

FORM 10-K
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2000

OR

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

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.)

525 DEL REY AVENUE, SUITE C, SUNNYVALE, CA 94086
(Address of principal offices) (zip code)

Registrant's telephone number, including area code: (408) 731-8670

Securities registered pursuant to Section 12(b) of the Act:
NONE

Securities registered pursuant to Section 12(g) of the Act:
COMMON STOCK, $.01 PAR VALUE
JUNIOR PREFERRED STOCK PURCHASE RIGHTS
Title of class

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. /X/

Aggregate market value of Common Stock held by non-affiliates at March 20, 2001: $42,643,084. Inclusion of shares held beneficially by any person should

not be construed to indicate that such person possesses the power, direct or indirect, to direct or cause the direction of management policies of the registrant, or that such person is controlled by or under common control with the Registrant. Common stock outstanding at March 20, 2001: 20,994,035 shares.

FORWARD LOOKING STATEMENTS

This report contains certain forward-looking statements regarding, among other things, the expected results of our operations, the progress of our product development and clinical programs and of our collaborations, the need for, and timing of, additional capital and capital expenditures, strategic partner collaboration prospects, costs of manufacture of products, the protection of and the need for additional intellectual property rights, regulatory matters, the need for additional facilities and potential market opportunities. Our actual results may vary materially from those contained in such forward-looking statements because of risks to which we are subject, such as risks of lack of available funding, failure to develop strategic partnerships, delays in research, adverse results from our research or development programs, obsolescence of our technology, competition from third parties, termination of our collaborations, intellectual property rights of third parties, unavailability of needed raw materials, our failure, or our collaborators' failure, to perform, litigation, regulatory restrictions, and other risks to which we are subject.

SEE "CAUTIONARY FACTORS RELEVANT TO FORWARD-LOOKING INFORMATION" FILED HEREWITH AS EXHIBIT 99 AND INCORPORATED HEREIN BY REFERENCE.

ITEM 1.

BUSINESS

OVERVIEW

We are engaged in research aimed at the development of therapies that would use stem and progenitor cells derived from fetal or adult sources to treat, and possibly cure, human diseases and injuries such as Parkinson's disease, hepatitis, diabetes, and spinal cord injuries. The body uses certain key cells known as stem cells to produce all the functional mature cell types found in normal organs of healthy individuals. Progenitor cells are cells that have already developed from the stem cells, but can still produce one or more types of mature cells within an organ.

Many diseases, such as Alzheimer's, Parkinson's, and other degenerative diseases of the brain or nervous system, involve the failure of organs that cannot be transplanted. Other diseases, such as hepatitis and diabetes, involve organs such as the liver or pancreas that can be transplanted, but there is a very limited supply of those organs available for transplant. We estimate, based on information available to us from the Alzheimer's Association, the Centers for Disease Control, the Family Caregiver's Alliance and the Spinal Cord Injury Information Network, that these conditions affect more than 18 million people in the United States and account for more than $150 billion annually in health care costs.

Our proposed therapies are based on the transplanting of healthy human stem and progenitor cells to repair or replace central nervous system, pancreas or liver tissue that has been damaged or lost as a result of disease or injury, potentially returning patients to productive lives and significantly reducing health care costs. We believe that we have achieved significant progress in research regarding stem cells of the central nervous system through the advances we have made in the isolation, purification and transplantation of central nervous system stem and progenitor cells. We have also made advances in our research programs to discover the stem cells of the pancreas and of the liver. We have established an intellectual property position in all three areas of our

stem cell research--the central nervous system, the pancreas and the liver--by patenting our discoveries and entering into exclusive licensing arrangements. We believe that, if successfully developed, our platform of stem cell technologies may create the basis for therapies that would address a number of conditions with significant unmet medical needs.

We were formerly known as CytoTherapeutics, Inc. Until mid-1990 we had programs in a different technology, encapsulated cell therapy, as well as stem cell programs. We now focus exclusively on the discovery, development and commercialization of our proprietary platform of stem cell technologies. Effective May 2000 we changed our name to StemCells, Inc.

CELL THERAPY BACKGROUND

ROLE OF CELLS IN HUMAN HEALTH AND TRADITIONAL THERAPIES

Cells maintain normal physiological function in healthy individuals by secreting or metabolizing substances, such as sugars, amino acids, neurotransmitters and hormones, which are essential to life. When cells are damaged or destroyed, they no longer produce, metabolize or accurately regulate those substances. Impaired cellular function is associated with the progressive decline common to many degenerative diseases of the nervous system, such as Parkinson's disease, Alzheimer's disease and amyotrophic lateral sclerosis. Recent advances in medical science have identified cell loss or impaired cellular function as leading causes of degenerative diseases. Biotechnology advances have led to the identification of some of the specific substances or proteins that are deficient. While administering these substances or proteins as medication does overcome some of the limitations of traditional pharmaceuticals such as lack of specificity, there is no existing technology that can deliver them to the precise sites of action and in the appropriate physiological quantities or for the duration required to

cure the degenerative condition. Cells, however, do this naturally. As a result, investigators have considered replacing failing cells that are no longer producing the needed substances or proteins by implanting stem or progenitor cells capable of regenerating the cell that the degenerative condition has damaged or destroyed. Where there has been irreversible tissue damage or organ failure, transplantation of stem cells offers the possibility of generating new and healthy tissue, thus potentially restoring the organ function and the patient's health.

THE POTENTIAL OF OUR STEM CELL-BASED THERAPY

We believe that, if successfully developed, stem cell-based therapy--the use of stem or progenitor cells to treat diseases--has the potential to provide a broad therapeutic approach comparable in importance to traditional pharmaceuticals and genetically engineered biologics.

Stem cells are rare and only available in limited supply, whether from the patients themselves or from donors. Cells obtained from the same person who will receive them may be abnormal if the patient is ill or the tissue is contaminated with disease-causing cells. Also, the cells can often be obtained only through significant surgical procedures. The challenge, therefore, has been three-fold:

1) to identify the stem cells;

2) to create techniques and processes that can be used to expand these rare cells in sufficient quantities for effective transplants; and

3) to establish a bank of normal human stem or progenitor cells that can be used for transplantation into individuals whose own cells are not suitable because of disease or other reasons.

We have developed and demonstrated a process, based on a proprietary IN VITRO culture system in chemically defined media, that reproducibly grows normal human central nervous system, or CNS, stem and progenitor cells. We believe this

is the first reproducible process for growing normal human CNS stem cells. More recently, we have discovered markers on the cell surface that identify the human CNS stem cells. This allows us to purify them and eliminate other unwanted cell types. Together, these discoveries enable us to select normal human CNS stem cells and to expand them in culture to produce a large number of pure stem cells.

Because these cells have not been genetically modified, they may be especially suitable for transplantation and may provide a safer and more effective alternative to therapies that are based on cells derived from cancer cells, from cells modified by a cancer gene to make them grow, from an unpurified mixture of many different cell types, or from animal derived cells. We believe our proprietary stem cell technologies may enable therapies to replace specific cells that have been damaged or destroyed, permitting the restoration of function through the replacement of normal cells where this has not been possible in the past. In our research, we have shown that stem cells of the central nervous system transplanted into hosts are accepted, migrate, and successfully specialize to produce mature neurons and glial cells.

More generally, because the stem cell is the pivotal cell that produces all the functional mature cell types in an organ, we believe these cells, if successfully identified and developed for transplantation, may serve as platforms for five major areas of regenerative medicine and biotechnology:

- tissue repair and replacement,

- correction of genetic disorders,

- drug discovery and screening,

- gene discovery and use, and

- diagnostics.

We will be pursuing key alliances in these areas.

OUR PLATFORM OF STEM CELL TECHNOLOGIES

Stem cells have two defining characteristics:

- some of the cells developed from stem cells produce all the kinds of mature cells making up the particular organ; and

- they "self renew"--that is, other cells developed from stem cells are themselves new stem cells, thus permitting the process to continue again and again.

Stem cells are known to exist for many systems of the human body, including the blood and immune system, the central and peripheral nervous systems (including the brain), and the liver, pancreas endocrine, and the skin systems. These cells are responsible for organ regeneration during normal cell replacement and, to a more or less limited extent, after injury. We believe that further research and development will allow stem cells to be cultivated and administered in ways that enhance their natural function, so as to form the basis of therapies that will replace specific subsets of cells that have been damaged or lost through disease, injury or genetic defect.

We also believe that the person or entity that first identifies and isolates a stem cell and defines methods to culture any of the finite number of different types of human stem cells will be able to obtain patent protection for the methods and the composition, making the commercial development of stem cell treatment and possible cure of currently intractable diseases financially feasible.

Our strategy is to be the first to identify, isolate and patent multiple types of human stem and progenitor cells with commercial importance. Our

portfolio of issued patents includes a method of culturing normal human central nervous system stem and progenitor cells in our proprietary chemically defined medium, and our published studies show that these cultured and expanded cells give rise to all three major cell types of the central nervous system. Also, a separate study sponsored by us using these cultured stem and progenitor cells showed that the cells are accepted, migrate, and successfully specialize to produce neurons and glial cells.

More recently, we announced the results of a new study that showed that human central nervous system stem cells can be successfully isolated by markers present on the surface of freshly obtained brain cells. We believe this is the first reproducible process for isolating highly purified populations of well-characterized normal human central nervous system stem cells, and have applied for a composition of matter patent. Because the cells are highly purified and have not been genetically modified, they may be especially suitable for transplantation and may provide a safer and more effective alternative than therapies that are based on cells derived from cancer cells, or from cells modified by a cancer gene to make them grow, or from an unpurified mixture of many different cell types or cells derived from animals. We have also filed an improved process patent for the growth and expansion of these purified normal human central nervous system cells.

Neurological disorders such as Parkinson's disease, epilepsy, Alzheimer's disease, and the side effects of stroke, affect a significant portion of the U.S. population and there currently are no effective long-term therapies for them. We believe that therapies based on our process for identifying, isolating and culturing neural stem and progenitor cells may be useful in treating such diseases. We are continuing our research into, and have initiated the development of, human central nervous system stem and progenitor cell-based therapies for these diseases.

We continue to advance our research programs to discover the islet stem cell in the human pancreas and the liver stem cell. Islet cells are the cells that produce insulin, so islet stem cells may be useful in the treatment of Type 1 diabetes and those cases of Type 2 diabetes where insulin secretion is

defective. Liver stem cells may be useful in the treatment of diseases such as hepatitis, cirrhosis of the liver and liver cancer.

EXPECTED ADVANTAGES OF OUR STEM CELL TECHNOLOGY

NO OTHER TREATMENT

To the best of our knowledge, no one has developed an FDA-approved method for replacing lost or damaged tissues from the human nervous system. Replacement of tissues in other areas of the human body is limited to those few sites, such as bone marrow or peripheral blood cell transplants, where transplantation of the patient's own cells is now feasible. In a few additional areas, including the liver, transplantation of donor organs is now used, but is limited by the scarcity of organs available through donation. We believe that our stem cell technologies have the potential to reestablish function in at least some of the patients who have suffered the losses referred to above.

REPLACED CELLS PROVIDE NORMAL FUNCTION

Because stem cells can duplicate themselves, or self-renew, and specialize into the multiple kinds of cells that are commonly lost in various diseases, transplanted stem cells may be able to migrate limited distances to the proper location within the body, to expand and specialize and to replace damaged or defective cells, facilitating the return to proper function. We believe that such replacement of damaged or defective cells by functional cells is unlikely to be achieved with any other treatment.

RESEARCH EFFORTS AND PRODUCT DEVELOPMENT PROGRAMS

OVERVIEW OF RESEARCH AND PRODUCT DEVELOPMENT STRATEGY

We have devoted substantial resources to our research programs to isolate and develop a series of stem and progenitor cells that we believe can serve as a basis for replacing diseased or injured cells. Our efforts to date have been directed at methods to identify, isolate and culture large varieties of stem and progenitor cells of the human nervous system, liver and pancreas and to develop therapies utilizing these stem and progenitor cells.

The following table lists the potential therapeutic indications for, and current status of, our primary research and product development programs and projects. The table is qualified in its entirety by reference to the more detailed descriptions of such programs and projects appearing elsewhere in this prospectus. We continually evaluate our research and product development efforts and reallocate resources among existing programs or to new programs in light of experimental results, commercial potential, availability of third party funding, likelihood of near-term efficacy, collaboration success or significant technology enhancement, as well as other factors. Our research and product development programs are at relatively early stages of development and will require substantial resources to commercialize.

RESEARCH AND PRODUCT DEVELOPMENT PROGRAMS

PROGRAM DESCRIPTION AND OBJECTIVE	STAGE/STATUS(1)
HUMAN NEURAL STEM CELL	PRECLINICAL
Repair or replace damaged central nervous system tissue (including spinal cord, degenerated retinas and tissue affected by certain genetic disorders)	- Demonstrated IN VITRO the ability to initiate and expand stem cell-containing human neural cultures and specialization into three types of central nervous system cells - Demonstrated the ability of neurosphere-initiating stem cells from human brain - Demonstrated in rodent studies that transplanted human brain-derived stem cells are accepted and properly specialized into the three major cell types of the central nervous system
PANCREAS ISLET STEM CELL	RESEARCH
Repair or replace damaged pancreas islet tissue	- Identified markers on the surface of cells to identify, isolate and culture islet stem cells of the pancreas - Commenced small animal testing
LIVER STEM CELL	RESEARCH
Repair or replace damaged liver tissue including tissue resulting from certain metabolic genetic diseases	- Demonstrated the production of hepatocytes from purified mouse hematopoietic stem cells - Identified IN VITRO culture assay for growth of human bipotent liver progenitor cells that can produce both bile duct and hepatocytes - Showed that the in vitro culture of human bipotent liver cells can also grow human hepatitis virus

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(1) "Research" refers to early stage research and product development activities IN VITRO, including the selection and characterization of product candidates for preclinical testing. "Preclinical" refers to further testing of a defined product candidate IN VITRO and in animals prior to clinical studies.

RESEARCH AND DEVELOPMENT PROGRAMS

Our portfolio of stem cell technology results from our exclusive licensing of central nervous system, stem and progenitor cell technology, animal models for the identification and/or testing of stem and progenitor cells and our own

research and development efforts to date. We believe that therapies using stem cells represent a fundamentally new approach to the treatment of diseases caused by lost or damaged tissue. We have assembled an experienced team of scientists and scientific advisors to consult with and advise our scientists on their continuing research and development of stem and progenitor cells. This team includes, among others, Irving L. Weissman, M.D., of Stanford University, Fred H. Gage, Ph.D., of The Salk Institute and David Anderson, Ph.D., of the California Institute of Technology.

BRAIN STEM AND PROGENITOR CELL RESEARCH AND DEVELOPMENT PROGRAM

We began our work with central nervous system stem and progenitor cell cultures in collaboration with NeuroSpheres, Ltd., in 1992. We believe that NeuroSpheres was the first to invent these cultures.

We are the exclusive, worldwide licensee from NeuroSpheres to such inventions and associated patents and patent applications for all uses, including transplantation in the human body, as embodied in these patents. See "License Agreements and Sponsored Research Agreements--NeuroSpheres, Ltd."

In 1997, our scientists invented a reproducible method for growing human CNS, stem and progenitor cells in cultures. In preclinical IN VITRO and early IN VIVO studies, we demonstrated that these cells specialize into all three of the cell types of the central nervous system. Because of these results, we believe that these cells may form the basis for replacement of cells lost in certain degenerative diseases. We are continuing research into, and have initiated the development of, our human CNS stem and progenitor cell cultures. We have initiated the cultures and demonstrated that these cultures can be expanded for a number of generations IN VITRO in chemically defined media. In collaboration with us, Dr. Anders Bjorklund has shown that cells from these cultures can be successfully transplanted and accepted into the brains of rodents where they subsequently migrated and specialized into the appropriate cell types for the site of the brain into which they were placed.

In 1998, we expanded our preclinical efforts in this area by initiating programs aimed at the discovery and use of specific monoclonal antibodies to facilitate identification and isolation of CNS and other stem and progenitor cells or their specialized progeny. Also in 1998, our researchers devised methods to advance the IN VITRO culture and passage of human CNS stem cells that resulted in a 100-fold increase in CNS stem and progenitor cell production after 6 passages. A U.S. patent on those methods has since been allowed. We are expanding our preclinical efforts toward the goal of selecting the proper indications to pursue.

In December 1998, we announced that the US Patent and Trademark Office had granted patent No. 5,851,832, covering our methods for the human CNS cell cultures containing central nervous system stem cells, for compositions of human CNS cells expanded by these methods, and for use of these cultures in human transplantation. These human CNS stem and progenitor cells expanded in culture may be useful for repairing or replacing damaged central nervous system tissue, including the brain and the spinal cord.

In October 1999, the US Patent and Trademark Office granted patent number 5,968,829 entitled "Human CNS Neural Stem Cells," covering our composition of matter patent for human CNS stem cells, and also allowed a separate patent application for our media for culturing human CNS stem cells.

Also in 1999, we announced the filing of a US patent application covering our proprietary process for the direct isolation of normal human CNS stem cells based on the markers found to be present on the surface of freshly obtained brain cells. Since the filing of this patent application, our researchers have completed a study designed to identify, isolate and culture human CNS stem cells utilizing this proprietary process. In November 1999, we announced the study's first results: Our researchers, by using our proprietary markers on the surface of the cell, had succeeded in identifying, isolating and purifying human CNS stem cells from brain tissue, and were able to expand the number of these cells

in culture.

We believe that this is the first study to show a reproducible process for isolating highly purified populations of well-characterized normal human CNS stem cells. Because the cells are normal human CNS stem cells and have not been genetically modified, they may be especially suitable for transplantation and may provide a safer and more effective alternative to therapies that are based on cells derived from cancer cells or from an unpurified mix of many different cell types, or from animal derived cells.

In January 2000, we reported what we regard as an even more important result: In long term animal studies, our researchers were able to take these purified and expanded stem cells and transplant them into the normal brains of immunodeficient mouse hosts, where they take hold and grow into neurons and glial cells.

During the course of the study, the transplanted human CNS stem cells survived for as long as one year and migrated to specific functional domains of the host brain, with no sign of tumor formation or adverse effects on the animal recipients; moreover, the cells were still dividing. These findings show that when CNS stem cells isolated and cultured with our proprietary processes are transplanted, they adopt the characteristics of the host brain and act like normal stem cells. In other words, the study suggests the possibility of a continual replenishment of normal human brain cells.

As noted above, human CNS stem and progenitor cells harvested and purified and expanded using our proprietary processes may be useful for creating therapies for the treatment of degenerative brain diseases such as Parkinson's, Huntington's and Alzheimer's disease. These conditions affect more than 5 million people in the United States and there are no effective long-term therapies currently available. We believe the ability to purify human brain stem cells directly from fresh tissue is important because:

- it provides an enriched source of normal stem cells, not contaminated by other unwanted or diseased cell types, that can be expanded in culture without fear of also expanding some unwanted cell types;

- it opens the way to a better understanding of the properties of these cells and how they might be manipulated to treat specific diseases. For example, in certain genetic diseases such as Tay Sachs and Gaucher's, a key metabolic enzyme required for normal development and function of the brain is absent. Brain-derived stem cell cultures might be genetically modified to produce those proteins. The modified brain stem cells could be transplanted into patients with these genetic diseases;

- the efficient acceptance of these non-transformed normal human stem cells into host brains means that the cell product can be tested in animal models for its ability to correct deficiencies caused by various human neurological diseases. This technology could also provide a unique animal model for the testing of drugs that act on human brain cells either for effectiveness of the drug against the disease or its toxicity to human nerve cells.

