06 Rights Limited to Those Expressed

The rights granted to SCI and ReN hereunder shall be limited to the rights expressly stated to be granted hereunder and no additional rights or licenses are implied.

3. **PAYMENTS AND REPORTS**

3.01 ReN shall make the following payments to SCI:

(a) Milestone payments

Within 30 days following the achievement by ReN or by an Affiliate or sub-licensee hereunder of ReN of each of the following events, on a Product by Product basis, ReN shall give written notice thereof to SCI and shall pay to SCI the corresponding payments described below.

*** upon initiation of the first human Phase I Clinical Trial of each ReN Product *** in the ReN Transplantation Field;

*** upon completion of the first human Phase II Clinical Trial of each ReN Product *** in the ReN Transplantation Field;

*** upon submission of the first BLA or its foreign counterpart for each ReN Product *** in the ReN Transplantation Field;

*** upon approval of a BLA or its foreign counterpart for each ReN Product *** in the ReN Transplantation Field in the first of the United States, the European Union or Japan;

*** upon initiation of the first human Phase II Clinical Trial of a ReN NCT; and

*** upon the First Commercial Sale of a ReN NCT.

For purposes of determining whether a milestone payment is due pursuant to this subsection (a) with respect to a given label Indication, a Product (the "Follow-on Product") shall not be considered as distinct from a Product as to which a milestone payment was previously made for the same label Indication (the "Initial Product") if the clinical development of the Follow-on Product was lawfully conducted without the requirement that a new (as distinguished from an amended) IND be filed with respect to the clinical testing of such Follow-on Product, i.e. that clinical development of the Follow-on Product occurred pursuant to the same IND (whether or not amended) as that applicable to the Initial Product. Accordingly, a Follow-on-Product developed pursuant to the same IND as the Initial Product shall not trigger (or accrue a payment obligation for) the milestone payments already paid for such Initial Product with respect to a given label Indication.

In addition, the Parties acknowledge that a single development program intended to yield a single commercial Product for a specific Indication or set of Indications may involve the simultaneous development of multiple Product for that Indication or set of Indications, each based on a different Cell Line or combination of Cell Lines, and that the

Product as to which one milestone event occurs (e.g. that due on the completion of a Phase II Clinical Trial) may subsequently be abandoned and replaced by a back-up Product developed in the course of such development plan, for the same Indication or set of Indications, as to which the same milestone event occurs. In such event, the Parties intend that each milestone payment shall be paid only one time for each Indication regardless of whether such milestone payment is achieved by more than one Product developed for such Indication or set of Indications in the course of the same development program.

Subject to the clarifications in the preceding two paragraphs, the Parties intend that achievement of each "Milestone Event" (defined as the initiation of a given Phase I Clinical Trial, completion of a given Phase II Clinical Trial, submission of a given BLA or approval of a BLA, to the extent triggering a milestone payment above) shall result in an obligation to make the corresponding payment obligation every time such Milestone Event occurs unless the subsequent occurrence of the Milestone Event involves both the same Product *** as a previous Milestone Event for which milestones were already paid. *** Furthermore, it is understood and agreed that no more than one milestone payment (in the applicable amount specified above, and not multiples thereof) shall be made with respect to a given Milestone Event, without limiting any milestones due for a subsequent occurrence of the same Milestone Event for a different Indication or Product. Thus, for example completion of a given Phase II Clinical Trial for a given Product within the applicable Field will trigger only one payment of ***, regardless of whether the Product in such trial was a combination product containing two biological compounds from two different Cell Lines and regardless of whether the Indication targeted in such trial could potentially cover different patient populations or be subdivided into subtypes or subgroups.

(b) Royalties

During the applicable Royalty Term for each ReN Product or ReN NCT Product, on a country-by-country basis, ReN shall pay to SCI a *** royalty on any and all Net Sales of each ReN Product in the ReN Transplantation Field in such country and a *** royalty on any and all Net Sales of each ReN NCT in the ReN Discovery Field in such country, regardless of the number of Valid Claims of the SCI Patent Rights that are applicable. During the applicable Royalty Term for each Unregulated Cell, ReN shall also pay to SCI a *** royalty on any and all Net Sales of Unregulated Cells by ReN or any Affiliate of ReN (but not for sales by permitted sublicensees (as per Section 2.03(a)(i)) or distributors of ReN with respect to such Unregulated Cells).

(c) Sub-license Revenues

ReN shall pay to SCI *** of all ReN Sub-license Revenue with respect to ReN Products and ReN NCTs. In addition, ReN shall pay to SCI ten (10) percent of all revenues ReN receives (whether in the form of license fees, milestones payments or royalties calculated as a function of the sale or use of Unregulated Cells) from its sub-licensees and distributors of Unregulated Cells within the ReN Reagent Field for the sale of (and/or the

right to make, use, or sell) Unregulated Cells (excluding any such revenues that fall within the categories of (a), (b) and/or (c) of the "Sub-license Revenue" definition in Section 1.37).