PANCREAS STEM CELLS DISCOVERY RESEARCH PROGRAMS

Our discovery program directed to the identification, isolation and culturing of the pancreas stem and progenitor cells has, to the present, been conducted by Nora Sarvetnick, Ph.D., of The Scripps Research Institute, in collaboration with some of our senior researchers. It is our intention to bring the research on stem and progenitor cells of the pancreas in house We expect that Dr. Sarvetnick will continue to consult with us.

According to diabetes and juvenile diabetes foundations, between 800,000 and 1.5 million Americans have Type 1 diabetes, which is often called "juvenile diabetes" and most commonly diagnosed in childhood; and 30,000 new patients are diagnosed with the disease every year. It is a costly, serious, lifelong

condition, requiring constant attention and insulin injections every day for survival.

About 15 million other people in the United States have Type 2 diabetes mellitus, which is also a chronic and potentially fatal condition; and more than 700,000 new patients are diagnosed annually.

In 1998, we obtained an exclusive, worldwide license from The Scripps Research Institute to novel technology developed by Dr. Sarvetnick which may facilitate the identification and isolation of pancreas stem and progenitor cells by using a mouse model that continuously regenerates the pancreas. We believe that stem cells produce the regeneration, in which case this animal model may be useful for identifying specific markers on the cell surface unique to the pancreas stem cells. We believe this may lead to the development of cell-based treatments for Type 1 diabetes and that portion of Type 2 diabetes characterized by defective secretion of insulin.

In 1999, advances in the research sponsored by us resulted in our obtaining additional exclusive, worldwide licenses from The Scripps Research Institute to novel markers on the cell surface identified by Dr. Sarvetnick and her research team as being unique to the pancreas islet stem cell for which we have now filed a US patent application. In collaboration with Dr. Sarvetnick, we continue to advance the discovery program directed at the identification, isolation and culturing of pancreas stem and progenitor cells utilizing this technology.

LIVER STEM CELLS DISCOVERY RESEARCH PROGRAMS

We initiated our discovery work for the liver stem and progenitor cell through a sponsored research agreement with Markus Grompe, Ph.D., of Oregon Health Sciences University. Dr. Grompe's work focuses on the discovery and development of a suitable method for identifying and assessing liver stem and progenitor cells for use in transplantation. We have also obtained a worldwide exclusive license to a novel mouse model of liver failure for evaluating cell transplantation developed by Dr. Grompe.

Approximately 1 in 10 Americans suffers from diseases and disorders of the liver for which there are currently no effective, long-term treatments. In 1998, our researchers continued to advance methods for establishing enriched cell populations suitable for transplantation in preclinical animal models. We are focused on discovering and utilizing our proprietary methods to identify, isolate and culture liver stem and progenitor cells and to evaluate these cells in preclinical animal models.

In 1999, our researchers devised a culture assay that we will use in our efforts to identify liver stem and progenitor cells. In addition to supporting the growth of an early human liver bipotent progenitor cell, it is also possible to infect this culture with human hepatitis virus, providing a valuable system for study of the virus. This technology could also provide a unique IN VITRO model for the testing of drugs that act on, or are metabolized by, human liver cells.

An important element of our stem cell discovery program is the further development of intellectual property positions with respect to stem and progenitor cells. We have also obtained rights to certain inventions relating to stem cells from, and are conducting stem cell related research at, several academic institutions. We expect to expand our search for new stem and progenitor cells and to seek to acquire rights to additional inventions relating to stem and progenitor cells from third parties.

WIND-DOWN OF ENCAPSULATED CELL THERAPY RESEARCH AND DEVELOPMENT PROGRAMS

Until mid-1999, we engaged in research and development in encapsulated cell therapy technology, or ECT, including a pain control program funded by AstraZeneca Group plc. The results from the 85-patient double-blind, placebo-controlled trial of our encapsulated bovine cell implant for the treatment of severe, chronic pain in cancer patients did not, however, meet the

criteria AstraZeneca had established for continuing trials for the therapy, and in June 1999, AstraZeneca terminated the collaboration.

Consequently, in July 1999, we announced plans for the restructuring of our research operations to abandon all further ECT research and to concentrate our resources on the research and development of our proprietary platform of stem cell technology. We reduced our workforce by approximately 68 full-time employees who had been focused on ECT programs, wound down our research and manufacturing operations in Lincoln, Rhode Island, and relocated our remaining research and development activities, and our corporate headquarters, to the facilities of our wholly owned subsidiary, StemCells California, Inc., in Sunnyvale, California. We are actively seeking to sublease, assign or sell our interest in our former corporate headquarters building and our pilot manufacturing and cell processing facility in Rhode Island.

In December 1999 we sold our intellectual property assets related to our ECT to Neurotech S.A., a privately held French company, in exchange for a payment of $3 million, royalties on future product sales, and a portion of certain revenues Neurotech may in the future receive from third parties. We retained certain non-exclusive rights to use the ECT in combination with our proprietary stem cell technology, and in the field of vaccines for prevention and treatment of infectious diseases.

In a related development, by mutual consent we and the Advanced Technology Program of the National Institute of Standards and Technology terminated two grants previously awarded to us for our encapsulated cell therapy and stem cell-related research. The encapsulated cell therapy grant was obviated by the sale of the technology to Neurotech. The funding agency has invited us to resubmit a proposal consistent with the new directions we are taking in our research and development of our platform of stem cell technologies.

SUBSIDIARY

STEMCELLS CALIFORNIA, INC.

On September 26, 1997, we acquired by merger StemCells, Inc. (now StemCells California, Inc.), a California corporation, in exchange for 1,320,691 shares of our common stock and options and warrants for the purchase of 259,296 common shares. Simultaneously with the acquisition, its President, Richard M. Rose, M.D., became our President, Chief Executive Officer and a director, and Irving L. Weissman, M.D., a founder of the California corporation, became a member of our board of directors. We, as the sole stockholder of our subsidiary, voted on February 23, 2000, to amend its Certificate of Incorporation to change its name to StemCells California, Inc.

CORPORATE COLLABORATIONS

CORPORATE INVESTMENT

In July 1996, we, together with certain founding scientists, established Modex Therapeutics SA, a Swiss biotherapeutics company, to pursue extensions of our former technology of ECT for certain applications outside the central nervous system. Modex, headquartered in Lausanne, Switzerland, was formed to integrate technologies developed by us and by several other institutions to develop products to treat diseases such as diabetes, obesity and anemia. After our disposition of the encapsulated cell technology in December 1999, we no longer had common research or development interests with Modex, but we held approximate 17% of its stock. Modex completed an initial public offering on June 23, 2000, in the course of which we realized a gain of approximately $1.4 million from the sale of certain shares. After Modex's IPO, we owned 126,193 shares, or approximately 9%, of Modex's equity, subject to a lockup until December 23, 2000. The closing market price of Modex stock on the Swiss Neue Market exchange on January 2, 2001 was 210.00 Swiss francs, or approximately $130.39, per share. On January 9, 2001, we sold 22,616 Modex shares for a net price of 182.00 Swiss francs per share, which converts to $112.76 per share, for total proceeds of approximately $2,550,000. In connection

with this sale, we agreed not to resell any more of our remaining 103,577 Modex shares until April 12, 2001. The market value of our Modex holdings at March 27, 2001 was $8,732,797 based on the closing market price of Modex stock on the Swiss Neue Market exchange at that date of 145.00 Swiss francs per share, or approximately $84.31, per share.

LICENSE AGREEMENTS AND SPONSORED RESEARCH AGREEMENTS

SPONSORED RESEARCH AGREEMENTS

Under Sponsored Research Agreements with The Scripps Research Institute and Oregon Health Sciences University, we funded certain research in return for licenses or options to license the inventions resulting from the research. We have also entered into license agreements with the

California Institute of Technology. All of these agreements relate largely to stem or progenitor cells and or to processes and methods for the isolation, identification, expansion or culturing of stem or progenitor cells.

Our research agreement with Scripps expired on November 14, 2000. It is our intention to bring the research on stem and progenitor cells of the pancreas in house. Dr. Nora Sarvetnick, who led the research at Scripps, will continue to consult with us. Our license agreements with Scripps are not affected by the expiration of the research agreement. They will terminate upon expiration, revocation or invalidation of the patents licensed to us, unless governmental regulations require a shorter term. These license agreements also will terminate earlier if we breach without curing our obligations under the agreement or if we declare bankruptcy, and we can terminate the license agreements at any time upon notice. Upon the initiation of the Phase II trial for our first product using Scripps licensed technology, we must pay Scripps $50,000 and upon completion of that Phase II trial we must pay Scripps an additional $125,000. Upon approval of the first product for sale in the market, we must pay Scripps $250,000. Our license agreements with the California Institute of Technology will expire upon expiration, revocation, invalidation or abandonment of the patents licensed to us. We can terminate any of these license agreements by giving 30 days' notice to the California Institute of Technology. Either party can terminate these license agreements upon a material breach by the other party. We issued 12,800 shares of common stock amounting to $10,000 to the California Institute of Technology upon execution of the license agreements, and we must pay an additional $10,000 upon the issuance of the patent licensed to us under the relevant agreement. We also will pay $5,000 on the anniversary of the issuance of the patent licensed to us under the relevant agreement. These amounts are creditable against royalties we must pay under the license agreements. The maximum royalties that we will have to pay to the California Institute of Technology will be $2 million per year, with an overall maximum of $15 million. Once we pay the $15 million maximum royalty, the licenses will become fully paid and irrevocable.

LICENSE AGREEMENTS

We have entered into a number of license agreements with commercial and non-profit institutions, as well as a number of research-plus-license agreements with academic organizations. The research agreements provide that we will fund certain research costs, and in return, will have a license or an option for a license to the resulting inventions. Under the license agreements, we will typically be subject to obligations of due diligence and the requirement to pay royalties on products that use patented technology licensed under such agreements.

SIGNAL PHARMACEUTICALS, INC.

In December 1997, we entered into two license agreements with Signal Pharmaceuticals, Inc. under which each party licensed to the other certain patent rights and biological materials for use in defined fields. An initial disagreement as to the interpretation of the licensed rights was resolved by the parties, and the agreements are operating in accordance with their terms. Signal

has now been acquired by Celgene. Each agreement with Signal will terminate at the expiration of all patents licensed under it, but the licensing party can terminate earlier if the other party breaches its obligations under the agreement or declares bankruptcy. Also, the party receiving the license can terminate the agreement at any time upon notice to the other party. Under these agreements, we must reimburse Signal for payments it must make to the University of California based on products we develop and for 50% of certain other payments Signal must make.

NEUROSPHERES, LTD.

In March 1994, we entered into a Contract Research and License Agreement with NeuroSpheres, Ltd., which was clarified in a License Agreement dated as of April 1, 1997. Under the agreement as clarified, we obtained an exclusive patent license from NeuroSpheres in the field of transplantation, subject to a limited right of NeuroSpheres to purchase a nonexclusive license from us, which right was not exercised and has expired. We have developed additional intellectual property relating to the subject matter of the license. We entered into an additional license agreement with NeuroSpheres as of October 30, 2000, under which we obtained an exclusive license in the field of non-transplant uses, such as drug discovery and drug testing, so that together the licenses are exclusive for all uses of the technology. We made up-front payments to NeuroSpheres of 65,000 shares of our common stock in October 2000 and $50,000 in January 2001, and we will make additional cash payments when milestones are achieved in the non-transplant field, or in any products employing NeuroSpheres patents for generating cells of the blood and immune system from neural stem cells. In addition we reimbursed Neurospheres for patent costs amounting to $341,000. Milestone payments would total $500,000 for each product that is approved for market. Our agreements with NeuroSpheres will terminate at the expiration of all patents licensed to us, but can terminate earlier if we breach without curing our obligations under the agreement or if we declare bankruptcy. We would have a security interest in the licensed technology in the event that NeuroSpheres declares bankruptcy.

MANUFACTURING

The keys to successful commercialization of brain stem and progenitor cells are efficacy, safety, consistency of the product, and economy of the process. We expect to address these issues by appropriate testing and banking representative vials of large-scale cultures. Commercial production is expected to involve expansion of banked cells and packaging them in appropriate containers after formulating the cells in an effective carrier. The carrier may also be used to improve the stability and acceptance of the stem cells or their progeny. Because of the early stage of our stem and progenitor cell programs, all of the issues that will affect manufacture of stem and progenitor cell products are not yet clear.

MARKETING

We expect to market and sell our products primarily through co-marketing, licensing or other arrangements with third parties. There are a number of substantial companies with existing distribution channels and large marketing resources who are well equipped to market and sell our products. It is our intent to have the marketing of our products undertaken by such partners, although we may seek to retain limited marketing rights in specific narrow markets where the product may be addressed by a specialty or niche sales force.

PATENTS, PROPRIETARY RIGHTS AND LICENSES

We believe that proprietary protection of our inventions will be of major importance to our future business. We have an aggressive program of vigorously seeking and protecting our intellectual property which we believe might be useful in connection with our products. We believe that our know-how will also provide a significant competitive advantage, and we intend to continue to develop and protect our proprietary know-how. We may also from time to time seek to acquire licenses to important externally developed technologies.

We have exclusive or non-exclusive rights to a portfolio of patents and patent applications related to various stem and progenitor cells and methods of deriving and using them. These patents and patent applications relate mainly to compositions of matter, methods of obtaining such cells, and methods for preparing, transplanting and utilizing such cells. Currently, our U.S. patent portfolio in the stem cell

therapy area includes twenty-two issued U.S. patents, seven of which issued in 2000. An additional twenty-seven patent applications are pending, five of which have been allowed.

We own, or have filed, the following United States Patents and patent applications: U.S. Patent Number 5,968,829 (Human CNS neural stem cells); U.S. Patent Number 6,103,530 (Human CNS neural stem cells--culture media); Application Number WO 99/11758 (Cultures of human CNS neural stem cells); and Application Number WO 00/36091 (An animal model for identifying a common stem/ progenitor to liver cells and pancreatic cells); Application Number WO98/50526 (Generation, characterization, and isolation of neuroepithelial stem cells and lineage restricted intermediate precursor); Application Number WO 00/50572 (Use of collagenase in the preparation of neural stem cell cultures); and Application Number WO 00/47762 (Enriched neural stem cell populations and methods of identifying, isolating, and enriching neural stem cells).

We have licensed the following United States Patents or pending patent applications from Neurospheres Holdings Ltd.: U.S. Patent Number 5,851,832 (IN VITRO proliferation); U.S. Patent Number 5,750,376 (IN VITRO genetic modification); U.S. Patent Number 5,981,165 (IN VITRO production of dopaminergic cells from mammalian central nervous system multipotent stem cell compositions); U.S. Patent Number 6,093,531 (Generation of hematopoietic cells from multipotent neural stem cells); U.S. Patent Number 5,980,885 (Methods for inducing IN VIVO proliferation of precursor cells); U.S. Patent Number 6,071,889 (Methods for IN VIVO transfer of a nucleic acid sequence to proliferating neural cells); U.S. Patent Number 6,165,783 (Methods of inducing differentiation of multipotent neural stem cells); Application Number WO 93/01275 (Mammalian central nervous system multipotent stem cell compositions); Application Number WO 94/09119 (Remyelination using mammalian central nervous system multipotent stem cell compositions); Application Number WO 94/10292 (Biological factors useful in differentiating mammalian central nervous system multipotent stem cell compositions); Application Number WO 94/16718 (Genetically engineered mammalian central nervous system multipotent stem cell compositions); Application Number WO 96/15224 (Differentiation of mammalian central nervous system multipotent stem cell compositions); Application Number WO 99/2196 (Erythropoietin-mediated neurogenesis); Application Number WO 99/16863 (Generation of hematopoietic cells); Application Number WO 98/22127 (Pretreatment with growth factors to protect against CNS damage); Application Number WO 97/3560 (IN SITU manipulation of cells of the hippocampus); Application Number WO 96/09543 (IN VITRO models of CNS functions and dysfunctions); Application Number WO 95/13364 (IN SITU modification and manipulation of stem cells of the CNS); Application Number WO 96/15226 (IN VITRO production of dopaminergic cells from mammalian central nervous system multipotent stem cell composition); and Application Number WO 96/15266 (Regulation of neural stem cell proliferation).

We have licensed the following United States Patents or pending patent applications from the University of California, San Diego: U.S. Patent Number 5,776,948 (Method of production of neuroblasts); U.S. Patent Number 6,013,521 (Method of production of neuroblasts); U.S. Patent Number 6,020,197 (Method of production of neuroblasts); and Application Number WO 94/16059 (Method of production of neuroblasts).

We have licensed the following United States Patents or pending patent applications from the California Institute of Technology: U.S. Patent Number 5,629,159 (Immortalization and disimmortalization of cells); Application Number WO 96/40877 (Immortalization and disimmortalization of cells); U.S. Patent Number 5,935,811 (Neuron restrictive silencer factor proteins); Application Number WO 96/27665 (Neuron restrictive silencer factor proteins); U.S. Patent

Number 5,589,376 (Mammalian neural crest stem cells); U.S. Patent Number 5,824,489 (Methods for isolating mammalian multipotent neural crest stem cells); Application Number WO 94/02593 (Mammalian neural crest stem cells); U.S. Patent Number 5,654,183 (Genetically engineered mammalian neural crest stem cells); U.S. Patent Number 5,928,947 (Mammalian multipotent neural crest stem cells); U.S. Patent Number 5,693,482 (IN VITRO neural crest stem cell assay); U.S. Patent

Number 6,001,654 (Methods for differentiating neural stem cells to neurons or smooth muscle cells (TGFb)); Application Number WO 98/48001 (Methods for differentiating neural stem cells to neurons or smooth muscle cells (TGFb)); U.S. Patent Number 5,672,499 (Methods for immortalizing multipotent neural crest stem cells); U.S. Patent Number 5,849,553 (Immortalizing and disimmortalizing multipotent neural crest stem cells); and U.S. Patent Number 6,033,906 (Differentiating mammalian neural stem cells to glial cells using neuregulins).

We also rely upon trade-secret protection for our confidential and proprietary information and take active measures to control access to that information.

Our policy is to require our employees, consultants and significant scientific collaborators and sponsored researchers to execute confidentiality agreements upon the commencement of an employment or consulting relationship with us. These agreements generally provide that all confidential information developed or made known to the individual by us during the course of the individual's relationship with us is to be kept confidential and not disclosed to third parties except in specific circumstances. In the case of employees and consultants, the agreements generally provide that all inventions conceived by the individual in the course of rendering services to us shall be our exclusive property.