(d) In addition to the payments provided in subsections (a), (b) and (c), above, as provided in the Subscription Agreement, ReN shall secure the delivery to SCI of Ordinary Shares constituting seven and one-half percent (7.5%) of the Fully Diluted Share Capital of ReNeuron Group PLC as of the date on which such shares are issued. As provided in the Subscription Agreement, SCI shall also benefit from certain anti-dilution protection in respect of such share holding. The further rights of SCI as a result of its ownership of such Ordinary Share are as specified in the Subscription Agreement and in the articles of association of ReNeuron Group PLC.

3.02 SCI shall make the following payments to ReN:

(a) Milestone payments

Within 30 days following the achievement by SCI or by an Affiliate or sub-licensee of SCI of each of the following events, on a Product by Product basis, SCI shall give written notice thereof to ReN and shall pay to ReN the corresponding payments described below.

*** upon initiation of the first human Phase I Clinical Trial of each SCI Product *** in the SCI Field.

*** upon completion of the first human Phase II Clinical Trial of each SCI Product *** in the SCI Field.

*** upon submission of the first BLA or its foreign counterpart for each SCI Product *** in the SCI Field.

*** upon approval of a BLA or its foreign counterpart for each SCI Product *** in the SCI Field in the first of the United States, the European Union or Japan.

For purposes of determining whether a milestone payment is due pursuant to this subsection (a) with respect to a given label Indication, a Product (the "Follow-on Product") shall not be considered as distinct from a Product as to which a milestone payment was previously made for the same label Indication (the "Initial Product") if the clinical development of the Follow-on Product was lawfully conducted with the requirement that a new (as distinguished from an amended) IND be filed with respect to the clinical testing of such Follow-on Product, i.e. that clinical development of the Follow-on Product occurred pursuant to the same IND (whether or not amended) as that applicable to the Initial Product. Accordingly, a Follow-on-Product developed pursuant to the same IND as the Initial Product shall not trigger (or accrue a payment obligation

for) the milestone payments already paid for such Initial Product with respect to a given label Indication.

In addition, the Parties acknowledge that a single development program intended to yield a single commercial Product for a specific Indication or set of Indications may involve the simultaneous development of multiple Product for that Indication or set of Indications, each based on a different Cell Line or combination of Cell Lines, and that the Product as to which one milestone event occurs (e.g. that due on the completion of a Phase II Clinical Trial) may subsequently be abandoned and replaced by a back-up Product developed in the course of such development plan, for the same Indication or set of Indications, as to which the same milestone event occurs. In such event, the Parties intend that each milestone payment shall be paid only one time for each Indication regardless of whether such milestone payment is achieved by more than one Product developed for such Indication or set of Indications in the course of the same development program.

Subject to the clarifications in the preceding two paragraphs, the Parties intend that achievement of each "Milestone Event" (defined as the initiation of a given Phase I Clinical Trial, completion of a given Phase II Clinical Trial, submission of a given BLA or approval of a BLA, to the extent triggering a milestone payment above) shall result in an obligation to make the corresponding payment obligation every time such Milestone Event occurs unless the subsequent occurrence of the Milestone Event involves both the same Product *** as a previous Milestone Event for which milestones were already paid. *** Furthermore, it is understood and agreed that no more than one milestone payment (in the applicable amount specified above, and not multiples thereof) shall be made with respect to a given Milestone Event, without limiting any milestones due for a subsequent occurrence of the same Milestone Event for a different Indication or Product. Thus, for example completion of a given Phase II Clinical Trial for a given Product within the applicable Field will trigger only one payment of ***, regardless of whether the Product in such trial was a combination product containing two biological compounds from two different Cell Lines and regardless of whether the Indication targeted in such trial could potentially cover different patient populations or be subdivided into subtypes or subgroups.

(b) Royalties

During the Royalty Term for each SCI Product, on a country-by-country basis, SCI shall pay to ReN a *** royalty on any and all Net Sales of such Products in such country regardless of the number of Valid Claims within the ReN Patent Rights that are applicable.

(c) Sub-license Revenues

SCI shall pay to ReN *** of all SCI Sub-license Revenue.

3.03 Reports and Payments

Within sixty (60) days after the end of each calendar quarter each Party shall deliver to the other Party a written report showing all royalties and payments due on account of Net Sales and Sublicense Revenues due under this Agreement, on a Product-by-Product and country-by-country basis. With respect to sales made or Sub-license Revenues received in currencies other than Dollars, conversion to Dollars shall be made using the closing buying price quoted by Bank of America N.T.S.A. (in the case of SCI) and Barclay's Bank (in the case of ReN) for the last business day of the calendar quarter in which such sale was made or Sub-license Revenue received. All amounts shown to have accrued by each such report shall be payable on the date such report is due.

3.04 Payments Subject to Embargo

Where royalties and payments are due hereunder on account of Net Sales completed in a country where, by reason of currency regulations or taxes of any kind, it is illegal for the paying Party to transfer such payments out of such country for Net Sales in that country, such payments shall be deposited in the other Party's account in a bank or other depository in such country in a currency that is permitted for the paying Party to make the transfer for the benefit or credit of the other Party entitled to receive such payments.

3.05 Withholding Taxes

If a Party is required to withhold tax on royalties or payments on account of sublicense revenues payable to the other Party hereunder, such taxes shall be deducted, provided that the receiving Party shall be furnished at the time of deduction with suitable documentation for obtaining credits to which the receiving Party may be entitled as a result of such withholding on the income taxes of the receiving Party.

3.06 Records

Each Party shall keep, and shall require all Affiliates and its sub-licensee(s) to keep, full, true and accurate books of accounts and other records containing all information and data which may be necessary to ascertain and verify all royalties and payments on account of sublicense revenues payable hereunder. During the term of this Agreement and for a period of two years following its termination, the receiving Party shall have the right from time to time (not to exceed once during each calendar year), to have an accounting firm of nationally recognized standing in the relevant jurisdiction inspect, at the receiving Party's expense, on a confidential basis, the books, records and supporting data of the paying Party. If such inspection shall reveal that the Paying party has not accurately reported and paid royalties and payments on account of Sub-license Revenues due to the receiving Party, then the paying Party shall pay to the receiving Party any shortfall in royalties payable plus interest thereon at a rate equal to the lesser of (a) eight percent per annum and (b) the highest lawful rate of interest in the receiving Party's jurisdiction at the time; or, if the paying Party has overpaid royalties, the receiving Party shall promptly refund the excess. If a shortfall greater than 10 percent of the royalties and payments on

account of sublicense revenues payable in any year should be found to be due, the Party that has underpaid shall pay the reasonable costs of the audit or inspection. Unless challenged within three years after a statement is rendered, royalties and payments on account of sublicense revenues calculated for the calendar quarter covered by such statement shall be conclusively presumed to be correct. Upon request by the receiving Party no more than once each calendar year, the paying party shall cause to be performed an audit of the books, records and supporting data of each Affiliate or its sub-licensee(s), unless the paying Party shall have had an audit of such Affiliate or its sub-licensee(s) performed within the preceding three month period, in which case the paying Party shall share the relevant results of such audit with the receiving Party without charge to the receiving Party. The reasonable costs of such requested audit shall be borne by the receiving Party unless such audit reveals that the paying Party, its Affiliate or its sub-licensee(s) has under reported Net Sales or Sub-License Revenues by more than 10 percent.

3.07 No Multiple Royalties

No multiple Royalties shall be payable because any Product or its manufacture, use or sale are or shall be covered by more than one patent or invention or otherwise licensed hereunder.

4. **CONFIDENTIAL INFORMATION**

4.01 Treatment of Confidential Information

Each Party hereto shall maintain the Confidential Information of the other Party in confidence, and shall not disclose, divulge or otherwise communicate such Confidential Information to any third party, or use it for any purpose, except pursuant to, and in order to carry out, the terms and objectives of this Agreement, and hereby agrees to exercise every reasonable precaution to prevent and restrain the unauthorized disclosure of such Confidential Information by any of its directors, officers, employees, consultants, subcontractors, sub-licensees or agents. In the event either Party becomes aware of the unauthorized disclosure (including publication) of the other Party's Confidential Information, or a material threat thereof, it shall promptly notify such other Party describing in reasonable detail the nature of the disclosure (or threat thereof) and the Confidential Information involved.

4.02 Release from Restrictions

The provisions of Section 4.01, above, shall not apply to any Confidential Information disclosed hereunder that is: required to be disclosed by the receiving Party to comply with applicable laws, court orders, or to comply with applicable governmental regulations (including without limitation to drug testing, marketing regulations and rules of NASD), in each case only to the extent required to carry out the work contemplated by this Agreement provided that the receiving Party provides prior written notice of such

disclosure to the other Party and takes reasonable and lawful actions to avoid and/or minimize the degree of such disclosure.

4.03 Confidential Agreements

Each Party has employment agreements with its respective employees and representatives having confidentiality and nonuse commitments consistent with their obligations hereunder and will require all of their sub-licensees hereunder, consultants, agents or others who have access to any of such information to execute similar confidentiality agreements covering all Confidential Information subject to Article 4 and will exercise its reasonable best efforts to obtain compliance therewith.