We have obtained rights from universities and research institutions to technologies, processes and compounds that we believe may be important to the development of our products. These agreements typically require us to pay license fees, meet certain diligence obligations and, upon commercial introduction of certain products, pay royalties. These include exclusive license agreements with NeuroSpheres, The Scripps Institute, the California Institute of Technology and the Oregon Health Sciences University, to certain patents and know-how regarding present and certain future developments in CNS and pancreas stem cells.

The patent positions of pharmaceutical and biotechnology companies, including those of the Company, are uncertain and involve complex and evolving legal and factual questions. The coverage sought in a patent application can be denied or significantly reduced before or after the patent is issued. Consequently, the Company does not know whether any of its pending applications will result in the issuance of patents, or if any existing or future patents will provide significant protection or commercial advantage or will be circumvented by others. Since patent applications are secret until patents are issued in the United States or until the applications are published in foreign countries, and since publication of discoveries in the scientific or patent literature often lags behind actual discoveries, the Company cannot be certain that it was the first to make the inventions covered by each of its pending patent applications or that it was the first to file patent applications for such inventions. There can be no assurance that patents will issue from the Company's pending or future patent applications or, if issued, that such patents will be of commercial benefit to the Company, afford the Company adequate protection from competing products or not be challenged or declared invalid.

In the event that a third party has also filed a patent application relating to inventions claimed in Company patent applications, the Company may have to participate in interference proceedings declared by the United States Patent and Trademark Office to determine priority of invention, which could result in substantial uncertainties and cost for the Company, even if the eventual outcome is favorable to the Company. There can be no assurance that the Company's patents, if issued, would be held valid by a court of competent jurisdiction.

A number of pharmaceutical, biotechnology and other companies, universities and research institutions have filed patent applications or have been issued patents relating to cell therapy, stem cells and other technologies potentially relevant to or required by the Company's expected products. The Company cannot predict which, if any, of such applications will issue as patents or the claims that might be allowed. The Company is aware that a number of companies have filed applications relating to stem cells. The Company is also aware of a number of patent applications and patents claiming use

of genetically modified cells to treat disease, disorder or injury. The Company is aware of two patents issued to a competitor claiming certain methods for treating defective, diseased or damaged cells in the mammalian CNS by grafting genetically modified donor cells from the same mammalian species.

If third party patents or patent applications contain claims infringed by the Company's technology and such claims or claims in issued patents are ultimately determined to be valid, there can be no assurance that the Company would be able to obtain licenses to these patents at a reasonable cost, if at all, or be able to develop or obtain alternative technology. If the Company is unable to obtain such licenses at a reasonable cost, it may be adversely affected. There can be no assurance that the Company will not be obliged to defend itself in court against allegations of infringement of third party patents. Patent litigation is very expensive and could consume substantial resources and create significant uncertainties. An adverse outcome in such a suit could subject the Company to significant liabilities to third parties, require disputed rights to be licensed from third parties, or require the Company to cease using such technology.

The Company has obtained rights from universities and research institutions to technologies, processes and compounds that it believes may be important to the development of its products. These agreements typically require the Company to pay license fees, meet certain diligence obligations and, upon commercial introduction of certain products, pay royalties. These include exclusive license agreements with NeuroSpheres, The Scripps Institute, the California Institute of Technology and the Oregon Health Sciences University to certain patents and know-how regarding present and certain future developments in neural and pancreatic stem cells. The Company's licenses may be canceled or converted to non-exclusive licenses if the Company fails to use the relevant technology or the Company breaches its agreements. Loss of such licenses could expose the Company to the risks of third party patents and/or technology. There can be no assurance that any of these licenses will provide effective protection against the Company's competitors.

COMPETITION

The targeted disease states for our initial products in some instances currently have no effective long-term therapies. However, we do expect that our initial products will have to compete with a variety of therapeutic products and procedures. Major pharmaceutical companies currently offer a number of pharmaceutical products to treat neurodegenerative and liver diseases, diabetes and other diseases for which our technologies may be applicable. Many pharmaceutical and biotechnology companies are investigating new drugs and therapeutic approaches for the same purposes, which may achieve new efficacy profiles, extend the therapeutic window for such products, alter the prognosis of these diseases, or prevent their onset. We believe that our products, when successfully developed, will compete with these products principally on the basis of improved and extended efficacy and safety and their overall economic benefit to the health care system. The market for therapeutic products that address degenerative diseases is large, and competition is intense. We expect competition to increase. We believe that our most significant competitors will be fully integrated pharmaceutical companies and more established biotechnology companies. Smaller companies may also be significant competitors, particularly through collaborative arrangements with large pharmaceutical or biotechnology companies. Many of these competitors have significant products approved or in development that could be competitive with our potential products.

Competition for our stem and progenitor cell products may be in the form of existing and new drugs, other forms of cell transplantation, ablative and simulative procedures, and gene therapy. We believe that some of our competitors are also trying to develop stem and progenitor cell-based technologies. We expect that all of these products will compete with our potential stem and progenitor cell products based on efficacy, safety, cost and intellectual property positions.

We may also face competition from companies that have filed patent applications relating to the use of genetically modified cells to treat disease, disorder or injury. We may be required to seek licenses from these competitors in order to commercialize certain of our proposed products.

Once our products are developed and receive regulatory approval, they must then compete for market acceptance and market share. For certain of our potential products, an important success factor will be the timing of market introduction of competitive products. This is a function of the relative speed with which we and our competitors can develop products, complete the clinical testing and approval processes, and supply commercial quantities of a product to market. These competitive products may also impact the timing of clinical testing and approval processes by limiting the number of clinical investigators and patients available to test our potential products.

While we believe that the primary competitive factors will be product efficacy, safety, and the timing and scope of regulatory approvals, other factors include, in certain instances, obtaining marketing exclusivity under the Orphan Drug Act, availability of supply, marketing and sales capability, reimbursement coverage, price, and patent and technology position.

GOVERNMENT REGULATION

Our research and development activities and the future manufacturing and marketing of our potential products are, and will continue to be, subject to regulation for safety and efficacy by numerous governmental authorities in the United States and other countries.

In the United States, pharmaceuticals, biologicals and medical devices are subject to rigorous Food and Drug Administration, or FDA, regulation. The Federal Food, Drug and Cosmetic Act, as amended, and the Public Health Service Act, as amended, the regulations promulgated thereunder, and other Federal and state statutes and regulations govern, among other things, the testing, manufacture, safety, efficacy, labeling, storage, export, record keeping, approval, marketing, advertising and promotion of our potential products. Product development and approval within this regulatory framework takes a number of years and involves significant uncertainty combined with the expenditure of substantial resources. In addition, the federal, state, and other jurisdictions have restrictions on the use of fetal tissue.

FDA APPROVAL

The steps required before our potential products may be marketed in the United States include:

STEPS	CONSIDERATIONS
1. Preclinical laboratory and animal tests	Preclinical tests include laboratory evaluation of the product and animal studies in specific disease models to assess the potential safety and efficacy of the product and our formulation as well as the quality and consistency of the manufacturing process.
2. Submission to the FDA of an	The results of the preclinical tests are submitted

application for an Investigational New Drug Exemption, or IND, which must become effective before U.S. human clinical trials may commence	to the FDA as part of an IND, and the IND becomes effective 30 days following its receipt by the FDA, as long as there are no questions, requests for delay or objections from the FDA.

STEPS	CONSIDERATIONS
3. Adequate and well-controlled human clinical trials to establish the safety and efficacy of the product	Clinical trials involve the evaluation of the product in healthy volunteers or, as may be the case with our potential products, in a small number of patients under the supervision of a qualified physician. Clinical trials are conducted in accordance with protocols that detail the objectives of the study, the parameters to be used to monitor safety and the efficacy criteria to be evaluated. Any product administered in a U.S. clinical trial must be manufactured in accordance with clinical Good Manufacturing Practices, or cGMP, determined by the FDA. Each protocol is submitted to the FDA as part of the IND. The protocol for each clinical study must be approved by an independent Institutional Review Board, or IRB, at the institution at which the study is conducted and the informed consent of all participants must be obtained. The IRB will consider, among other things, the existing information on the product, ethical factors, the safety of human subjects, the potential benefits of the therapy and the possible liability of the institution. Clinical development is traditionally conducted in three sequential phases, which may overlap: - In Phase I, products are typically introduced into healthy human subjects or into selected patient populations to test for adverse reactions, dosage tolerance, absorption and distribution, metabolism, excretion and clinical pharmacology. - Phase II involves studies in a limited patient population to (i) determine the efficacy of the product for specific targeted indications and populations, (ii) determine optimal dosage and dosage tolerance and (iii) identify possible adverse effects and safety risks. When a dose is chosen and a candidate product is found to be effective and to have an acceptable safety profile in Phase II evaluations, Phase III trials begin. - Phase III trials are undertaken to conclusively demonstrate clinical efficacy and to test further for safety within an expanded patient population, generally at multiple study sites. The FDA continually reviews the clinical trial plans and results and may suggest changes or may require discontinuance of the trials at any time if significant safety issues arise.

STEPS	CONSIDERATIONS
4. Submission to the FDA of marketing authorization applications	The results of the preclinical studies and clinical studies are submitted to the FDA in the form of marketing approval authorization applications.
5. FDA approval of the application(s) prior to any commercial sale or shipment of the drug. Biologic product manufacturing establishments located in certain states also may be subject to separate regulatory and licensing requirement	The testing and approval process will require substantial time, effort and expense. The time for approval is affected by a number of factors, including relative risks and benefits demonstrated in clinical trials, the availability of alternative treatments and the severity of the disease. Additional animal studies or clinical trials may be requested during the FDA review period which might add to that time.

After FDA approval for the initial indications and requisite approval of the manufacturing facility, further clinical trials may be required to gain approval for the use of the product for additional indications. The FDA may also require unusual or restrictive post-marketing testing and surveillance to monitor for adverse effects, which could involve significant expense, or may elect to grant only conditional approvals.

FDA MANUFACTURING REQUIREMENTS

Among the conditions for product licensure is the requirement that the prospective manufacturer's quality control and manufacturing procedures conform to the FDA's cGMP requirement. Even after product licensure approval, the manufacturer must comply with cGMP on a continuing basis, and what constitutes cGMP may change as the state of the art of manufacturing changes. Domestic manufacturing facilities are subject to regular FDA inspections for cGMP compliance which are normally held at least every two years. Foreign manufacturing facilities are subject to periodic FDA inspections or inspections by the foreign regulatory authorities with reciprocal inspection agreements with the FDA. Domestic manufacturing facilities may also be subject to inspection by foreign authorities.

ORPHAN DRUG ACT

The Orphan Drug Act provides incentives to drug manufacturers to develop and manufacture drugs for the treatment of diseases or conditions that affect fewer than 200,000 individuals in the United States. Orphan drug status can also be sought for treatments for diseases or conditions that affect more than 200,000 individuals in the United States if the sponsor does not realistically anticipate its product becoming profitable from sales in the United States. We may apply for orphan drug status for certain of our therapies. Under the Orphan Drug Act, a manufacturer of a designated orphan product can seek tax benefits, and the holder of the first FDA approval of a designated orphan product will be granted a seven-year period of marketing exclusivity in the United States for that product for the orphan indication. While the marketing exclusivity of an orphan drug would prevent other sponsors from obtaining approval of the same compound for the same indication, it would not prevent other types of products from being approved for the same use including, in some cases, slight variations on the originally designated orphan product.

PROPOSED FDA REGULATIONS

Proposed regulations of the FDA and other governmental agencies would place restrictions, including disclosure requirements, on researchers who have a financial interest in the outcome of their research. Under the proposed regulations, the FDA could also apply heightened scrutiny to, or exclude the results of, studies conducted by such researchers when reviewing applications to the FDA, which

contain such research. Certain of our collaborators have stock options or other

equity interests in us that could subject such collaborators and us to the proposed regulations.

Our research and development is based on the use of human stem and progenitor cells. The FDA has published a "Proposed Approach to Regulation of Cellular and Tissue-Based Products" which relates to the use of human cells. We cannot now determine the effects of that approach or what regulatory actions might be taken from it. Restrictions exist on the testing or use of cells, whether human or non-human.

OTHER REGULATIONS

In addition to safety regulations enforced by the FDA, we are also subject to regulations under the Occupational Safety and Health Act, the Environmental Protection Act, the Toxic Substances Control Act and other present and potential future foreign, Federal, state and local regulations.

Outside the United States, we will be subject to regulations which govern the import of drug products from the United States or other manufacturing sites and foreign regulatory requirements governing human clinical trials and marketing approval for our products. The requirements governing the conduct of clinical trials, product licensing, pricing and reimbursements vary widely from country to country. In particular, the European Union, or EU, is revising its regulatory approach to high tech products, and representatives from the United States, Japan and the EU are in the process of harmonizing and making more uniform the regulations for the registration of pharmaceutical products in these three markets.

REIMBURSEMENT AND HEALTH CARE COST CONTROL

Reimbursement for the costs of treatments and products such as ours from government health administration authorities, private health insurers and others both in the United States and abroad is a key element in the success of new health care products. Significant uncertainty often exists as to the reimbursement status of newly approved health care products.

The revenues and profitability of some health care-related companies have been affected by the continuing efforts of governmental and third party payers to contain or reduce the cost of health care through various means. Payers are increasingly attempting to limit both coverage and the level of reimbursement for new therapeutic products approved for marketing by the FDA, and are refusing, in some cases, to provide any coverage for uses of approved products for disease indications for which the FDA has not granted marketing approval. For example, in certain foreign markets, pricing or profitability of prescription pharmaceuticals is subject to government control. In the United States, there have been a number of Federal and state proposals to implement government control over health care costs.

EMPLOYEES

As of December 31, 2000, we had twenty-six full-time employees, of whom six have Ph.D. degrees, as well as two half-time employees. The equivalent of fifteen full-time employees work in research and development and laboratory support services. A number of our employees have held positions with other biotechnology or pharmaceutical companies or have worked in university research programs. No employees are covered by collective bargaining agreements.

SCIENTIFIC ADVISORY BOARD

Members of our Scientific Advisory Board provide us with strategic guidance in regard to our research and product development programs, as well as assistance in recruiting employees and collaborators. Each Scientific Advisory Board member has entered into a consulting agreement with us.

These consulting agreements specify the compensation to be paid to the consultant and require that all information about our products and technology be

kept confidential. All of the Scientific Advisory Board members are employed by employers other than us and may have commitments to or consulting or advising agreements with other entities that limit their availability to us. The Scientific Advisory Board members have generally agreed, however, for so long as they serve as consultants to us, not to provide any services to any other entities that would conflict with the services the member provides to us. Members of the Scientific Advisory Board offer consultation on specific issues encountered by us as well as general advice on the directions of appropriate scientific inquiry for us. In addition, Scientific Advisory Board members assist us in assessing the appropriateness of moving our projects to more advanced stages. The following persons are members of our Scientific Advisory Board:

- Irving L. Weissman, M.D., is the Karel and Avice Beekhuis Professor of Cancer Biology, Professor of Pathology and Professor of Developmental Biology at Stanford University. Dr. Weissman was a cofounder of SyStemix, Inc., and Chairman of its Scientific Advisory Board. He has served on the Scientific Advisory Boards of Amgen Inc., DNAX and T-Cell Sciences, Inc. Dr. Weissman is Chairman of the Scientific Advisory Board of StemCells.

- David J. Anderson, Ph.D., is Professor of Biology, California Institute of Technology, Pasadena, California and Investigator, Howard Hughes Medical Institute.

- Fred H. Gage, Ph.D., is Professor, Laboratory of Genetics, The Salk Institute for Biological Studies, La Jolla, California and Adjunct Professor, Department of Neurosciences, University of California, San Diego, California.

ITEM 2. PROPERTIES

Our current research laboratories and administrative offices are located in a leased 7,950 square-foot multipurpose building housing wet labs, specialty research areas and administrative offices located in Sunnyvale, California. The facilities are leased pursuant to lease agreements expiring August 31, 2001. These facilities were sufficient to accommodate our needs through the end of 2000, but our expanding endeavors require more space for both research and development in the future.

We have therefore entered a 5-year lease, as of February 1, 2001, for a 40,000 square foot facility, located in the Stanford Research Park in Palo Alto, California, which includes vivarium space as well as laboratories, offices, and a GMP (Good Manufacturing Practices) suite, signifying that the facility can be used to manufacture materials for clinical trials. The new facility will better enable us to achieve our goal of utilizing genetically unmodified human stem cells for the treatment of disorders of the nervous system, liver, and pancreas. We expect to vacate our current premises and be moved into the new facility by May, 2001.

We continue to lease the following facilities in Lincoln, Rhode Island obtained in connection with our former encapsulated cell technology: our former research laboratory and corporate headquarters building which contains 65,000 square feet of wet labs, specialty research areas and administrative offices held on a fifteen-year lease agreement, as well as a 21,000 square-foot pilot manufacturing facility and a 3,000 square-foot cell processing facility financed by bonds issued by the Rhode Island Industrial Facilities Corporation. In February, 2001, we subleased the 3,000 square foot facility and approximately one-third of the 65,000 square foot facility. We are actively seeking to sublease, assign or sell our remaining interests in these properties.

ITEM 3. LEGAL PROCEEDINGS

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDERS MATTERS

The common stock of StemCells is traded on the National Market System of NASDAQ under the Symbol STEM (Previously traded under the Symbol CTII until May 2000). The quarterly ranges of high and low sales prices for the last two fiscal years are shown below:

2000	HIGH	LOW
First Quarter	$20	$1 3/8
Second Quarter	$ 7 5/8	$2
Third Quarter	$11 41/61	$ 11/16
Fourth Quarter	$ 6 1/8	$2 1/4

1999	HIGH	LOW
First Quarter	$ 1 25/32	$1 5/32
Second Quarter	$ 1 3/8	$ 17/32
Third Quarter	$ 2 3/8	$ 11/16
Fourth Quarter	$ 1 5/8	$1

No cash dividends have been declared on the Company common stock since the Company's inception.

As of March 20th, 2001, there were approximately 278 holders of record of the common stock.

ITEM 6. SELECTED FINANCIAL DATA

	YEAR ENDED DECEMBER 31,				
	2000	1999	1998	1997	1996
	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)				
Statement of Operations Data					
Revenue from collaborative & licensing agreements(1)	$ 74	$ 5,022	$ 8,803	$ 10,617	$ 7,104
Research and development expenses	5,979	9,984	17,659	18,604	17,130
Acquired research and development	--	--	--	8,344	--
ECT wind-down and corporate relocation expenses	3,327	6,048	--	--	--
Net loss	$(11,125)	$(15,709)	$(12,628)	$(18,114)	$(13,759)
Basic and diluted net loss per share available to common shareholders before cumulative effect of an accounting change	$ (0.57)	$ (0.84)	$ (0.69)	$ (1.08)	$ (0.89)
Cumulative effect of a change in accounting principle(2)	$ (0.01)	--	--	--	--
Net loss per share applicable to common shareholders	$ (0.58)	$ (0.84)	$ (0.69)	$ (1.08)	$ (0.89)
Shares used in computing basic and diluted net loss per share	20,067	18,706	18,291	16,704	15,430

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(1) See footnote 3 in the consolidated financial statements

(2) See footnote 2 in the consolidated financial statements

	DECEMBER 31,				
	2000	1999	1998	1997	1996
	(IN THOUSANDS)				
Balance Sheet Data					
Cash, cash equivalents and marketable securities	$ 6,069	$ 4,760	$17,386	$29,050	$42,607
Restricted investments	16,356	--	--	--	--
Total assets	29,795	15,781	32,866	44,301	58,397
Long-term debt, including capitalized leases	2,605	2,937	3,762	4,108	8,223
Redeemable common stock	--	5,249	5,249	5,583	8,159
Stockholders' equity	22,982	3,506	17,897	28,900	34,747

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with the accompanying financial statements and the related footnotes thereto.