5. PRODUCT DEVELOPMENT EFFORTS

5.01 Diligence Development and Commercialization.

Each Party shall use reasonable efforts consistent with prudent business judgment in the development and commercialization of Products in any of its exclusive Fields.

5.02 Cooperation.

The Parties shall reasonably cooperate with each other with respect to safety reporting that is required by law or by ICH guideline, regulation or policy. If reporting to a regulatory or other governmental body is required, the Parties shall put in place a separate pharmaco-vigilance agreement with appropriate provisions to assure timely compliance. Any information shared between the Parties as a result of such safety reporting shall be used by the Party receiving such information solely for safety reporting and not as data to support a claim as to the efficacy or safety of any Product. Each Party shall share with the other Party any creditable information as to off-label or out-of-Field use of the former Party's Product and, upon the written request of either Party, the Parties shall meet and in good faith endeavor to reach agreement on means of correcting or abating such off-label or out-of-Field uses.

6. FILING OF PATENTS: PROSECUTION OF INFRINGERS

6.01 Filing, Prosecution, and Maintenance of Patents.

Each Party shall be solely responsible for filing, prosecution, maintenance and enforcement, in its sole discretion, of all patents or patent applications which are part of its Patent Rights, and shall be and remain the owner of all of its Patent Rights. Each Party shall engage its own patent counsel and in all respects control the prosecution of its Patent Rights, at its own cost.

6.02 Infringement of Patents by Third Parties.

(a) Notice of Infringement.

Each Party shall notify the other of any infringement of Patent Rights of either Party by Third Parties of which it becomes aware.

(b) Prosecution of Infringers.

Subject to subsection (c), below, each Party shall have the sole right, in its absolute discretion, to pursue actions against infringers of its Patent Rights, or not to pursue such actions, or to abandon or settle any such action (except to the extent that any settlement would involve the grant of a license inconsistent with a grant of rights pursuant to this Agreement). Should a Party (the "Owning Party") pursue such an action in the Field of the other Party (the "Licensed Party"), the Licensed Party will co-operate and allow the Owning Party to use its name in any such suit, to sue in its name or join it as a party to such suit if legally required provided that the Owning Party will indemnify and hold harmless the Licensed Party from any costs, damage or expenses incurred by the latter in respect of any such acts or co-operation. If the Owning Party recovers damages, by settlement or judgment or otherwise, then the amount recovered shall be divided as follows: (i) the reasonable and documented litigation expenses of the Owning Party shall be reimbursed, and (ii) the remainder shall be ***.

(c) Discussion

Following notice pursuant to subsection (a), above, at the request of the Party in whose Field the infringement is alleged to have occurred, the Parties shall promptly meet to discuss in good faith appropriate action, if any, to abate the alleged infringement.

(d) Unlicensed Competition.

The Parties acknowledge that the sale of a Product by or for a Party during the Royalty Term may be affected by competition from Third Parties that, for whatever reason, have chosen to compete in the Field of such Party with respect to a product incorporating a biologically active component the manufacture, use or sale of which such Party has been advised by competent counsel infringes one or more of the Patent Rights licensed to such Party hereunder (a "Competing Product"). With respect to sales of a Competing Product, when such Competing Product takes a Market Share in excess of *** for any calendar quarter in any country, the royalty rate applicable to Net Sales made in such country in such quarter shall be reduced by *** For purposes of this Section 6.02(c), "Market Share" shall be determined by the formula A divided by A + B (expressed as a percentage) in which A is the amount (determined by weight or otherwise) of that biologically active component of the Competing Product which is asserted to be infringing sold in such country during such calendar quarter and B is the amount (determined in the same manner) of Product with which such Competing Product competes that was sold by such Party in the subject country in such calendar quarter.

Unit sales of Competing Product shall be determined by the sales reported by IMS America Ltd. of Plymouth Meeting, Pennsylvania ("IMS") or its equivalent in other countries of the world or, if such sources are not available, such other source as the Parties shall mutually agree.

7. REPRESENTATIONS AND WARRANTIES

7.01 Corporate Representations.

Each Party represents and warrants to the other that:

(a) it has and has obtained all corporate authorizations and all other applicable consents, licenses, waivers or exemptions required to empower it to enter into this Agreement and to consummate the transactions contemplated hereby; and

(b) the execution and delivery of, and the performance by such Party of its obligations under, this Agreement will not:

(i) result in a breach of any provision of the memorandum or articles of incorporation or association of such Party;

(ii) result in a breach of any provision of, or constitute a default under, any instrument to which it is a party or by which it is bound; or

(iii) result in a breach of any order, judgment or decree of any court or governmental agency to which it is a party or by which it is bound.

(c) the obligations of such Party under this Agreement will constitute the legal, valid and binding obligation of it; and

(d) such Party is duly incorporated and validly existing under the laws of the jurisdiction in which it is incorporated.