The statements contained in this report, other than statements of historical fact, constitute forward-looking statements. 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 and product development programs, the need for, and timing of, additional capital and capital expenditures, partnering prospects, the need for additional intellectual property rights, effects of regulations, the need for additional facilities and potential market opportunities. Our actual results may vary materially from those contained in such forward-looking statements because of risks to which we are subject, such as failure to obtain a corporate partner or partners to support the development of our stem cell programs, our ability to sell, assign or sublease our interest in our facilities related to our encapsulated cell technology program, risks of delays in research, development and clinical testing programs, obsolescence of our technology, lack of available funding, competition from third parties, intellectual property rights of third parties, failure of our collaborators to perform, regulatory constraints, litigation and other risks to which we are subject. See "Cautionary Factors Relevant to Forward-Looking-Information" filed herewith as Exhibit 99 and incorporated herein by reference.

OVERVIEW

Since our inception in 1988, we have been primarily engaged in research and development of human therapeutic products. As a result of a restructuring in the second half of 1999, our sole focus is now on our stem cell technology. At the beginning of last year, by contrast, our corporate headquarters, most of our employees, and the main focus of our operations were primarily devoted to a different technology--encapsulated cell therapy, or ECT. Since that time, we terminated a clinical trial of the ECT then in progress, we wound down our other operations relating to the ECT, we terminated the employment of those who worked on the ECT, we sold the ECT and we relocated from Rhode Island to Sunnyvale, California. Comparisons with last year's results are correspondingly less meaningful than they may be under other circumstances.

We were known as CytoTherapeutics, Inc., until May 23, 2000, when we changed our name to StemCells, Inc.

We have not derived any revenues from the sale of any products, and we do

not expect to receive revenues from product sales for at least several years. We have not commercialized any product and in order to do so we must, among other things, substantially increase our research and development expenditures as research and product development efforts accelerate and clinical trials are initiated. We have incurred annual operating losses since inception and expect to incur substantial operating losses in the future. As a result, we are dependent upon external financing from equity and debt offerings and revenues from collaborative research arrangements with corporate sponsors to finance our operations.

There are no such collaborative research arrangements at this time and there can be no assurance that such financing or partnering revenues will be available when needed or on terms acceptable to us.

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, nonrecurring events, including without limitation the receipt of one-time, nonrecurring licensing payments, and the initiation or termination of research collaborations, in addition to the winding-down of terminated research and development programs referred to above.

RESULTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

Revenues totaled $74,000, $5,022,000 and $8,803,000 for the years ending December 31, 2000, 1999 and 1998, respectively. Revenues for 2000 are from Neurotech, S.A. in return for the assignment of our intellectual property assets relating to Encapsulated Cell Technology. Revenues for 1999 and 1998 were from collaborative agreements, earned primarily from a Development, Marketing and License Agreement with AstraZeneca Group plc, which was signed in March 1995 (the "Astra Agreement"). The decrease in revenues from 1998 to 1999 to 2000 resulted primarily from the June 1999 termination of the Astra Agreement.

Research and development expenses totaled $5,979,000 in 2000, as compared to $9,984,000 in 1999 and $17,659,000 in 1998. The decrease of $4,005,000, or 40%, from 1999 to 2000 and the decrease of $7,675,000 or 43%, from 1998 to 1999, was primarily attributable to the wind-down of research activities relating to our encapsulated cell technology, precipitated by termination of the Astra Agreement.

General and administrative expenses were $3,361,000 in 2000, compared with $4,927,000 in 1999 and $4,603,000 in 1998. The decrease of $1,566,000 or 32%, from 1999 to 2000 was primarily attributable to the relocation of our headquarters to a smaller facility as well as a reduction of personnel. Due to the wind-down of our encapsulated cell technology and relocation of our headquarters in October, the 1999 expenses are less than they would have been had these events not occurred.

Wind-down expenses related to our ECT research, our Rhode Island operations and the transfer of our headquarters to Sunnyvale, California totaled $3,327,000 and $6,048,000 for 2000 and 1999, respectively. No such expenses were incurred in 1998. 1999 expenses included accruals of approximately $1.6 million for employee severance costs, $1.9 million in losses and reserves for the write-down of related patents and fixed assets, $1.2 million for our costs of settlement of a 1989 funding agreement with RIPSAT, $700,000 of estimated additional carrying costs through June 30, 2000, and other related expenses totaling $760,000.

During 2000, we incurred approximately $290,000 of costs in excess of the amounts accrued as of December 31, 1999 for the carrying costs, including lease payments, property taxes and utilities, through the expected June 30, 2000 disposition of the Rhode Island facilities. During the third and fourth quarters of 2000 we incurred additional $1.3 million in carrying costs for the Rhode Island facilities, as we were unable to dispose of them, as expected. We have created a reserve of $1,780,000 related to the carrying costs for the Rhode Island facilities through 2001. On February 2001, we subleased portions of the

facilities and are actively seeking to sublease, assign or sell our remaining interests in the properties. However, there can be no assurance that we will be able to dispose of these facilities in a reasonable time, if at all.

Interest income for the years ended December 31, 2000, 1999 and 1998 totaled $303,000, $564,000 and $1,254,000, respectively. The average cash and investment balances were $5,668,000, $10,663,000

and $21,795,000 in 2000, 1999 and 1998, respectively. The decrease in interest income from 1998 to 1999 to 2000 was attributable to lower average balances.

In 2000, interest expense was $273,000, compared to $335,000 in 1999 and $472,000 in 1998. The decrease from 1998 to 1999 to 2000 was attributable to lower outstanding debt and capital lease balances.

During the second quarter 2000 we realized a $1,427,000 gain in connection with the sale of a portion of our investment in Modex. Modex Therapeutics Ltd ("Modex"), a Swiss biotechnology company that completed an initial public offering on June 23, 2000, and is publicly traded on the Swiss Neue Market exchange.

The net loss in 2000, 1999 and 1998 was $11,125,000, $15,709,000, and $12,628,000, respectively. The loss per share was $0.58, $.84 and $.69 in 2000, 1999 and 1998, respectively. The decrease from 1999 to 2000 is primarily attributable to the wind-down of our encapsulated cell technology research and our Rhode Island operations and offset by the elimination of revenue from the Astra Agreement. The increase from 1998 to 1999 is primarily attributable to the elimination of revenue from the Astra Agreement, which was terminated in June 1999, as well as expenses related to the wind-down of our encapsulated cell technology research and our other Rhode Island operations, the transfer of our corporate headquarters to Sunnyvale, California and an accrual for the our estimate of the costs of settlement of a funding agreement with RIPSAT.

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 $6,069,000 at December 31, 2000. Cash equivalents are invested in money market funds. We also hold shares of Modex Therapeutics Ltd ("Modex"), a Swiss biotechnology company that completed an initial public offering on June 23, 2000, and is publicly traded on the Swiss Neue Market exchange. During the second quarter 2000 we realized a $1,427,000 gain in connection with the sale of a portion of our investment in Modex. Our Modex stock has a fair market value of $16,356,000 on December 31, 2000. The fair market value of our Modex stock has varied significantly since the Modex public offering and may continue to vary significantly based on increases and decreases in the reported per share price, in Swiss francs, of the Modex stock and on foreign currency exchange rates. We had been prohibited under a lock-up agreement entered into at the time of Modex's secondary offering from selling any of our Modex holdings until December 23, 2000. On January 9, 2001, we sold 22,616 Modex shares for a net price of 182.00 Swiss francs per share, which converts to $112.76 per share, for total proceeds of $2,550,000. In connection with this sale, we agreed not to resell any more of our remaining 103,577 Modex shares until April 12, 2001. There is a limited trading market for Modex stock, and if we were to attempt to sell any significant portion of our remaining Modex holdings, we would likely be able to do so only at a significant discount to the then market price, if at all. If we sell some but not all of our Modex shares, it is likely that we would have to agree, in connection with the sale, to refrain from selling additional shares for several months. Our Modex stock has a fair value of $8,732,797 on March 27, 2001.

Our liquidity and capital resources were, in the past, significantly affected by our relationships with corporate partners, which were related to our

former ECT. These relationships are now terminated, and we have not yet established corporate partnerships with respect to our stem cell technology.

In the third quarter of 1999, we announced restructuring plans for the wind-down of operations relating to our ECT and to focus our resources on the research and development of our platform of proprietary stem cell technologies. We terminated approximately 68 full time employees and, in October 1999, relocated our corporate headquarters to Sunnyvale, California.

As part of our restructuring of operations and relocation of corporate headquarters to Sunnyvale, California, we identified a significant amount of excess fixed assets. In December of 1999, we completed the disposition of those excess fixed assets, from which we received more than $746,000. The proceeds were used to fund our continuing operations

On December 30, 1999 we sold our ECT and assigned our intellectual property assets in it to Neurotech S.A. for a payment of $3,000,000, royalties on future product sales, and a portion of certain Neurotech revenues from third parties. In addition, we retained certain non-exclusive rights to use ECT in combination with our proprietary stem cell technologies and in the field of vaccines for prevention and treatment of infectious diseases. We received $2,800,000 of the initial payment on January 3, 2000 with a remaining balance of $200,000 placed in escrow, to be released to us upon demonstration satisfactory to Neurotech that certain intellectual property is not subject to other claims. We received the remaining balance of $200,000 on December 04, 2000.

In July 1999, as a result of our decision to close our Rhode Island facilities, the Rhode Island Partnership for Science and Technology, or RIPSAT, alleged that we were in default under a June, 1989 Funding Agreement, and demanded payment of approximately $2.6 million. While we believe we were not in default under the Funding Agreement, we deemed it best to resolve the dispute without litigation and, on March 3, 2000, entered into a settlement agreement with RIPSAT, the Rhode Island Industrial Recreational Building Authority, or IRBA, and the Rhode Island Industrial Facilities Corporation, or RIIFC. We agreed to pay RIPSAT $1,172,000 in full satisfaction of all of our obligations to them under the Funding Agreement. At the same time, IRBA agreed to return to us the full amount of our debt service reserve, comprising approximately $610,000 of principal and interest, relating to the bonds we had with IRBA and RIIFC. The $610,000 debt service reserve was transferred directly to RIPSAT, leaving the remainder of approximately $562,000 to be paid by us. We made this payment in March of 2000.

Our liquidity and capital resources could have also been affected by a claim by Genentech, Inc., arising out of the their collaborative development and licensing agreement with us relating to the development of products for the treatment of Parkinson's disease; however, the claim was resolved with no effect on our resources. On May 21, 1998, Genentech exercised its right to terminate the Parkinson's collaboration and demanded that we redeem, for approximately $3,100,000, certain shares of our redeemable Common Stock held by Genentech. Genentech's claim was based on provisions in the agreement requiring us to redeem, at the price of $10.01 per share, the shares representing the difference between the funds invested by Genentech to acquire such stock and the amount expended by us on the terminated program less an additional $1,000,000. In March 2000, we entered into a Settlement Agreement with Genentech under which Genentech released us from any obligation to redeem any shares of our Common Stock held by Genentech, without cost to us. Accordingly, the $5.2 million of redeemable common stock shown as a liability in our December 31, 1999 balance sheet was transferred to equity in March, 2000 without any impact on our liquidity and capital resources. We and Genentech also agreed that all collaborations between us were terminated, and that neither of us had any rights to the intellectual property of the other.

We continue to have outstanding obligations in regard to our former facilities in Lincoln, Rhode Island, including lease payments and operating costs of approximately $1,200,000 per year associated with our former research laboratory and corporate headquarters building, and debt service payments and

operating costs of approximately $1,000,000 per year with respect to our pilot manufacturing and cell processing facility. 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.

On April 13, 2000, we sold 1,500 shares of our 6% cumulative convertible preferred stock plus warrants for a total of 75,000 shares of our common stock to two members of our Board of Directors for $1,500,000, on terms more favorable to us than we were able to obtain from outside investors. The

face value of the shares of preferred stock is convertible at the option of the holders into common stock at $3.77 per share. The holders of the preferred stock have liquidation rights equal to their original investments plus accrued but unpaid dividends. The investors would be entitled to make additional investments in our securities on the same terms as those on which we complete offerings of our securities with third parties within 6 months, if any such offerings are completed. They have waived that right with respect to the common stock transactions described below. If offerings totaling at least $6 million are not completed during the 6 months, the investors have the right to acquire up to a total of 1,126 additional shares of convertible preferred stock, the face value of which is convertible at the option of the holders into common stock at $6.33 per share. Any unconverted preferred stock is converted, at the applicable conversion price, on April 13, 2002 in the case of the original stock and two years after the first acquisition of any of the additional 1,126 shares, if any are acquired. The warrants expire on April 13, 2005.

On August 3, 2000, we completed a $4 million common stock financing transaction with Millennium Partners, LP, or the Fund, an investment fund with more than a billion dollars in assets under management. We received $3 million of the purchase price at the closing and received the remaining $1 million upon effectiveness of a registration statement covering the shares purchased by the Fund. The Fund purchased our common stock at $4.33 per share. The Fund may be entitled, pursuant to an adjustable warrant issued in connection with the sale of common stock to the Fund, to receive additional shares of common stock on eight dates beginning six months from the closing and every three months thereafter. The number of additional shares the Fund may be entitled to on each date will be based on the number of shares of common stock the Fund continues to hold on each date and the market price of our common stock over a period prior to each date. We will have the right, under certain circumstances, to cap the number of additional shares by purchasing part of the entitlement from the Fund. The Fund also received a warrant to purchase up to 101,587 shares of common stock at $4.725 per share. This warrant is callable by us at $7.875 per underlying share.

In addition, the Fund has the option for twelve months to purchase up to $3 million of additional common stock. On August 23, 2000 the Fund exercised $1,000,000 of its option to purchase additional common stock at $5.53 per share. The Fund paid $750,000 of the purchase price in connection with the closing on August 30, 2000, and paid the remaining $250,000 upon effectiveness of a registration statement covering the shares owned by the Fund. At the closing on August 30, 2000, we issued to the Fund an adjustable warrant similar to the one issued on August 3, 2000. This adjustable warrant was canceled by agreement between us and the Fund on November 1, 2000. The Fund also received a warrant to purchase up to 19,900 shares of common stock at $6.03 per share. This warrant is callable by us at $10.05 per underlying share.

We have limited liquidity and capital resources and must obtain significant additional capital resources in the future in order to sustain our product development efforts, for acquisition of technologies and intellectual property rights, for preclinical and clinical testing of our anticipated products, pursuit of regulatory approvals, acquisition of capital equipment, laboratory and office facilities, establishment of production capabilities and for general and administrative expenses. Our ability to obtain additional capital will be substantially dependent on our ability to obtain partnering support for our stem cell technology and, in the near term, on our ability to realize proceeds from

the sale, assignment or sublease of our facilities in Rhode Island. Failure to do so will have a material effect on our liquidity and capital resources. Until our operations generate significant revenues from product sales, we must rely on cash reserves and proceeds from equity and debt offerings, proceeds from the transfer or sale of our intellectual property rights, equipment, facilities or investments, government grants and funding from collaborative arrangements, if obtainable, to fund our operations.

We intend to pursue opportunities to obtain additional financing in the future through equity and debt financings, grants and collaborative research arrangements. 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, reduce or eliminate some or all of our research and product development programs or to license our potential products or technologies to third parties. Funding may not be available when needed--at all, or on terms acceptable to us. While our cash requirements may vary, as noted above, we currently expect that our existing capital resources, including income earned on invested capital, will be sufficient to fund our operations through December of 2001. Our cash requirements may vary, however, depending on numerous factors. 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.

RECENT ACCOUNTING PRONOUNCEMENT

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133), which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities--Deferral of the Effective Date of FASB Statement No. 133." We are required to adopt SFAS 133 effective January 1, 2001. Because we do not hold any derivative instruments and do not engage in hedging activities, management does not believe the adoption of SFAS 133 will have an impact on our financial position or results of operations.

ITEM 7A. QUANTITIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

On December 31, 2000, we have an investment in common stock of Modex Therapeutics Ltd. (Modex), a Swiss Biotherapeutics company. Our value in this investment is subject to both equity price risk and foreign currency exchange risk. Modex shares were offered in an initial public offering ("IPO") on the Swiss Neue Market on June 23, 2000 at a price of 168.00 Swiss francs. From the date of the IPO to March 9, 2001, the Modex closing share price has fluctuated from a high of 390.00 Swiss francs on October 6, 2000 to a low of 121.00 Swiss francs on March 01, 2001. On January 9, 2001, we sold 22,616 Modex shares for a net price of 182.00 Swiss francs per share, which converts to $112.76 per share, for total proceeds of $2,550,230. In connection with this sale, we agreed not to resell any more of our Modex shares until April 12, 2001. On March 27, 2001 the market price of Modex stock was 145.00 Swiss francs which converts to $84.31 using exchange rates on that date, which represents an estimated fair market value of $8,732,797. If we were to seek to liquidate all or part of our remaining 103,577 Modex shares, our proceeds would depend on the share price and foreign currency exchange rates at the time of conversion. Additionally, if we sell a sizable portion of our holdings, we may have to sell these shares at a discount to market price.

The company's sole market risk sensitive instrument is:

NO. OF SHARES	DESCRIPTION	ASSOCIATED RISKS	MARKET VALUE AT DECEMBER 31, 2000	EXPECTED FUTURE CASH FLOWS

126,193	Modex Therapeutics	Equity/Foreign Currency Translation	$16,356,334	(1)

(1) Although we have not formally adopted a liquidation plan for this investment, liquidation may be necessary to meet operating cash flow requirements. Under the agreement with Modex, we had been restricted from selling our holding through December 23, 2000 and, as noted above, we sold 22,616 shares on January 9, 2001 and agreed not to sell any more shares until April 12, 2001. If we sell some but not all of our remaining 103,577 shares, we likely would have to agree, in connection with the sale, to refrain from selling additional shares for several months.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

STEMCELLS, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

Stockholders and Board of Directors
StemCells, Inc.

We have audited the accompanying consolidated balance sheets of StemCells, Inc. (formerly CytoTherapeutics, Inc.) as of December 31, 2000 and 1999, and the related consolidated statements of operations, changes in redeemable common stock and stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of StemCells, Inc. at December 31, 2000 and 1999, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally

accepted in the United States.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for the beneficial conversion of preferred shares.

/s/ ERNST & YOUNG LLP

Palo Alto, California
February 23, 2001

STEMCELLS, INC.

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,	
	2000	1999
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,068,947	$ 4,760,064
Short-term restricted investments	16,356,334	--
Accrued interest receivable	16,725	42,212
Technology sale receivable	--	3,000,000
Debt service fund	--	609,905
Other current assets	524,509	558,674
Total current assets	22,966,515	8,970,855
Property held for sale	3,203,491	3,203,491
Property, plant and equipment, net	1,451,061	1,747,885
Other assets, net	2,173,912	1,858,768
Total assets	$ 29,794,979	$ 15,780,999
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 526,191	$ 631,315
Accrued expenses	837,358	970,546
Accrued wind-down costs	1,780,579	1,634,522
Current maturities of capital lease obligations	332,083	324,167
Total current liabilities	3,476,211	3,560,550
Capital lease obligations, less current maturities	2,605,000	2,937,083
Deposits	26,000	26,000
Deferred rent	705,746	502,353
Commitments		
Redeemable common stock, $.01 par value; 524,337 shares issued and outstanding at December 31, 1999, none at December 31, 2000	--	5,248,610
Stockholders' equity:		
Convertible Preferred Stock, $.01 par value; 1,000,000 shares authorized, 2,626 designated as 6% Cumulative Convertible Preferred Stock 1,500 shares issued and outstanding at December 31, 2000, none at December 31, 1999	1,500,000	--
Common stock, $.01 par value; 45,000,000 shares authorized; 20,956,887 and 18,635,565 shares issued and outstanding at December 31, 2000 and 1999, respectively	209,569	186,355
Additional paid-in capital	138,150,067	123,917,758
Accumulated deficit	(130,498,187)	(119,372,710)
Accumulated other comprehensive income	16,356,334	--
Deferred compensation	(2,735,761)	(1,225,000)
Total stockholders' equity	22,982,022	3,506,403
Total liabilities and stockholders' equity	$ 29,794,979	$ 15,780,999

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

STEMCELLS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	YEAR ENDED DECEMBER 31,		
	2000	1999	1998
Revenue from collaborative and licensing agreements	$ 74,300	$ 5,021,707	$ 8,803,163
Operating expenses:			
Research and development	5,979,007	9,984,027	17,658,530
General and administrative	3,361,231	4,927,303	4,602,758
Encapsulated Cell Therapy wind-down and corporate relocation	3,327,360	6,047,806	--
	12,667,598	20,959,136	22,261,288
Loss from operations	(12,593,298)	(15,937,429)	(13,458,125)
Other income (expense):			
Interest income	303,746	564,006	1,253,781
Interest expense	(272,513)	(335,203)	(472,400)
Gain on sale of Investment	1,427,686	--	--
Other income	8,902	--	48,914
	1,467,821	228,803	830,295
Net loss	$(11,125,477)	$(15,708,626)	$(12,627,830)
Deemed dividend to preferred shareholders	(265,000)	--	--
Net loss applicable to common shareholders before a cumulative effect of a change in accounting principle	$(11,390,477)	$(15,708,626)	$(12,627,830)
Cumulative effect of a change in accounting principle due to deemed dividend	$ (216,000)	$ --	$ --
Net loss applicable to common shareholders	$(11,606,477)	$(15,708,626)	$ 12,627,830)
Basic and diluted net loss per share applicable to common shareholders before cumulative effect	$ (.57)	$ (.84)	$ (.69)
Cumulative effect of a change in accounting principle	$ (.01)	--	--
Basic and diluted net loss per share applicable to common shareholders	$ (.58)	$ (.84)	$ (.69)
Shares used in computing basic and diluted net loss per share	20,067,760	18,705,838	18,290,548

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

STEMCELLS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN REDEEMABLE COMMON STOCK AND STOCKHOLDERS' EQUITY

	REDEEMABLE COMMON STOCK		COMMON STOCK		ADDITIONAL PAID-IN	ACCUMULATED	ACCUMULATED OTHER COMPREHENSIVE
	SHARES	AMOUNT	SHARES	AMOUNT	CAPITAL	DEFICIT	INCOME (LOSS)
Balances, December 31, 1997	557,754	$5,583,110	17,526,220	$175,262	$121,472,844	$ (91,036,254)	$(8,877)
Issuance of common stock under the stock purchase plan	--	--	43,542	436	83,622		

Common stock issued pursuant to employee benefit plan	--	--	84,812	848	143,025	--	--
Issuance of common stock--StemCells	--	--	101,320	1,013	505,587	--	--
Redeemable common stock lapses	(33,417)	(334,500)	33,417	334	334,166	--	--
Exercise of stock options	--	--	11,012	110	1,254	--	--
Deferred compensation--amortization and cancellations	--	--	--	--	321,108	--	--
Change in unrealized losses on marketable securities	--	--	--	--	--	--	3,679
Net loss	--	--	--	--	--	(12,627,830)	--
Comprehensive loss							
Balances, December 31, 1998	524,337	5,248,610	17,800,323	178,003	122,861,606	(103,664,084)	(5,198)

	DEFERRED COMPENSATION	TOTAL STOCKHOLDERS' EQUITY
Balances, December 31, 1997	$(1,702,820)	$ 28,900,155
Issuance of common stock under the stock purchase plan		84,058
Common stock issued pursuant to employee benefit plan	--	143,873
Issuance of common stock--StemCells	--	506,600
Redeemable common stock lapses	--	334,500
Exercise of stock options	--	1,364
Deferred compensation--amortization and cancellations	229,901	551,009
Change in unrealized losses on marketable securities	--	3,679
Net loss	--	(12,627,830)
Comprehensive loss		(12,624,151)
Balances, December 31, 1998	(1,472,919)	17,897,408

STEMCELLS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN REDEEMABLE COMMON STOCK AND STOCKHOLDERS' EQUITY (CONTINUED)

	REDEEMABLE COMMON STOCK		COMMON STOCK		ADDITIONAL PAID-IN	ACCUMULATED	ACCUMULATED OTHER COMPREHENSIVE
	SHARES	AMOUNT	SHARES	AMOUNT	CAPITAL	DEFICIT	INCOME (LOSS)
Balances, December 31, 1998	524,337	$5,248,610	17,800,323	$178,003	$122,861,606	$(103,664,084)	$(5,198)
Issuance of common stock	--	--	196,213	$ 1,962	$ 318,221	--	--
Issuance of common stock under the stock purchase plan	--	--	57,398	574	41,619		
Common stock issued pursuant to employee benefit plan	--	--	90,798	908	102,502	--	--
Exercise of stock options	--	--	490,833	4,908	513,534	--	--
Deferred compensation--amortization and cancellations	--	--	--	--	80,276	--	--
Change in unrealized losses on marketable securities	--	--	--	--	--	--	5,198
Net loss	--	--	--	--	--	(15,708,626)	--
Comprehensive loss							
Balances, December 31, 1999	524,337	5,248,610	18,635,565	186,355	123,917,758	(119,372,710)	--

	DEFERRED COMPENSATION	TOTAL STOCKHOLDERS' EQUITY
Balances, December 31, 1998	$(1,472,919)	$ 17,897,408
Issuance of common stock	--	$ 320,183
Issuance of common stock under the stock purchase plan		42,193
Common stock issued pursuant to employee benefit plan	--	103,410
Exercise of stock options	--	518,442
Deferred compensation--amortization and cancellations	247,919	328,195
Change in unrealized losses on marketable securities	--	5,198
Net loss	--	(15,708,626)
Comprehensive loss		(15,703,428)
Balances, December 31, 1999	(1,225,000)	3,506,403

STEMCELLS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN REDEEMABLE COMMON STOCK AND STOCKHOLDERS' EQUITY (CONTINUED)

	REDEEMABLE COMMON STOCK	PREFERRED STOCK	COMMON STOCK	ADDITIONAL PAID-IN

	SHARES	AMOUNT	SHARES	AMOUNT	SHARES	AMOUNT	CAPITAL
Balances, December 31, 1999.....	524,337	$ 5,248,610	--	--	18,635,565	$186,355	$123,917,758
Issuance of common stock to Millennium Partners LP, net of issuance costs of $598,563.....	--	--	--	--	1,104,435	$ 11,044	$ 4,390,393
Issuance of common stock related to license agreements.....	--	--	--	--	77,800	$ 778	$ 364,222
Common stock issued pursuant to employee benefit plan.....	--	--	--	--	6,672	$ 68	$ 27,112
Exercise of employee stock options.....	--	--	--	--	608,078	$ 6,081	$ 651,828
Redeemable common stock conversion.....	(524,337)	$(5,248,610)	--	--	524,337	$ 5,243	$ 5,243,367
Issuance of preferred stock.....	--	--	1,500	$1,500,000	--	--	--
Deferred compensation--amortization and cancellations.....	--	--	--	--	--	--	$ 3,555,387
Unrealized gain on short-term restricted investments.....	--	--	--	--	--	--	--
Net loss.....	--	--	--	--	--	--	--
Comprehensive Income.....							
Balances, December 31, 2000.....	--	--	1,500	$1,500,000	20,956,887	$209,569	$138,150,067

	ACCUMULATED DEFICIT	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	DEFERRED COMPENSATION	TOTAL STOCKHOLDERS' EQUITY
Balances, December 31, 1999.....	$(119,372,710)	$ --	$(1,225,000)	$ 3,506,403
Issuance of common stock to Millennium Partners LP, net of issuance costs of $598,563.....	--	--	--	$ 4,401,437
Issuance of common stock related to license agreements.....	--	--	--	$ 365,000
Common stock issued pursuant to employee benefit plan.....	--	--	--	$ 27,180
Exercise of employee stock options.....	--	--	--	$ 657,909
Redeemable common stock conversion.....	--	--	--	$ 5,248,610
Issuance of preferred stock.....	--	--	--	$ 1,500,000
Deferred compensation--amortization and cancellations.....	--	--	$(1,510,760)	$ 2,044,627
Unrealized gain on short-term restricted investments.....	--	$16,356,334	--	$ 16,356,334
Net loss.....	$ (11,125,477)	--	--	$(11,125,477)
Comprehensive Income.....				$ 5,230,858
Balances, December 31, 2000.....	$(130,498,187)	$16,356,334	$(2,735,761)	$ 22,982,022

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

STEMCELLS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEAR ENDED DECEMBER 31,		
	2000	1999	1998
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss.....	$(11,125,477)	$(15,708,626)	$(12,627,830)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization.....	738,593	1,717,975	2,244,146
Acquired research and development.....	--	--	551,009
Amortization of deferred compensation.....	2,044,627	328,195	--
Fair market adjustment for property held for sale.....		300,000	
Other non-cash charges.....		320,183	410,173
Gain on investment.....	(1,427,686)	--	--
Loss on sale of property, plant and equipment.....	--	1,117,286	--
Loss on sale of intangibles.....	--	440,486	--

Changes in operating assets and liabilities:			
Accrued interest receivable	25,488	164,397	346,577
Technology receivable	3,000,000	--	--
Other current assets	315,213	283,000	(265,665)
Accounts payable and accrued expenses	(92,255)	1,344,142	(2,378,613)
Deferred rent	203,393	279,680	--
Deferred revenue	--	(2,500,000)	2,483,856
Net cash used in operating activities	(6,318,104)	(11,913,282)	(9,236,347)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sale of Investments	1,427,686	--	--
Purchases of marketable securities		(4,397,676)	(18,982,387)
Proceeds from sales of marketable securities		13,923,813	22,573,625
Purchases of property, plant and equipment	(151,212)	(192,747)	(2,153,525)
Proceeds on sale of fixed assets	--	746,448	--
Acquisition of other assets	(886,751)	(558,311)	(400,219)
Disposal of other assets	--	440,486	--
Net cash provided by investing activities	389,723	9,962,013	1,037,494
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of common stock	4,401,437	145,603	227,931
Proceeds from the exercise of stock options	685,089	518,442	1,364
Common stock issued for agreements	365,000	--	--
Proceeds from issuance of preferred stock	1,500,000	--	--
Proceeds from debt financings	--	--	1,259,300
Change in debt service fund	609,905	--	--
Repayments of debt and lease obligations	(324,167)	(1,817,500)	(1,366,655)
Net cash provided by (used in) financing activities	7,237,264	(1,153,455)	121,940
Increase (decrease) in cash and cash equivalents	1,308,883	(3,104,724)	(8,076,913)
Cash and cash equivalents at beginning of year	4,760,064	7,864,788	15,941,701
Cash and cash equivalents at end of the year	$ 6,068,947	$ 4,760,064	$ 7,864,788
Supplemental disclosure of cash flow information:			
Interest paid	$ 272,513	$ 335,203	$ 444,047

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

1. NATURE OF BUSINESS

StemCells, Inc. (the "Company") is a biopharmaceutical company that operates in one segment, engaged in the development of novel stem cell therapies designed to treat human diseases and disorders. On May 23, 2000, the Company's name was

changed to Stem Cells, Inc. from CytoTherapeutics, Inc. by vote of the shareholders at the Annual Meeting.

As of December 31, 2000, the Company had cash and cash equivalents of approximately $6.1 million and a restricted short-term equity investment of approximately $16.4 million in Modex Therapeutics, a Swiss Biotherapeutics company. Since inception, the Company has incurred annual losses and negative cash flows from operations and has an accumulated deficit of approximately $130.5 million at December 31, 2000. The Company has not derived any revenues from the sale of any products, and does not expect to receive revenues from product sales for at least several years. As a result, the Company is dependent upon external financing from equity and debt offerings and revenues from collaborative research arrangements with corporate sponsors to finance its 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 the Company.

As noted above, the Company has a restricted investment in Modex Therapeutics, a Swiss Biotherapeutics company with a fair market value of approximately $16.4 million at December 31, 2000. On January 9, 2001, the Company sold 22,616 shares of Modex common stock for total proceeds of approximately $2.5 million. The Company is restricted from selling any of the remaining 103,577 shares until April 12, 2001. The value of the Company's holdings is subject to market risk and foreign currency fluctuation and could decrease significantly. The Company is currently in discussions with Modex to sell the remaining shares during 2001. If the Company decided to sell the Modex shares, due to relatively small trading volume in Modex shares and the relatively large size of the Company holdings, or other factors, the Company may not be able to sell its Modex shares at their market value or at all, and the Company may have to sell these shares at a significant discount to the market price.

If the Company is unable to obtain the necessary proceeds from the sale of Modex shares, significant reductions in spending and the delay or cancellation of planned activities may be necessary. In such event, the Company intends to implement expense reduction plans in a timely manner to enable the Company to meet its operating cash requirements through December 31, 2001.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include accounts of the Company and StemCells California, Inc., a wholly owned subsidiary. Significant intercompany accounts have been eliminated in consolidation.

USE OF ESTIMATES

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States, that requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)
CASH EQUIVALENTS AND INVESTMENTS

Cash equivalents include funds held in investments with original maturities of three months or less when purchased. The Company's policy regarding selection of investments, pending their use, is to ensure safety, liquidity, and capital

preservation while obtaining a reasonable rate of return.

The Company determines the appropriate classification of securities at the time of purchase and reevaluates such designation as of each balance sheet date. The Company classifies such holdings as available-for-sale securities, which are carried at fair value, with unrealized gains and losses reported as a separate component of stockholders' equity.

COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). The only component of other comprehensive income (loss) is unrealized gains and losses on our available-for-sale securities. Comprehensive income (loss) has been disclosed in the statement of changes in redeemable common stock and stockholders' Equity.

PROPERTY, PLANT AND EQUIPMENT

As a result of the Company's decision to exit the encapsulated cell technology and relocate its corporate headquarters to Sunnyvale, California, certain property considered by management to no longer be necessary has been made available for sale or lease. The aggregate carrying value of such property has been reviewed by management, subject to appraisal and adjusted downward to estimated market value.

Property, plant and equipment, including that held under capital lease obligations, is stated at cost and depreciated using the straight-line method over the estimated life of the respective asset, or the lease term if shorter, as follows:

Building and improvements	3 - 15 years
Machinery and equipment	3 - 10 years
Furniture and fixtures	3 - 10 years

PATENT AND LICENSE COSTS

The Company capitalizes certain patent costs related to patent applications. Accumulated costs are amortized over the estimated economic life of the patents, not to exceed 17 years, using the straight-line method, commencing at the time the patent is issued. Costs related to patent applications are charged to expense at the time such patents are deemed to have no continuing value. At December 31, 2000 and 1999, total costs capitalized were $638,000 and $718,000 and the related accumulated amortization were $9,000 and $9,000, respectively. Patent expense totaled $305,000, $539,000, and $3,000 in 2000, 1999 and 1998, respectively.

In December 1999 the Company sold its Encapsulated Cell Technology ("ECT") to Neurotech, S.A. for an initial payment of $3,000,000, which was paid in 2000, royalties on future product sales, and a portion of certain Neurotech revenues from third parties in return for the assignment to Neurotech

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)
of intellectual property assets relating to ECT. In addition, the Company retained certain non-exclusive rights to use ECT in combination with its proprietary stem cell technology and in the field of vaccines for prevention and treatment of infectious diseases. The patent portfolio that was sold had a net

book value of $3,180,000. In year 2000 the Company received $74,300 representing a portion of revenues received by Neurotech from third parties.

STOCK BASED COMPENSATION

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. The Company accounts for stock option grants in accordance with APB Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, and, accordingly, recognizes no compensation expense for qualified stock option grants.

For certain non-qualified stock options granted to non-employees, the Company accounts for these grants in accordance with FAS No. 123--ACCOUNTING FOR STOCK-BASED COMPENSATION AND EITF96-18--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 consulting expenses the estimated fair value of such options as calculated using the Black-Scholes valuation model, and is remeasured during the vesting period. Fair value is determined using methodologies allowable by FAS No. 123. The cost is amortized over the vesting period of each option or the recipient's contractual arrangement, if shorter.

LONG LIVED ASSETS

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

INCOME TAXES

The liability method is used to account for income taxes. Deferred tax assets and liabilities are determined based on differences between financial reporting and income tax bases of assets and liabilities as well as net operating loss carry forwards and are measured using the enacted tax rates and laws that are expected to be in effect when the differences reverse. Deferred tax assets may be reduced by a valuation allowance to reflect the uncertainty associated with their ultimate realization.

REVENUE RECOGNITION

Revenues from collaborative agreements 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. StemCells recognizes non-refundable upfront license fees and certain other related fees on a straight-line basis over the development period. Fees associated with substantive at risk, performance milestones are recognized as revenue upon their completion, as defined in the respective agreements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)
RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133), which

establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities--Deferral of the Effective Date of FASB Statement No. 133." The Company is required to adopt SFAS 133 effective January 1, 2001. Because the Company does we does not hold any derivative instruments and does not engage in hedging activities, management does not believe the adoption of SFAS 133 will have an impact on our financial position or results of operations.