7.02 Intellectual Property Representations.

(a) ReN represents and warrants as follows:

(i) to ReN's knowledge as of the Effective Date, the patents/patent applications listed in Schedule 1.28 are subsisting and no challenge has been taken to them by any Third Party;

(ii) ReN owns or Controls the ReN Patents;

(iii) Schedule 1.28 is, as of the Effective Date, a complete and accurate list of all patents and patent applications that ReN owns or Controls which

cover or claim the right to manufacture, use or sell an SCI Product within the SCI Field;

(iv) to ReN's knowledge as of the Effective Date, there are no Third Party patents or patent applications that present a freedom to operate barrier to compositions of c-MycER Cells or nucleic acid components used to generate compositions of c-MycER Cells, or to the use of C-MycER Cells in the SCI Field; and

(v) no in-license from a Third Party in existence as of the Effective Date under which Patent Rights are sub-licensed by ReN to SCI hereunder contains a restriction or limitation on SCI's ability to exercise the full scope of the rights granted to it hereunder.

(b) SCI represents and warrants as follows:

(i) to SCI's knowledge as of the Effective Date, the patents/patent applications listed in Schedule 1.34 are subsisting and no challenge has been taken to them by a Third Party;

(ii) SCI owns or Controls the SCI Patents;

(iii) Schedule 1.34 is, as of the Effective Date, a complete and accurate list of all patents and patent applications that SCI owns or Controls which cover or claim the right to manufacture, use or sell a product or compound of any sort within the ReN Transplantation Field or the ReN Discovery Field;

(iv) to SCI's knowledge as of the Effective Date, there are no Third Party patents or patent applications that that present a freedom to operate barrier to compositions of neural stem cells; and

(v) no in-licenses from a Third Party in existence as of the Effective Date under which Patent Rights are sub-licensed by SCI to ReN hereunder contains a restriction or limitation on ReN's ability to exercise the full scope of its rights hereunder.

Except as otherwise expressly set forth in Sections 7.01 through 7.02, above, or as otherwise stated in this Agreement, ReN and SCI make no representations and extend no warranties of any kind in relation to the matters addressed under this Agreement. ReN and SCI expressly disclaim any representations and extend no warranties of any kind in relation to whether or not the practice, as licensed under this Agreement, of the ReN Licensed Technology, will violate the rights of any third party. Neither ReN nor SCI has conducted any infringement analysis on potential Products that may be developed under the Parties' respective Patent Rights or the ReN c-MycER Cell Technology. THE REPRESENTATIONS AND WARRANTIES IN SECTIONS 7.01 THROUGH 7.02 ARE IN LIEU OF ALL OTHER REPRESENTATIONS, WARRANTIES AND CONDITIONS, EXPRESS OR IMPLIED OR ARISING UNDER ANY LEGAL

THEORY, CONCERNING THE ReN LICENSED TECHNOLOGY, PATENT RIGHTS OR CELL TECHNOLOGY, OR ANY OF IT, INCLUDING BUT NOT LIMITED TO THOSE OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE.

8. **ASSIGNMENT**

8.01 No Right to Assign.

Neither Party shall have the right, whether in connection with a merger or consolidation or with the sale of substantially all of its assets or otherwise, to assign this Agreement or any of the rights and licenses herein granted without the consent of the other Party, which consent may be granted or withheld in the latter Party's sole discretion. Notwithstanding the foregoing, ***; provided, however, that the assigning Party shall remain primarily liable to the other Party for the performance by the assigning Party's Affiliates of the assigning Party's obligations hereunder.

8.02 Performance by Subcontractors

Either Party may perform its obligations hereunder through its Affiliates, consultants or subcontractors, but shall be responsible to the other Party for the performance of any such third party.

9. **TERM AND TERMINATION**

9.01 Term.

Unless sooner terminated as provided herein, the licenses granted to ReN under Sections 2.01 (a), (b) and (c) shall expire on a country-by-country basis upon the later of (i) the expiration of the last to expire of the SCI Patent Rights in such country, or (ii) the expiration of the last to expire of the Royalty Terms for all ReN Products, ReN NCTs and Unregulated Cells in such country. The license granted to SCI under Section 2.02 shall expire on a country-by-country basis upon the later of (i) the expiration of the last to expire of the ReN Patent Rights in such country, or (ii) the expiration of the last to expire of the Royalty Terms for all SCI Products in such country. Upon the expiration of the last remaining license as provided above, this Agreement shall terminate; provided, however, that with respect to any ReN Products or ReN NCTs for which human clinical trials have been initiated (or which are in a later stage of development or commercialization at the time of such termination), the applicable terms of this Agreement (i.e., Sections 2.01, 2.03 and 9.01 and Articles 3 (other than 3.02), 5 and 8) shall remain in effect with respect to such ReN Products and ReN NCTs (on a Product-by-Product basis) until the Royalty Term for each such Product expires or, if earlier, when development of such Product ceases (provided, further that, if no First Commercial Sale of a given Product has occurred prior to seven (7) years after the date of Agreement termination, the aforementioned surviving terms shall also terminate with respect to such Product). Notwithstanding the foregoing, if ReN has not raised at least *** in the

aggregate through the issuance of equity securities within 15 months after the Effective Date, this Agreement shall immediately terminate.