In November 2000, the FASB issued Emerging Issues Task Force Issue No. 00-27, "Application of EITF Issue No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios, to Certain Convertible Instruments" ("EITF 00-27") which is effective retroactively to September 1999 for all such instruments. EITF 00-27 clarifies the accounting for instruments with beneficial conversion features or contingently adjustable conversion ratios. According to the new accounting principle, the beneficial conversion features should be calculated by first allocating the proceeds received from the financing among the convertible instrument and the detachable warrants and then, measuring the beneficial conversion feature between the stated conversion price of the convertible instrument and the effective conversion price based on the allocated proceeds. Previously, the beneficial conversion feature calculation was based on the difference between the stated conversion price of the convertible instrument and the fair value of the Company's stock price on the closing date of the financing. As a result of the new accounting principle, the Company modified the calculation of the beneficial conversion features associated with its 6% cumulative convertible preferred stock.

The Company has presented the effect of adopting the new accounting principle as a cumulative effect of a change in accounting principle as allowed for in EITF 00-27. Accordingly, the Company has recognized an additional $216,000 of deemed dividend on preferred stock.

RESEARCH AND DEVELOPMENT COSTS

The Company expenses all research and development costs as incurred.

NET LOSS PER SHARE

Basic and diluted net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period, less shares subject to repurchase. The Company has excluded outstanding stock options and warrants, and shares subject to repurchase from the calculation of diluted loss per common share because all such securities are anti-dilutive for all applicable periods presented.

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

Until mid-1999, the Company engaged in research and development in encapsulated cell therapy technology, including a pain control program funded by AstraZeneca Group plc. The results from the

3. WIND-DOWN OF ENCAPSULATED CELL TECHNOLOGY RESEARCH AND DEVELOPMENT PROGRAM (CONTINUED)

85-patient double-blind, placebo-controlled trial of our encapsulated bovine cell implant for the treatment of severe, chronic pain in cancer patients did not, however, meet the criteria AstraZeneca had established for continuing trials for the therapy, and in June 1999 AstraZeneca terminated the collaboration, as allowed under the terms of the original collaborative

agreement signed in 1995.

As a result of termination, management determined in July 1999 to restructure its research operations to abandon all further encapsulated cell technology research and concentrate its resources on the research and development of its proprietary platform of stem cell technologies.

The Company wound down its research and manufacturing operations in Lincoln, Rhode Island, and relocated its remaining research and development activities, and its corporate headquarters, to the facilities of its wholly owned subsidiary, StemCells California, Inc., in Sunnyvale, California, in October 1999. The Company terminated legal, professional and consulting contractual arrangements in support of ECT research. The Company had used these legal, professional and consulting contractual arrangements to meet regulatory requirements in support of its research work, to support contractual arrangements with clinical sites, to provide assistance at clinical sites in administrating therapy and documenting activities, and to assist in compliance with FDA and other regulations regarding its clinical trials. ECT related patent law work was also terminated. The Company also engaged professional consultants in connection with the determination to exit its ECT activities and restructure its operations, which concluded with the exit from ECT activities and relocation of its corporate headquarters to California. The Company reduced its workforce by approximately 58 employees who had been focused on ECT programs and 10 administrative employees. As a result, the Company sold excess furniture and equipment in December 1999 and is seeking to sublease the science and administrative facility and to sell the pilot manufacturing facility.

Wind-down expenses totaled $3,327,360 and $6,047,806, for the year ended December 31, 2000 and 1999, respectively. No such expenses were incurred in 1998. These expenses relate to the wind-down of our encapsulated cell technology research and other Rhode Island operations and the transfer of the corporate headquarters to Sunnyvale, California. Expenses for the year 2000, includes an accrual for the estimated lease and facility costs related to the facilities in Rhode Island through 2001. Expenses for the year 1999 also includes an accrual for the estimate of the costs of settlement of a 1989 funding agreement with the Rhode Island Partnership for Science and Technology ("RIPSAT").

At December 31, 1999, the Company's $1.6 million wind-down reserve included approximately $1.2 million for the RIPSAT settlement and approximately $0.4 million for Rhode Island facility for the estimated lease payments and operating costs of the Rhode Island facilities through an expected disposal date of June 30, 2000. In 2000 the Company settled with RIPSAT, paid $1.2 million and paid 0.4 million related to Rhode Island facilities. The Company did not sublet the Rhode Island facilities in 2000 and therefore made a change in estimate to accrue additional expenses of $3.3 million to cover operating lease payments, utilities, taxes, insurance, maintenance, interest and other non-employee expenses through 2001. At December 31, 2000 the remaining wind-down reserve totaled $1.7 million.

3. WIND-DOWN OF ENCAPSULATED CELL TECHNOLOGY RESEARCH AND DEVELOPMENT PROGRAM (CONTINUED)

A description of wind-down expenses, including the amounts and periods of recognition, are as follows:

	YEAR ENDED DECEMBER 31, 1999	YEAR ENDED DECEMBER 31, 2000

Employee severance costs.....	$1,554,000	
Impairment losses(1):		
Fixed assets.....	800,000	
ECT patents.....	260,000	
	1,060,000	
Rhode Island facilities carrying costs(2):		
Corporate headquarters.....	702,000	$3,327,000
PILOT MANUFACTURING PLANT.....	562,000	
	1,264,000	3,327,000
EMPLOYEE OUTPLACEMENT.....	200,000	
RIPSAT settlement(3).....	1,172,000	
Loss on sale of assets(4):		
Fixed assets.....	318,000	
ECT patents.....	180,000	
	498,000	
Write-down of pilot plant(5).....	300,000	
	$6,048,000	$3,327,000

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(1) Management's estimate of the fixed asset impairment was derived from communications with an outside auction house. The patent impairment loss was based on preliminary negotiations with parties interested in acquiring the patents.

(2) Facilities carrying costs include operating lease payments, utilities, property taxes, insurance, maintenance, interest and other non-employee related expenses necessary to maintaining these facilities through the expected date of disposition (December 31, 2001)

(3) The Company originally received funding from the Rhode Island Partnership for Science and Technology (RIPSAT) for purposes of conducting ECT activities conditioned upon maintaining the operation within the state. RIPSAT claimed that the Company's decision to exit ECT activities and close the Rhode Island operation was in violation of the funding arrangement and that the Company was obligated to return a portion of the funding proceeds. Although the Company disputed these claims, during the fourth quarter of 1999, management determined it was in the best interest of the Company to settle the issue.

(4) The Company held an auction to sell all ECT fixed assets. Proceeds from that sale resulted in a loss, which was related to machinery and equipment ($292,000), and furniture and fixtures ($26,000).

(5) The write-down of the pilot plant was based on an independent property appraisal.

3. WIND-DOWN OF ENCAPSULATED CELL TECHNOLOGY RESEARCH AND DEVELOPMENT PROGRAM (CONTINUED)

Property held for sale at December 31, 2000 and 1999, consisted of $3.2 million relating to the Company's pilot plant facility located in Lincoln, Rhode Island. The company suspended depreciation of these assets in 1999. The balance reflected the $300,000 write-down included as part of the additional

wind-down expenses recognized in accordance with Financial Accounting Standards Board Statement 121, which requires that long-lived assets be reviewed for impairment whenever events or circumstances indicate that the carrying value of the asset may not be recoverable. There were no such assets at December 31, 1998.

4. STEMCELLS CALIFORNIA, INC.

In September 1997, a merger of a wholly owned subsidiary of the company and StemCells California, Inc. was completed. As part of the acquisition of StemCells, Richard M. Rose, M.D., became President, Chief Executive Officer and director of the Company and Dr. Irving Weissman became a director of the Company. Upon consummation of the merger, the Company entered into consulting arrangements with the principal scientific founders of StemCells: Dr. Irving Weissman, Dr. Fred H. Gage and Dr. David Anderson. Additionally, in connection with the merger, the Company was granted an option by the former shareholders of StemCells to repurchase 500,000 of the Company's shares of Common Stock exchanged for StemCells shares, upon the occurrence of certain events. To attract and retain Drs. Rose, Weissman, Gage and Anderson, and to expedite the progress of the Company's stem cell program, the Company awarded these individuals options to acquire a total of approximately 1.6 million shares of the Company's common stock, at an exercise price of $5.25 per share, the quoted market price at the grant date. The Company also designated a pool of 400,000 options to be granted to persons in a position to make a significant contribution to the success of the stem cell program. Under the original grants, approximately 100,000 of these options were exercisable immediately on the date of grant, 1,031,000 of these options would vest and become exercisable only upon the achievement of specified milestones related to the Company's stem cell development program and the remaining 468,750 options would vest over eight years. In connection with the 468,750 options issued to a non-employee, Dr. Anderson, the Company recorded deferred compensation of $1,750,000, the fair value of such options at the date of grant, which will be amortized over an eight-year period. The fair value was determined using the Black-Scholes method.

Effective October 31, 2000, the Company agreed with Drs. Weissman and Gage to revise their 468,750 milestone-vesting stock options to time-based vesting, on the same schedule as Dr. Anderson's option. Under each of the revised options, 168,750 shares vested immediately, and the remaining 300,000 shares will vest at 50,000 per year on September 25, until September 25, 2005, when the final 100,000 shares will vest. The exercise price remains $5.25 per share. The Company recorded $1,647,000 as compensation expense for the fair market value of the vested portion of such options in an amount determined using the Black-Scholes method. The deferred compensation expense associated with the unvested portion of the grants was determined to be approximately $1,338,000. As part of the revision of the options, Drs. Weissman and Gage relinquished all rights under an agreement. These individuals had the right to license the non-brain stem cell technology in exchange for a payment to the Company equal to all prior funding for such research plus royalty payments. We plan to revalue the options using the Black-Scholes method on a quarterly basis and recognize additional compensation expense accordingly.

5. INVESTMENTS

In October 1997, the Company completed a series of transactions, which resulted in the establishment of its previously 50%-owned Swiss subsidiary, Modex Therapeutics, Ltd., (Modex) as an independent company.

In April 1998, Modex completed an additional equity offering, in which the Company did not participate. This resulted in a reduction in the Company's ownership to less than 20% ownership; therefore, the Company accounted for this

investment under the cost method from that date.

At December 31, 2000 the Company owned 126,193 shares of Modex. Modex completed an initial public offering of shares on the Swiss Exchange on June 23, 2000. Accordingly, with an established market value, the investment is recorded as available-for-sale at a fair market value of $16,356,334 as at December 31, 2000. The unrealized gain was reported as other comprehensive income in the statement of stockholders' equity.

The pre-existing royalty-bearing Cross License Agreement between the Company and Modex was assigned by the Company to Neurotech S.A., a privately held French company, as part of the sale of the intellectual property assets related to the Company's encapsulated cell therapy technology to Neurotech. Under the terms of the sale to Neurotech, the Company will receive a portion of revenues Neurotech receives from Modex under the Cross License Agreement.

6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of the following:

	DECEMBER 31,	
	2000	1999
Building and improvements	$ 703,095	$ 665,890
Machinery and equipment	1,766,448	1,691,136
Furniture and fixtures	188,736	219,260
	2,658,279	2,576,286
Less accumulated depreciation and amortization	(1,207,218)	(828,401)
	$1,451,061	$1,747,885

Depreciation expense was $451,000, $1,436,000, and $1,720,000 for the years ending December 31, 2000, 1999 and 1998, respectively.

As part of restructuring our operations, sale of our encapsulated cell technology ("ECT"), and relocation of our corporate headquarters to Sunnyvale, California, we identified fixed assets associated with the ECT or otherwise no longer needed. In December of 1999, we disposed of these excess fixed assets, realizing proceeds of approximately $746,000. These assets had a net book value of approximately $1,063,000 after a write-down of 800,000, which was based on an estimate of expected sale proceeds.

Certain property, plant and equipment have been acquired under capital lease obligations. These assets totaled $5,827,000 at December 31, 2000 and 1999, respectively, with related accumulated amortization of $2,747,000 at December 31, 2000 and 1999, respectively. As a result of the Company's

6. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)
decision to exit ECT and relocate to Sunnyvale, California, this property has been classified as held for sale.

7. OTHER ASSETS

Other assets are as follows:

	DECEMBER 31, 2000	DECEMBER 31, 1999
Patents, net	$ 629,203	$ 708,823
License agreements, net	669,000	282,750
Security deposit--building lease	750,000	750,000
Deposit--other	16,321	--
Deferred financing costs, net	109,388	117,195
	$2,173,912	$1,858,768

At December 31, 2000 and 1999, accumulated amortization was $1,140,000 and $857,000, respectively, for patents and license agreements.

8. ACCRUED EXPENSES

Accrued expenses are as follows:

	DECEMBER 31, 2000	DECEMBER 31, 1999
External services	$219,051	$ 97,439
Employee compensation	109,007	306,342
Collaborative research	--	222,140
Other	509,300	344,625
	$837,358	$970,546

9. LEASES

The Company has 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 its pilot manufacturing facility. 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. Fixed interest rates vary with the respective bonds' maturities, ranging from 5.1% to 9.5%. The bonds contain certain restrictive covenants which limit, among other things, the payment of cash dividends and the sale of the related assets. In addition, the Company was required to maintain a debt service reserve until December 1999. On March 3, 2000 the Company entered into a settlement agreement with RIPSAT, the Rhode Island Industrial Recreational Building Authority ("IRBA") and the Rhode Island Industrial Facilities Corporation ("RIIFC"). The Company agreed to pay RIPSAT $1,172,000 in full satisfaction of all obligations of the Company to RIPSAT under the

9. LEASES (CONTINUED)

Funding Agreement dated as of June 22, 1989. On execution and delivery of this Agreement, IRBA agreed to return to the Company the full amount of the Company's debt serve reserve ("Reserve Funds") of approximately $610,000 of principal and interest, relating to the bonds the Company has with IRBA and RIIFC. In order to avoid the loss of interest on the Reserve Funds due to early termination of certain investments, the parties agreed that the Company would render a net payment to RIPSAT in the amount of approximately $562,000.

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 a rent escalation clause and accordingly, the Company is recognizing rent expense on a straight line basis. At December 31, 2000, the Company has $705,746 in deferred rent expense.

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 new facility includes vivarium space, laboratories, offices, and a GMP (Good Manufacturing Practices) suite. GMP facilities can be used to manufacture materials for clinical trials. The rent will average approximately $3.15 million per year over the term of the lease.

As of December 31, 2000, future minimum lease payments under operating and capital leases and principal payments on equipment loans are as follows:

	CAPITAL LEASES	OPERATING LEASES	SUBLEASE INCOME
2001	$ 589,217	$ 3,584,061	$ 295,854
2002	519,719	2,392,988	400,658
2003	436,909	4,568,274	395,676
2004	425,713	4,677,197	416,507
2005	412,587	4,789,388	437,338
Thereafter	2,311,577	8,797,417	130,761
Total minimum lease payments	4,695,722	$28,809,325	$2,076,794
Less amounts representing interest	1,758,639		
Present value of minimum lease payments	2,937,083		
Less current maturities	332,083		
Capitalized lease obligations, less current maturities	$2,605,000		

Rent expense for the years ended December 31, 2000, 1999 and 1998, was $1,111,000, $947,000 and $1,052,000, respectively.

10. STOCKHOLDERS' EQUITY

SALE OF COMMON STOCK

On August 3, 2000, the Company completed a $4 million common stock financing transaction with Millennium Partners, LP (the "Fund"). StemCells received $3 million of the purchase price at the

10. STOCKHOLDERS' EQUITY (CONTINUED)
closing and received the remaining $1 million upon effectiveness of a registration statement covering the shares owned by the Fund. The Fund purchased the Company's common stock and warrants at $4.33 per share. As set forth in an adjustable warrant issued to the Fund on the closing date, the Fund may be entitled to receive additional shares of common stock on eight dates beginning six months from the closing and every three months thereafter. The adjustable warrant may be exercised at any time prior to the thirtieth day after the last of such dates. The number of additional shares the Fund may be entitled to on each date will be based on the number of shares of common stock the Fund continues to hold on each date and the market price of the Company's common stock over a period prior to each date. The exercise price per share under the adjustable warrant is $0.01. Such warrants provide the Fund with the opportunity to acquire additional common shares at a nominal value if the value of the common stock that the Fund holds decreases. The Company will have the right, under certain circumstances, to cap the number of additional shares by purchasing part of the entitlement from the Fund at a purchase price based on the market price of such shares. No portion of the sale proceeds was assigned to the adjustable warrants, as the ultimate number of shares issuable upon exercise of the warrants was not determinable and the net impact on the Company's equity from any such allocation of proceeds would have been zero. The Fund also received a five-year warrant to purchase up to 101,587 shares of common stock at $4.725 per share. This warrant is callable at any time by StemCells at $7.875 per underlying share. The calculated value of this callable warrant using the Black-Scholes method is $376,888, which was treated as a credit to paid in capital in stockholders' equity. The Company accounts for the sale of the stock and warrants or the exercise of warrants by adding that portion of the proceeds equal to the par value of the new shares to common stock and the balance, including the value of the warrants, to paid in capital. In addition, any repurchase of the shares or warrants by the Company would also be accounted for through paid in capital.

In the Purchase Agreement governing the August 3, 2000 sale to the Fund, the Company granted the Fund an option to purchase up to an additional $3 million of its common stock and a callable warrant and an adjustable warrant. The Fund can exercise this option in whole or in part at any time prior to August 3, 2001. The price per share of common stock to be issued upon exercise of the option will be based on the average market price of the common stock for a five-day period prior to the date on which the option is exercised. On August 23, 2000, the Fund exercised $1,000,000 of its option to purchase additional common stock. The Fund paid $750,000 of the purchase price in connection with the closing on August 30, 2000, and the Fund paid the remaining $250,000 upon effectiveness of a registration statement covering the shares owned by the Fund. The Fund purchased the Company's common stock at $5.53 per share, which amount was based upon the average market price of the common stock for the five-day period prior to August 23, 2000. An adjustable warrant similar to the one issued on August 3, 2000 was issued to the Fund on August 30, 2000, but was cancelled on November 1, 2000 by agreement of the Company and the Fund. The Fund also received a five -year warrant to purchase up to 19,900 shares of common stock at $6.03 per share. This warrant is callable by the Company at any time at $10.05 per underlying share. The calculated value of this callable warrant using the Black-Scholes method is $139,897, which the Company accounted for as a credit to paid in capital.

The adjustable warrant contains provisions regarding the adjustment or replacement of the warrants in the event of stock splits, mergers, tender offers and other similar events. The adjustable

warrant also limits the number of shares that can be beneficially owned by the Fund to 9.99% of the total number of outstanding shares of Common Stock.

REDEEMABLE COMMON STOCK

In November 1996, the Company signed certain collaborative development and licensing agreements with Genentech, Inc, including one under which Genentech purchased 829,171 shares of redeemable common stock for $8.3 million to fund development of products to treat Parkinson's disease. The Agreement also provided that Genentech had the right, at its discretion, to terminate the Parkinson's program at specified milestones in the program, and that if the program were terminated, Genentech had the right to require the Company to repurchase from Genentech the shares of the Company's common stock having a value equal to the amount by which the $8.3 million exceeded the expenses incurred by the Company in connection with such studies by more than $1 million, based upon the share price paid by Genentech. Accordingly, the common stock is classified as redeemable common stock until such time as the related funds are expended. At December 31, 1998, $3,051,000 had been spent on the collaboration with Genentech and, accordingly, the Company has reclassified those common shares and related value to stockholders' equity. On May 21, 1998, Genentech exercised its right to terminate the collaboration and negotiations ensued with respect to the amount of redeemable common stock to be redeemed in accordance with the agreement and the method of such redemption. In March 2000, the Company reached a settlement of this matter with Genentech. Under the settlement agreement, Genentech released the Company from any obligation to redeem any shares of the Company's Common Stock held by Genentech. Accordingly, the Company reclassified the amount currently recorded as Redeemable Common Stock ($5,248,000) to Stockholders' Equity in March 2000. The Company and Genentech also agreed that all of the agreements between them were terminated and that neither had any claim to the intellectual property of the other.

STOCK ISSUED FOR TECHNOLOGY LICENSES

Under a 1997 License Agreement with NeuroSpheres, Ltd., the Company obtained an exclusive patent license in the field of transplantation. The Company entered into an additional license agreement with NeuroSpheres as of October 31, 2000, under which the Company obtained an exclusive license in the field of non-transplant uses, such as drug discovery and drug testing, so that together the licenses are exclusive for all uses of the technology. The Company made up-front payments to NeuroSpheres of 65,000 shares of its common stock and $50,000, and will make additional cash payments when milestones are achieved in the non-transplant field, or in any products employing NeuroSpheres patents for generating cells of the blood and immune system from neural stem cells.

The Company also entered into license agreements with the California Institute of Technology and issued 12,800 shares of common stock upon execution of the license agreements. The Company must pay an additional $10,000 upon the issuance of the patent licensed under the relevant agreement

COMMON STOCK ISSUED

In 1998, the Company entered into an agreement with a Company advisor, under which the advisor prepared a strategic and business overview and provided related implementation support for the Company. The advisor agreed to accept cash and the Company's common stock as partial payment for its services. In 1999, the Company issued the $187,500 of common stock due to the advisor.

SALE OF 6% CUMULATIVE CONVERTIBLE PREFERRED STOCK

On April 13, 2000 the Company issued 1,500 shares of 6% cumulative convertible preferred stock plus a warrant for 75,000 shares of our common stock to two members of its Board of Directors for $1.500,000 on terms more favorable to the Company than it was then able to obtain from outside investors. The shares are convertible at the option of the holders into common stock at $3.77 per share (based on the face value of the preferred shares). The conversion price may be below the trading market price of the stock at the time of conversion. The Company has valued the beneficial conversion feature reflecting the April 13, 2000 commitment date and the most beneficial per share discount available to the preferred shareholders. Such value was $481,000 and is treated as a deemed dividend as of the commitment date. The holders of the preferred stock have liquidation rights equal to their original investment plus accrued but unpaid dividends.

STOCK OPTION AND EMPLOYEE STOCK PURCHASE PLANS

The Company has adopted several stock plans that provide for the issuance of incentive and nonqualified stock options, performance awards and stock appreciation rights, at prices to be determined by the Board of Directors, as well as the purchase of Common Stock under an employee stock purchase plan at a discount to the market price. In the case of incentive stock options, such price will not be less than the fair market value on the date of grant. Options generally vest ratably over four years and are exercisable for ten years from the date of grant or within three months of termination. At December 31, 2000, the Company had reserved 3,828,371 shares of common stock for the exercise of stock options.

The following table presents the combined activity of the Company's stock option plans (exclusive of the plans noted below) for the years ended December 31:

	2000		1999		1998	
	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding at January 1.....	939,335	$2.65	1,654,126	$3.62	2,446,573	$7.48
Granted.....	2,485,090	4.08	536,078	1.08	1,174,118	1.70
Exercised.....	(540,927)	1.015	(604,362)	1.50	(11,012)	.12
Canceled.....	(166,532)	4.77	(646,507)	5.31	(1,955,553)	7.08
Outstanding at December 31.....	2,716,966	4.32	939,335	$2.65	1,654,126	$3.62
Options exercisable at December 31.....	731,523	$4.01	594,216	$3.44	1,108,936	$4.33

In addition to the options noted above, in conjunction with the StemCells California merger, StemCells California options originally issued under a prior StemCells California options plan were exchanged for options to purchase 250,344 shares of the Company's common stock at $.01 per share; 96,750 of these options vest and become exercisable only upon achievement of specified milestones, and the remaining 78,210 options vest over three years from the date of grant. Additionally, the Company adopted the 1997 StemCells, Inc. StemCells California Research Stock Option Plan (the StemCells California Research Plan) whereby an additional 2,000,000 shares of Common Stock have

10. STOCKHOLDERS' EQUITY (CONTINUED)

been reserved. During 1997, the Company awarded options under the StemCells Research Plan to purchase 1.6 million shares of the Company's common stock to the Chief Executive Officer and scientific founders of StemCells at an exercise price of $5.25 per share; approximately 100,000 of these options were exercisable immediately, 1,031,000 of these options vest and become exercisable only upon achievement of specified milestones and the remaining 469,000 options vest over eight years. For the year 2000 the options have been incorporated into the number of options granted so as to be reflected in the total of options outstanding as of December 31, 2000

FAS 123 DISCLOSURES

The Company has adopted the disclosure provisions only of Statement of Financial Accounting Standards No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION ("FAS 123") and accounts for its stock option plans in accordance with the provisions of APB 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES.

The following table presents weighted average price and life information about significant option groups outstanding at December 31, 2000:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YRS.)	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE
Less than $5.00	944,216	8.68	$ 2.063	370,023	$ 1.53
$5.01 - $10.00	1,691,750	6.87	5.26	280,500	5.27
Greater than $10.00	81,000	1.30	11.03	81,000	11.03
	2,716,966			731,523	

Pursuant to the requirements of FAS 123, the following are the pro forma net loss and net loss per share amounts for 2000, 1999, and 1998, as if the compensation cost for the option plans and the stock purchase plan had been determined based on the fair value at the grant date for grants in 2000, 1999, and 1998, consistent with the provisions of FAS 123:

	2000		1999		1998	
	AS REPORTED	PRO FORMA	AS REPORTED	PRO FORMA	AS REPORTED	PRO FORMA
Net loss	$(11,125,477)	$(12,160,752)	$(15,708,626)	$(15,764,569)	$(12,627,830)	$(14,919,389)
Net loss per share	$ (.58)	$ (.62)	$ (.84)	$ (.84)	$ (.69)	$ (.82)

The weighted average fair value per share of options granted during 2000, 1999 and 1998 was $4.13, $.82 and $3.40, respectively. The fair value of options and shares issued pursuant to the stock

10. STOCKHOLDERS' EQUITY (CONTINUED)
purchase plan at the date of grant were estimated using the Black-Scholes model with the following weighted average assumptions:

	OPTIONS			STOCK PURCHASE PLAN		
	2000	1999	1998	2000	1999	1998
Expected life (years).....	5	5	5	N/A	.5	.5
Interest rate.....	6.5%	5.5%	5.2%	N/A	5.0%	4.6%
Volatility.....	167.8	96.7%	63.5%	N/A	96.7%	63.5%

The Company has never declared nor paid dividends on any of its capital stock and does not expect to do so in the foreseeable future. On August 04, 1999 the board suspended the 1992 Employee Stock Purchase Plan.

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

STOCK WARRANTS

The Company issued warrants to purchase 8,952 shares of common stock in conjunction with the StemCells California merger, warrants to purchase 31,545 shares in conjunction with various equipment leasing agreements, and warrants to purchase 434,500 shares in connection with a public offering of common stock in April 1995. All of these expired at various dates in 2000.

COMMON STOCK RESERVED

The Company has the following shares of common stock reserved for the exercise of options, warrants and other contingent issuances of common stock.

Shares reserved for exercise of stock options.....	3,828,371
Shares reserved for warrants.....	2,292,625
StemCell option conversions.....	250,344
Total.....	6,371,340

11. RESEARCH AGREEMENTS

In November 1997, StemCells California, Inc., a wholly owned subsidiary of the Company, signed a Research Funding and Option Agreement with The Scripps Research Institute ("Scripps") relating to certain stem cell research. Under the terms of the Agreement, StemCells agreed to fund research in the total amount of approximately $931,000 at Scripps over a period of three years. StemCells paid Scripps approximately $307,000 in 1998, $309,000 in 1999, and $225,739 in 2000. In addition, the Company agreed to issue to Scripps 4,837 shares of the Company's common stock and a stock option to purchase 9,674 shares of the Company's Common Stock with an exercise price of $.01 per share

11. RESEARCH AGREEMENTS (CONTINUED)
upon the achievement of specified milestones. Under the Agreement, StemCells has an option for an exclusive license to the inventions resulting from the sponsored research, subject to the payment of royalties and certain other amounts, and is obligated to make payments totaling $425,000 for achievement of certain milestones.

In March 1995, the Company signed a collaborative research and development agreement with AstraZeneca for the development and marketing of certain encapsulated-cell products to treat pain. AstraZeneca made an initial, nonrefundable payment of $5,000,000, included in revenue from collaborative agreements in 1995, a milestone payment of $3,000,000 in 1997 and was to remit up to an additional $13,000,000 subject to achievement of certain development milestones. Under the agreement, the Company was obligated to conduct certain research and development pursuant to a four-year research plan agreed upon by the parties. Over the term of the research plan, the Company originally expected to receive annual payments of $5 million to $7 million from AstraZeneca, which was to approximate the research and development costs incurred by the Company under the plan. Subject to the successful development of such products and obtaining necessary regulatory approvals, AstraZeneca was obligated to conduct all clinical trials of products arising from the collaboration and to seek approval for their sale and use. AstraZeneca had the exclusive worldwide right to market products covered by the agreement. Until the later of either the expiration of all patents included in the licensed technology or a specified fixed term, the Company was entitled to a royalty on the worldwide net sales of such products in return for the marketing license granted to AstraZeneca and the Company's obligation to manufacture and supply products. AstraZeneca had the right to terminate the original agreement beginning April 1, 1998. On June 24, 1999, AstraZeneca informed the Company of the results of AstraZeneca's analysis of the double-blind, placebo-controlled trial of the Company's encapsulated bovine cell implant for the treatment of severe, chronic pain in cancer patients. AstraZeneca determined that, based on criteria it established, the results from the 85-patient trial did not meet the minimum statistical significance for efficacy established as a basis for continuing worldwide trials for the therapy. AstraZeneca therefore indicated that it did not intend to continue the trials of the bovine cell-containing implant therapy and executed its right to terminate the agreement. The Company has no additional funding obligations with AstraZeneca.

The Company has entered into other collaborative research agreements whereby the Company funds specific research programs. Pursuant to such agreements, the Company is typically granted rights to the related intellectual property or an option to obtain such rights on terms to be agreed, in exchange for research funding and specified royalties on any resulting product revenue. The Company's principal academic collaborations had been with Brown University and Dr. Aebischer and Centre Hospitalier Universitaire Vaudois in Switzerland. However, with the termination of the Company's encapsulated cell technology program and its new focus on the stem cell field, its principal academic collaborations are now with Scripps Institute and the Oregon Health Science University. Research and development expenses incurred under these collaborations amounted to approximately $314,000, $868,000, and $1,259,000 for the years ended December 31, 2000, 1999 and 1998, respectively. The Company has no other significant collaborative research funding obligations.

12. INCOME TAXES

Due to net losses incurred by the Company in each year since inception, no provision for income taxes has been recorded. At December 31, 2000, the Company had tax net operating loss carry forwards of $110,000,000 and research and development tax credit carry forwards of $4,100,000, which expire in the years 2004 through 2020. Utilization of the Company's net operating loss may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss before utilization.

Significant components of the Company's deferred tax assets and liabilities are as follows:

	DECEMBER 31,	
	2000	1999
Deferred tax assets:		
Capitalized research and development costs.....	$ 6,000,000	$ 4,331,000
Net operating losses.....	44,000,000	38,478,000
Research and development credits.....	4,260,000	4,035,000
Other.....	1,020,000	928,000
	55,280,000	47,772,000
Deferred tax liabilities:		
Unrealized gain on investment.....	(6,543,000)	--
Patents.....	(127,000)	(246,000)
Valuation allowance.....	(48,610,000)	(47,526,000)
Net deferred tax assets.....	$ --	$ --

Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance. The valuation allowance increased by $6,272,000 during 1999, and $5,459,000 during 1998.

13. EMPLOYEE RETIREMENT PLAN

The Company has a qualified defined contribution plan covering substantially all employees. Participants are allowed to contribute a fixed percentage of their annual compensation to the plan and the Company may match a percentage of that contribution. The Company matches 50% of employee contributions, up to 6% of employee compensation, with the Company's common stock. The related expense was $33,000, $103,000, and $146,000 for the years ended December 31, 2000, 1999 and 1998, respectively.

14. SUBSEQUENT EVENTS (UNAUDITED)

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, California. The new facility includes animal space, laboratories, offices, and a GMP (Good Manufacturing Practices) suite. GMP facilities can be used to manufacture materials for clinical trials. The rent will average approximately $3.15 million per year over the term of the lease. The Company continues to lease the facilities in Lincoln, Rhode Island

14. SUBSEQUENT EVENTS (UNAUDITED) (CONTINUED)
obtained in connection with its former encapsulated cell technology, but has now succeeded in subleasing parts of those facilities: the 3,000 square-foot cell processing facility and approximately one-third of its former scientific and administrative facility ("SAF"). The Company continues to seek to sublet the remainder of the approximately 65,000 square foot SAF and the 21,000 square-foot pilot manufacturing facility, or to assign or sell its interests in these

properties. There can be no assurance however, that we will be able to dispose of these properties in a reasonable time, if at all.

In February 2001, the Company was awarded a two-year, $300,000 per year grant from the NIH's Small Business Innovation Research (SBIR) office. The grant, which will support joint work with virologist Dr. Jeffrey Glenn at Stanford University, is aimed at characterizing the human cells that can be infected by human hepatitis viruses and to develop a small animal model using the cells that are most infectable by these viruses to develop screening assays and identify novel drug for the disease.

On January 9, 2001, the Company sold 22,616 Modex shares for a net price of 182.00 Swiss francs per share, which converts to $112.76 per share, for total proceeds of $2,550,000. In connection with this sale, the Company agreed not to resell any more of its Modex shares until April 12, 2001. On March 07, 2001 the market price of Modex stock was 145.00 Swiss francs which converts to $84.31 using exchange rates on that date, which represents an estimated fair market value of $8,732,797 for the remaining shares. If the Company were to seek to liquidate all or part of the remaining 103,577 Modex shares, the proceeds would depend on the share price and foreign currency exchange rates at the time of conversion.

15. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

	QUARTER			
	FIRST	SECOND	THIRD	FOURTH
	(IN THOUSANDS, EXCEPT PER SHARE DATA)			
2000:				
Net revenue	$ --	$ --	$ --	$ 74
Operating expenses	1,799	1,939	2,553	6,378
Net Loss	(1,794)	(532)	(2,539)	(6,260)
Basic and diluted net loss per share applicable to common shareholders before cumulative effect	$ (0.09)	$ (0.04)	$ (0.13)	$ (0.30)
Cumulative effect of a change in accounting principle(1)	--	--	--	$ (0.01)
Net loss per share applicable to common shareholders	$ (0.09)	$ (0.04)	$ (0.13)	$ (0.31)
1999:				
Net revenue	$ 2,501	$ 2,521	$ --	$ --
Operating expenses	4,562	4,454	6,690	5,253
Net Loss	(1,932)	(1,840)	(6,711)	(5,226)
Basic and diluted net loss per share	$ (0.10)	$ (0.10)	$ (0.36)	$ (0.27)

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(1) See note 2 to the Consolidated Financial Statements

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT, PROMOTERS AND CONTROL

DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth the name, age and position of each of our executive officers, key members of management, and directors.

NAME	AGE	POSITION
John J. Schwartz, Ph.D.	67	Director, Chairman of the Board
Martin M. McGlynn	54	Director, President and Chief Executive Officer
Mark J. Levin	50	Director
Roger M. Perlmutter M.D., Ph.D.	48	Director
Irving L. Weissman, M.D.	61	Director

- John J. Schwartz, Ph.D., was elected to the board of directors in December 1998 and was elected Chairman of the board at the same time. He was formerly Senior Vice President and General Counsel of SyStemix, Inc. from 1993 to 1995, and then President and Chief Executive Officer of SyStemix, Inc. from 1995 to 1997. Dr. Schwartz is currently President of Quantum Strategies Management Company, a registered investment advisor located in Atherton, California. Prior to his positions at SyStemix, he served as Assistant Professor and a Vice President and General Counsel at Stanford University in California. Dr. Schwartz graduated from Harvard Law School in 1958 and received his Ph.D. in physics from the University of Rochester in 1966.

- Martin M. McGlynn joined the company on January 15, 2001 when he was appointed President and Chief Executive Officer of the company and of its wholly-owned subsidiary, StemCells California, Inc. From 1994 until he joined the company, Mr. McGlynn was President and Chief Executive Officer of Pharmadigm, Inc., a privately held company in Salt Lake City, Utah, engaged in research and development in the fields of inflammation and genetic immunization. Mr. McGlynn received a bachelor of commerce degree from University College, Dublin, Ireland in 1968, a diploma in industrial engineering from the Irish Institute of Industrial Engineering in 1970, and a diploma in production planning from the University of Birmingham, England in 1971.

- Mark J. Levin is a founder of the company and has served as a director since the company's inception. From inception until January 1990 and from May 1990 until February 1991, Mr. Levin served as the company's President and acting Chief Executive Officer. From November 1991 until March 1992, he served as Chief Executive Officer of Tularik, Inc., a biotechnology company. From August 1991 until August 1993, Mr. Levin was Chief Executive Officer and a director of Focal, Inc., a biomedical company. Mr. Levin is currently the Chairman of the Board and Chief Executive Officer of Millennium Pharmaceuticals, Inc., a biotechnology company. Mr. Levin is also currently on the Board of Directors of Tularik, Inc.

- Roger M. Perlmutter, M.D., Ph.D., was elected to the board of directors in December 2000. Dr. Perlmutter is Executive Vice President, Research and Development, of Amgen, Inc., a position he has held since January 2001. Prior to joining Amgen, Dr. Perlmutter was Executive Vice President, Worldwide Basic Research and Preclinical Development, Merck Research Laboratories, a division of Merck & Co., Inc., a position he held since August 1999. He joined Merck in February 1997 as Senior Vice President, Merck Research Laboratories, from February 1997 to December 1998 and as Executive Vice President from February 1999 to July 1999. Prior to joining Merck, Dr. Perlmutter was a professor in the Departments of Immunology, Biochemistry and Medicine at the

University of Washington from January 1991 to January 1997 and served as chairman of the Department of Immunology at the University of Washington from May 1989 to

January 1997. He also was an Investigator at the Howard Hughes Medical Institute from July 1984 to February 1997. Dr Perlmutter has been a member of the board of directors of The Irvington Institute for Immunological Research since 1997 and of the Institute for Systems Biology since 1999. He also serves as President of the Merck Genome Research Institute, a position he has held since March 2000.