9.02 Defaults.

If either Party shall fail to perform any of its material obligations hereunder, the other Party may notify the defaulting Party of such default, stating in such notice the obligation which the defaulting Party shall have failed to perform, and, if the defaulting party shall not have cured such default within 60 days after the giving of such notice (the "Cure Period) then the Party not in default may, at its option and in addition to its other remedies under law, terminate this Agreement by giving the defaulting Party notice of such termination within fifteen (15) days after the end of the Cure Period.

9.03 Bankruptcy.

To the extent allowed under applicable law, either Party may terminate this Agreement if, at any time, the other Party shall file in any court or agency pursuant to any statute or regulation of any state or country, a petition in bankruptcy or insolvency or for reorganization or for an arrangement or for the appointment of a receiver or trustee of the Party or of its assets, or if the other Party proposes a written agreement of composition or extension of its debts, or if the other party shall be served with an involuntary petition against it, filed in any insolvency proceeding, and such petition shall not be dismissed or stayed within 60 days after the filing thereof, or if the other Party shall propose or be a party to any dissolution or liquidation, or if the other Party shall make an assignment for the benefit of creditors.

9.04 ***.

***

9.05 Effect of Termination: Survival

Termination of this Agreement for any reason shall not release either Party from any liability or obligation to the other Party that matured prior to the effective date of such termination. Either Party may, however, after the effective date of such termination, sell Products then on hand or in the process of manufacture at the time of such termination, provided that each Party shall pay to the other Party the royalties thereon as required of this Agreement and shall submit the reports required by Article 3 hereof on the sales of such Products. The provisions of Articles 1, 4, 10, 11, 12 (except for Section 12.04) and 13 and Sections 3.01(c), 3.02(c) and 9.05 of this Agreement shall survive termination or expiration of this Agreement for any reason. Except as otherwise provided in this Section 9.05, all rights and obligations of the parties under this Agreement shall terminate upon the expiration or termination of this Agreement.

10. **RESOLUTION OF DISPUTES**

All disputes arising between the Parties with respect to or as a result of this Agreement shall be resolved by arbitration before a three member panel pursuant to the rules of the International Chamber of Commerce. Such proceedings shall be brought and maintained in London, England if initiated by SCI and in San Francisco, California, USA, if initiated by ReN.

The arbitrators' ruling shall be, in the absence of fraud or manifest error, binding and conclusive upon both Parties and may be enforced in a court of competent jurisdiction. The arbitrators may not award punitive or exemplary damages but may, in their discretion, award costs and attorneys' fees to the prevailing Party.

Notwithstanding the foregoing, either Party shall have the right, without waiving any right or remedy available to such Party under this Agreement or otherwise, to seek and obtain from any court of competent jurisdiction any interim or provisional relief that is necessary or desirable to protect the rights or property of such Party, pending the selection of the arbitrators hereunder or pending the arbitrator's determination of any dispute hereunder.

11. SETTLEMENT OF CLAIMS

11.01 No Admission of Liability. By entering into this Agreement, ReN admits to no liability or wrong-doing with respect to infringement of the SCI Patent Rights.

11.02 Past Claims. In consideration of the covenants and agreements contained herein, SCI, on behalf of itself and on behalf of its predecessors, successors, assigns, and Affiliates (collectively, the "Releasors"), hereby releases and forever discharges ReN, its predecessors, successors, assigns, Affiliates, employees, officers, and directors from any all claims, actions, suits or demands (and any resulting liabilities, costs, expense and losses of any type), whether known or unknown, fixed or contingent, that the Releasors had or now have: (a) for past infringement of the SCI Patent Rights, or (b) which were asserted in the action brought by SCI against ReN in the United States District Court for the District of Maryland prior to the Effective Date. SCI represents and warrants that there has been no assignment, transfer or other disposition of any interest in any of the subject matter released in the preceding sentence.

11.03 Waiver. All rights under Section 1542 of the Civil Code of the State of California, and under any and all similar laws of any governmental entity, are hereby expressly waived. Each party is aware that said Section 1542 of the Civil Code provides as follows:

> "A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor."

11.04 Full Settlement. The Parties agree that this Agreement (together with the Subscription Agreement) is in full and complete settlement of any rights that either Party (or any of its successors, licensees or assigns) may have against the other Party in connection with

infringement of the Patent Rights of the other Party prior to the Effective Date. This Agreement may be pleaded as full and complete defense to any action, suit or claim and may be used as an injunction against any such action, suit, claim, or other proceeding of any type which may be prosecuted, initiated or attempted in violation of the terms hereof. The prevailing Party shall be entitled to receive from the other Party the Prevailing Party's reasonable attorneys' fees and other related legal expenses incurred in defending against any suit, action or claim brought to enforce the terms and conditions of this Agreement.

12. INDEMNIFICATION AND INSURANCE

12.01 Indemnification by ReN. ReN hereby agrees to defend, hold harmless and indemnify (collectively "Indemnify") SCI and its Affiliates, and its and their agents, directors, officers and employees (the "SCI Indemnitees") from and against any and all liabilities, expenses, damages and/or losses (including without limitation reasonable legal expenses and attorneys' fees) (collectively "Losses") resulting from suits, claims, actions and demands, in each case brought by a Third Party (each, a "Third-Party Claim"), arising directly or indirectly out of: (i) a breach of any of ReN's representations and warranties pursuant to this Agreement; or (ii) the research, development, manufacture, storage, handling, use, sale, offer for sale, distribution or importation of Products by ReN and/or its Affiliates and/or its sublicensees hereunder. ReN's obligation to Indemnify the SCI Indemnitees pursuant to this Section 12.01 shall not apply to the extent that any such Losses (A) arise from the negligence or intentional misconduct of any SCI Indemnitee; (B) arise from any breach by SCI of this Agreement; or (C) are Losses for which SCI is obligated to Indemnify ReN Indemnitees pursuant to Section 12.02, below.

12.02 Indemnification by SCI. SCI hereby agrees to Indemnify ReN and its Affiliates, and its and their agents, directors, officers and employees (the "ReN Indemnitees") from and against any and all Losses resulting from Third-Party Claims arising directly or indirectly out of:(i) a breach of any of SCI's representations and warranties pursuant to this Agreement; or (ii) the research, development, manufacture, storage, handling, use, sale, offer for sale, distribution or importation of Products by SCI and/or its Affiliates and/or its sublicensees hereunder. SCI's obligation to Indemnify ReN Indemnitees pursuant to the foregoing sentence shall not apply to the extent that any such Losses (A) arise from the negligence or intentional misconduct of any ReN Indemnitee; (B) arise from any breach by ReN of this Agreement; or (C) are Losses for which ReN is obligated to Indemnify the ReN Indemnitees pursuant to Section 12.01, above.

12.03 Procedure. To be eligible to be indemnified hereunder, the indemnified Party shall provide the indemnifying Party with prompt notice of the Third-Party Claim giving rise to the indemnification obligation pursuant to this Article 12 and the exclusive ability to defend (with the reasonable cooperation of the indemnified Party) or settle any such claim; provided, *however*, that the indemnifying Party shall not enter into any acknowledgement of liability nor settlement for damages other than monetary damages without the indemnified Party's written consent, such consent not to be unreasonably withheld or delayed. The indemnified Party shall have the right to participate, at its own expense and with counsel of its choice, in the defense of any claim or suit that has been assumed by the indemnifying Party. If the Parties cannot agree as to the application of Section 12.01 or 12.02 to any particular Third Party Claim, the Parties may conduct separate defenses of such Third Party Claim. Each Party reserves the right to claim indemnity from the other in accordance with Sections 12.01 and 12.02, above, upon resolution of

the underlying claim, notwithstanding the provisions of this Section 12.03 requiring the indemnified Party to tender to the indemnifying Party the exclusive ability to defend such claim or suit.

12.04 Insurance. Each Party shall procure and maintain levels of product liability and general liability insurance which are consistent with normal business practices of prudent companies similarly situated, at all times during which any Product is being clinically tested in human subjects or commercially distributed or sold by or on behalf of such Party. It is understood that such insurance or self-insurance shall not be construed to create a limit of either Party's liability with respect to its indemnification obligations under this Article 12. Each Party shall provide the other with written evidence of such insurance upon request.

12.05 Limitation of Liability. WITHOUT LIMITING EITHER PARTY'S INDEMNIFICATION OBLIGATIONS UNDER ARTICLE 12, NEITHER PARTY NOR ITS RESPECTIVE AFFILIATES AND LICENSEES SHALL BE LIABLE FOR SPECIAL, EXEMPLARY, CONSEQUENTIAL OR PUNITIVE DAMAGES, WHETHER IN CONTRACT, WARRANTY, TORT, STRICT LIABILITY OR OTHERWISE.

13. MISCELLANEOUS

13.01 Publicity.

Neither party will use the name of the other Party in any advertising or promotions, communicate, comment or originate any publicity, news release or other public announcement, written or oral, without the prior written approval of the other party except as otherwise required by applicable law, regulation, court order or the rules of stock exchanges and any other applicable regulatory authorities.

13.02 Governing Law.

This Agreement shall be governed by and interpreted in accordance with the laws of the State of California, without regard to conflicts of laws principles.

13.03 Force Majeure.

In the event that either Party is prevented from performing or is unable to perform any of its obligations under this Agreement due to any act of God; fire; casualty; flood; war; act of terrorism; strike; lockout; failure of public utilities; injunction or any act, exercise, assertion or requirement of governmental authority, including any governmental law, order or regulation permanently or temporarily prohibiting or reducing the level of research development or production work hereunder or the manufacture, use or sale of Products; epidemic; destruction or production facilities; riots; insurrection; inability to procure or use materials, labor, equipment, transportation or energy sufficient to meet experimentation or manufacturing needs; or any other cause beyond the reasonable control of the Party invoking this Section 13.03 if such Party shall have used its reasonable best efforts to avoid such occurrence, such Party shall give notice to the other party in writing promptly, and thereupon the affected Party's performance shall be

excused, and the time for performance shall be extended for the period of delay or inability to perform due to such occurrence. At the end of such period, the Party whose performance is excused shall give prompt notice to the other Party.

13.04 Waiver.

The waiver by either Party of a breach or a default of any provision of this Agreement by the other Party shall not be construed as a waiver of any succeeding breach of the same or any other provision, nor shall any delay or omission on the part of either Party to exercise or avail itself of any right, power or privilege that it has or may have hereunder operate as a waiver of any right, power or privilege by such Party.

13.05 Notices.

Any notice or other communication in connection with this Agreement must be in writing and delivered either personally by facsimile or by certified mail, return receipt requested, and shall be effective when delivered to the addressee at the address specified above or such other address as the addressee shall have specified in a notice actually received by the addressor.

13.06 No Agency.

Nothing herein shall be deemed to constitute either Party as the agent or representative of the other Party, or both Parties as joint venturers or partners for any purpose. Each Party shall be an independent contractor, not an employee or partner of the other. Neither Party shall be responsible for the acts or omission authority to speak for, represent or obligate the other Party in any way without prior written authority from the other Party.

13.07 Entire Agreement.

This Agreement contains the full understanding of the parties with respect to the subject matter hereof. No waiver, alteration or modification of any of the provisions hereof shall be binding unless made in writing and signed by the Parties by their respective officers thereunto duly authorized.

13.08 Headings.

The headings contained in this Agreement are for convenience of reference only and shall not be considered in construing this Agreement.

13.09 Severability.

In the event that any provision of this Agreement is to be unenforceable because it is invalid or any relevant jurisdiction, the validity of the remaining provision obligations of the Parties shall, in the jurisdictions to be unenforceable, be construed and enforced particular provisions held to be unenforceable.

13.10 Patent Marking.

All packaging containing individual Products, and/or documentation therefor, and/or to the extent possible any Products sold by or by authorization of any Party, shall be marked permanently and legibly with the number of each applicable patent(s) licensed hereunder in accordance with each country's patent laws, including Title 35, United States Code.

13.11 Successors and Assigns.

This Agreement shall be binding upon and inure to the benefit of the Parties hereto and their successors and permitted assigns.

13.12 Counterparts.

This Agreement may be executed in any number of counterparts (which shall include facsimile counterparts), each of which shall be deemed an original but all of which taken together shall constitute one and the same instrument.

13.13 Recordation.

Each Party shall have the right, at its cost, at any time, to record or register an acknowledgement of the licenses granted under this Agreement in any applicable patent office or other appropriate facility, and the other Party shall provide reasonable assistance in effecting such recording.

13.14 Joint Drafting.

This Agreement was jointly drafted and prepared by both Parties hereto and no presumption in favor of or against any Party hereto shall be made with respect to the interpretation of any provision of this Agreement.

IN WITNESS WHEREOF, the Parties hereto have caused this Agreement to be executed in their names by their properly and duly authorized officers or representatives as of the date first above written.

RENEURON LIMITED

By: /s/ Michael Hunt

Title: Chief Executive Officer

STEMCELLS, INC.

By: /s/ Martin McGlynn

Title: President and Chief Executive Officer

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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) 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

(d) 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 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 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 controls 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 28, 2005

/s/ Martin McGlynn

Martin McGlynn
President and Chief Executive Officer

Exhibit 31.2

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

I, Judi Lum, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) 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

(d) 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 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 controls 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 28, 2005

/s/ Judi Lum
Judi Lum
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, 2005 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 28, 2005

/s/ Martin McGlynn

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, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Judi Lum, 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 28, 2005

/s/ Judi Lum

Judi Lum
Chief Financial Officer