- Irving L. Weissman, M.D., Director, is the Karel and Avice Beekhuis Professor of Cancer Biology, Professor of Pathology and Professor of Developmental Biology at Stanford University. Stanford has employed Dr. Weissman since July 1967, and he has been a Faculty member since January 1969. He has been a full professor of pathology since September 1987, and also of developmental biology since July 1989. Since October 1990, Dr. Weissman has also served as a professor of biology (by courtesy). He has been Chairman of the Stanford University Immunology Program since 1986. Dr. Weissman was a cofounder of SyStemix, Inc., and Chairman of its Scientific Advisory Board. He has served on the Scientific Advisory Boards of Amgen Inc., DNAX and T-Cell Sciences, Inc. Dr. Weissman is a member of the National Academy of Sciences and also serves as Chairman of our Scientific Advisory Board. He also serves as Chief Executive Officer and a member of the Board of Managers of Celtrans, LLC.

Our Restated Certificate of Incorporation and Amended and Restated By-laws provide for the classification of the board of directors into three classes, as nearly equal in number as possible, with the term of office of one class expiring each year. There are no family relationships between any of our directors or executive officers. Our executive officers are elected by, and serve at the discretion of, the board of directors.

ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth the compensation paid by us to our Chief Executive Officer during the fiscal years ended December 31, 2000, 1999, and 1998 and the two other most highly compensated executive officers who served in such capacities during the fiscal year ended December 31, 2000 but who were not serving in such capacities as of the end of such fiscal year. There were no other persons serving as executive officers at the end of such fiscal year.

SUMMARY COMPENSATION TABLE

		ANNUAL COMPENSATION			AWARDS LONG TERM COMPENSATION		
NAME AND PRINCIPAL POSITION	YEAR	SALARY ($)	BONUS ($)	OTHER ANNUAL COMPENSATION ($)	RESTRICTED STOCK AWARDS ($)	SECURITIES UNDERLYING OPTIONS (#)	ALL OTHER COMPENSATION
George W. Dunbar, Jr. ..... Acting President and Chief Executive Office(1)	2000	186,538	50,000	--	--	82,031	--
Richard M. Rose M.D..... Chief Executive Officer(2)	2000	309,632	--	--	--	--	--
	1999	279,974	--	--	--	--	4,667(3)
	1998	286,553	--	--	--	150,000(4)	11,330(5)
Ann Tsukomoto, Ph.D. ..... VP, Scientific Operations	2000	159,054	--	--	--	--	4,783(6)
Ronnda Bartel, Ph.D..... VP, Scientific Development	2000	129,668	--	--	--	--	3,245(7)

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(1) Mr. Dunbar became Acting President and Chief Executive Officer effective as of February 1, 2000, and resigned from that position effective as of January 15, 2001.

(2) Dr. Rose became Chief Executive Officer on September 26, 1997. Dr. Rose resigned as a director and officer of the company and its wholly owned subsidiary effective as of January 31, 2000.

(3) Represents the personal portion of the use of a company vehicle, as well as $5,000 of fair market value of our matching contributions of common stock to Dr. Rose's account in the company's 401(k) Plan.

(4) Represents the regrant of an option in the original amount of 200,000 shares which was reduced to 150,000 shares as a result of the employee equity incentive repricing plan approved by the Board of Directors on July 10,1998.

(5) Represents $4,666.56 of fair market value of the company matching contributions of common stock to Dr. Rose's account in our 401(k)Plan.

(6) Represents $4,783 of fair market value of the company matching contributions of common stock to Dr. Ann Tsukomoto

(7) Represents $3,245 of fair market value of the company matching contributions of common stock to Dr. Ronnda Bartel

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding the beneficial ownership of the Company's Common Stock as of March 09, 2001 by (i) each person known by the Company to be the beneficial owner of more than 5% of the Company's outstanding Common Stock, (ii) each director and nominee for director, (iii) each executive officer named in the Summary Compensation Table and (iv) all executive officers and directors of the Company as a group. Except as otherwise indicated, the Company believes that the beneficial owners of the Common Stock listed below, based on information furnished by such owners, have sole investment and voting power with respect to such shares, subject to community property laws where applicable, and that there are no other affiliations among the stockholders listed in the table.

NAME OF BENEFICIAL OWNER	SHARES BENEFICIALLY OWNED*	PERCENTAGE OF CLASS BENEFICIALLY OWNED*
Donald Kennedy, Ph.D.	10,309(1)	**
Mark J. Levin	347,775(2)	1.5%
Martin M. McGlynn	--	
Roger Perlmutter, M.D., Ph.D.	--	**
John J. Schwartz, Ph.D.	115,588(3)	**
Irving Weissman, M.D.	291,308(4)	1.3%
George W. Dunbar, Jr.	50,049(5)	**
All directors and executive officers as a group (7 persons)	815,029	3.6%
Millennium Partners, LP	2,152,393(6)	9.5%

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* All numbers are based on information obtained by questionnaire or filings on Forms 13D or 13G received by the Company.

** Less than one percent.

(1) Includes 10309 shares issuable upon exercise of stock options exercisable within 60 days.

(2) Includes 37,400 shares issuable upon exercise of stock options exercisable within 60 days. Includes 198,871 shares issuable upon conversion of 6% cumulative convertible preferred shares at the currently applicable conversion price. Does not include a warrant to purchase 37,500 shares

exercisable at a price above the current market price. Includes 111,504 shares held outright.

(3) Includes 115,588 shares issuable upon exercise of stock options exercisable within 60 days.

(4) Includes 34,486 shares issuable upon exercise of stock options exercisable within 60 days and 7,160 shares issuable upon exercise of warrants exercisable within 60 days. Includes 198,871 shares issuable upon conversion of 6% cumulative convertible preferred shares at the currently applicable conversion price. Does not include a warrant to purchase 37,500 shares exercisable at a price above the current market price. Includes a total of 50,791 shares owned by trusts for the benefit of Dr. Weissman's children as to which he disclaims beneficial ownership.

(5) Includes 26,031 shares issuable upon exercise of stock options exercisable within 60 days. Includes 24,018 shares held outright. Mr. Dunbar was appointed Acting President and Chief Executive Officer of the Company's wholly owned subsidiary, StemCells California, Inc., effective as of November 8, 1999, and was appointed Acting President and Chief Executive Officer of the Company effective as of February 1, 2000.

(6) Includes 1,054,835 shares held outright. Includes 101,587 shares currently issuable upon the exercise of warrants issued on August 3, 2000. Includes 19,900 shares currently issuable upon the exercise of warrants issued on August 30, 2000. Includes 461,894 if shares currently issuable upon exercise of an option issued on August 3, 2000 to purchase up to $2 million of our Common Stock based upon the market price of the Common Stock at the time of the exercise. Includes 50,808 shares issuable upon the exercise of warrants issuable upon exercise of the afore mentioned option. Includes 463,369 shares issuable upon exercise of an adjustable warrant.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Dr. Schwartz, a member and Chairman of the Board of Directors, was retained in July 1998 to serve as a consultant to us rendering strategic business advice and consulting services, including assistance in the negotiation and consummation of strategic collaboration transactions specified by us. Under terms of an agreement dated December 19, 1998, and amended as of July 1, 1999 (the "Letter Agreement") Dr. Schwartz agreed to serve as a Director and Chairman of the Board of Directors of the Company for a term expiring at the 2001 Annual Meeting of Stockholders. The Letter Agreement incorporates certain payments provided for under a consulting services agreement dated July 27, 1998, and amended as of December 19, 1998 (the "Consulting Services Agreement"). As a result, Dr. Schwartz is entitled to a retainer of $192,000 per year plus $1,500 for each Board meeting or Committee meeting (if held at a date and time separate from the Board meeting) physically attended and $500 for each Board meeting or Committee meeting (if held at a date and time separate from the Board meeting) held by conference call, payable quarterly in arrears. Dr. Schwartz is obligated to spend no less than thirty business days per calendar quarter devoted to the performance of his duties under the Letter Agreement. In the event Dr. Schwartz devotes more than thirty business days in any calendar quarter to the performance of his duties, Dr. Schwartz is entitled to receive additional compensation at the rate of $1,500 per day. Under the Letter Agreement, Dr. Schwartz was granted a stock option covering 40,000 shares of Common Stock that vests in equal portions on the last day of each of the 29 months of the term of the Letter Agreement. By virtue of provisions incorporated from the Consulting Services Agreement, Dr. Schwartz also holds an option to purchase 76,000 shares of the Company's Common Stock at $1.281 per share, the fair market value of the Company's Common Stock at the time the option was granted, vesting at a rate of 3,167 shares per month for the ensuing 23 months after the date of the grant, with a final vesting of 3,159 shares in the 24th month, plus another option to purchase 48,000 shares of Common Stock at the then current fair market value of the Company's Common Stock on July 27, 1999, vesting at a rate of 2,000 shares per month. In the event Dr. Schwartz ceases to be Chairman of the Board of Directors, either as a result of an affirmative vote of the Board of

Directors for reasons other than cause or due to his disability or his resignation from such position, but remains a Director, his cash compensation and remaining unvested portion of the 40,000-share time-based stock option will be reduced to the then current rate for a Director of the Company, plus $5,000 per month pursuant to the Consulting Services Agreement. In the event Dr. Schwartz ceases to be Chairman of the Board of Directors, either as a result of an affirmative vote of the Board of Directors for reasons other than cause or due to his disability or his resignation from such position, and then he resigns as a Director or is removed as a Director pursuant to the Company's By-laws, the Company shall have no further obligation to pay cash compensation to Dr. Schwartz under the Letter Agreement but he would receive $5,000 per month pursuant to the Consulting Services Agreement. Dr. Schwartz shall have one year from such date to exercise the vested portion of the 40,000-share time-based option and any unvested portion of that option shall lapse. In

the event Dr. Schwartz is removed from his positions as Director and Chairman of the Board of Directors for cause, as defined in the Letter Agreement, the Company shall have no further obligation to pay cash compensation to Dr. Schwartz under the Letter Agreement, any unvested portion of the 40,000-share time-based option shall lapse and the exercise of any vested portion shall be governed by the terms of the Company's 1992 Equity Incentive Plan. The termination of the Letter Agreement for any reason shall have no effect on the Consulting Services Agreement, which had an initial term through July 27, 2000 and was renewed on a month-to-month basis, and Dr. Schwartz shall serve as a consultant to the Company rendering strategic business advice and counseling services, including assistance in the negotiation and consummation of strategic collaboration transactions specified by the Company as provided therein. At a meeting of the Board on February 23, 2000, in order to conserve cash and demonstrate his continuing confidence in the Company's future, the Board of Directors, upon the suggestion of Dr. Schwartz, approved a resolution revising the compensation arrangement between Dr. Schwartz and the Company, for the period commencing January 1, 2000. Under this resolution, Dr. Schwartz waives any and all cash payments which may accrue to him for his retainer, monthly and meeting fees, and agrees to take, in lieu of such cash payments, compensation in the form of options to purchase shares of the Company's common stock at below-market prices ($0.25 per share). To effectuate the intention of Dr. Schwartz and other members of the Board to change the form but not the amount of compensation, Dr. Schwartz will be granted options covering a number of shares of the Company's common stock such that the difference between the aggregate exercise price of such options and the aggregate market value of the shares underlying such options (using the closing price of the Company's common stock for the date of the subject Board or Committee meeting (if such Committee meeting is not held contemporaneously with a Board meeting) or, with respect to the quarterly or monthly retainer payments of $33,000 and $5,000 respectively, the closing price for the last business day of the quarter or month) is equal to the compensation he is entitled to receive. All options so issued to Dr. Schwartz vest immediately. The Consulting Services Agreement expired under its terms on July 27, 2000 and the board of directors renewed it on a month-to-month basis on September 19, 2000.

Dr. Weissman, a member of the Board of Directors, was retained in September 1997 to serve as a consultant to us. Pursuant to his Consulting Agreement, Dr. Weissman has agreed to provide consulting services to us and serve on our Scientific Advisory Board. We agreed to pay Dr. Weissman $50,000 per year for his services and granted him an option to purchase 500,000 shares of Common Stock for $5.25 per share, of which 31,250 shares vested at the date of grant. Originally, the remainder of the option would have vested upon the occurrence of certain milestones related to the Company's stem cell research program and in the event of certain changes of control. We agreed to amend the option on October 27, 2000 so that the shares would become exercisable over eight years from the original grant date (so the option is currently exercisable for 200,000 shares) or in the event of certain changes of control. We have recorded a compensation expense of $823,759 during the fourth quarter of 2000 as a result of this change in the vested portion of the option. The deferred compensation expense associated with the unvested portion of the grants was recorded as $669,116. We plan to revalue the options using the Black-Scholes

method on a quarterly basis and recognize additional compensation expense accordingly. The Company also agreed to nominate Dr. Weissman for a position on the Board of Directors. The Consulting Agreement contains confidentiality, noncompetition, and assignment of invention provisions and is for a term of fifteen years, subject to earlier termination by us for cause or frustration of purpose and earlier termination by Dr. Weissman for good reason. Dr. Weissman initially received no compensation as a member of the Board of Directors or for attending meetings of the Board or its committees or meetings of our Scientific Advisory Board, but was reimbursed for reasonable expenses he incurred in attending such meetings. In December 2000, we agreed with Dr. Weissman that we would pay him the same compensation paid to other members of the Board.

Martin McGlynn joined the company as President and Chief Executive Officer on January 15, 2001. Under the terms of an agreement between Mr. McGlynn and us, Mr. McGlynn is entitled to an annual base salary of $275,000 per year, reviewable annually by the Board of Directors, and a bonus, in

the Board's sole discretion, of up to 25% of his base salary. Mr. McGlynn was granted an option to purchase 400,000 shares of Common Stock with an exercise price equal to the fair market value of the Common Stock on the date of his employment. One-fourth of these options will vest on the first anniversary of his employment and the remaining three-fourths will vest in equal monthly installments during his second through fourth years of employment. The Board may, in its sole discretion, grant Mr. McGlynn a bonus option to purchase up to an additional 25,000 shares. The vesting under the option is subject to acceleration in the event of certain changes of control. We also agreed to pay Mr. McGlynn a $50,000 relocation bonus and reimburse him for relocation expenses. Our agreement with Mr. McGlynn provides that if his employment is terminated by the Company without cause or by Mr. McGlynn for good reason, he will be entitled to severance payments equal to one year's base salary and he will receive healthcare benefits under our plans for one year after termination. If Mr. McGlynn's employment is terminated as a result of his disability, he will receive up to six months' base salary. If we terminate Mr. McGlynn's employment for cause or if he resigns, he will not be entitled to any severance or other benefits.

George W. Dunbar, Jr., Acting President and Chief Executive Officer from February 1, 2000 to January 15, 2001, was a founding member of iCEO, LLC ("iCEO") in September 1999. Mr. Dunbar joined the company as Acting President of StemCells California, Inc., our wholly owned subsidiary, and he held this position until January 15, 2001. Under the terms of two agreements dated as of November 17, 1999 and effective as of November 8, 1999, the first between us and iCEO and the second between us and Mr. Dunbar, Mr. Dunbar agreed to serve as Acting President of StemCells California, Inc., our wholly owned subsidiary. Pursuant to the terms of his agreement with us, Mr. Dunbar was entitled to an annual salary of $175,000 and was granted a stock option to purchase 48,000 shares of our common stock that vested at the rate of 4,000 shares per month commencing on December 6, 1999 and continuing until fully vested so long as he served as Acting President. The vesting under the option was subject to acceleration in the event of certain changes of control. Additionally, the agreement provided that the Board would consider once per quarter the grant of an option for an additional 3,000 shares if it is determined that the services rendered by Mr. Dunbar during the preceding quarter exceeded expectations. The agreement with Mr. Dunbar had no provisions for any severance payments or other benefits upon Mr. Dunbar's resignation or termination. Pursuant to the terms of the agreement between iCEO and us, iCEO was entitled to receive annual compensation of $75,000 for so long as Mr. Dunbar continued to serve in his role as Acting President of StemCells California, Inc. or in any other interim role with the Company. In addition, iCEO was granted a stock option to purchase 48,000 shares of our common stock that vested at the rate of 4,000 shares per month commencing on December 6, 1999 and continuing until fully vested so long as Mr. Dunbar served as Acting President of StemCells California, Inc. or in any other interim role with the company. Additionally, the iCEO agreement provided that the Board would consider once per quarter the grant of an option to iCEO for an additional 3,000 shares if it is determined that the services rendered by Mr. Dunbar during the preceding quarter exceeded expectations. As a member of

iCEO, Mr. Dunbar was entitled to receive, once annually, a distribution of his assigned allocable percentage of net taxable income and net long-term gain with respect to the pooled income and gain from shares of stock or exercised options received by iCEO from its clients, including that received from us. When Mr. Dunbar was appointed Acting President and Chief Executive Officer effective as of February 1, 2000, there was no adjustment to his or iCEO's compensation or stock options. In the event that during the period of his service as Acting President and Chief Executive Officer or within 120 days from the termination of such services, Mr. Dunbar were to become a permanent employee in any capacity, we would be obligated under the iCEO agreement to pay iCEO a fee equal to one-third of the then targeted first year's compensation for Mr. Dunbar. Our agreements with Mr. Dunbar and iCEO expired in November 2000 and at that time we paid Mr. Dunbar a bonus of $50,000 and granted him an immediately exercisable option to purchase 12,031 shares of common stock. We continued to employ Mr. Dunbar in the same capacity until January 15, 2001 at an annual salary of $250,000, and

also granted him an option to purchase 8,000 shares of common stock for each additional month, or pro rata portion of a month, of his employment.

In April 2000, we sold 750 shares of our 6% cumulative convertible preferred stock plus a warrant to purchase 37,500 shares of our common stock to each of Dr. Weissman and Mr. Levin for $750,000, for a total of $1,500,000, on terms more favorable to us than we were able to obtain from outside investors. The face value of the shares is convertible at the option of the holder into common stock at $3.77 per share. The holders of the preferred stock have liquidation rights equal to their original investments plus accrued but unpaid dividends. The investors would be entitled to make additional investments in our securities on the same terms as those on which we complete offerings of our securities with third parties within 6 months, if any such offerings are completed. If offerings totaling at least $6 million are not completed during the 6 months, the investors have the right to acquire up to a total of 1,126 additional shares of convertible preferred stock the face value of which is convertible at the option of the holder into common stock at $6.33 per share. Any unconverted preferred stock will be converted into common stock on April 13, 2002 in the case of the original stock issued and two years after the first acquisition of any of the additional 1,126 shares, if any are acquired. The warrants expire on April 13, 2005.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(A) DOCUMENTS FILED AS PART OF THIS FORM 10-K.

(1) Financial Statement Schedules:

Schedules not included herein are omitted because they are not applicable or the required information appears in the Financial Statements or Notes thereto.

(2) Exhibits.

EXHIBIT NO.	TITLE OR DESCRIPTION
3.1*	Restated Certificate of Incorporation of the Registrant
3.2++	Amended and Restated By-Laws of the Registrant.
4.1*	Specimen Common Stock Certificate.
4.2++++	Form of Warrant Certificate issued to a certain purchaser of the Registrant's Common Stock in April 1995.
4.3X	Warrant to Purchase Common Stock--Mark Angelo

4.4X	Warrant to Purchase Common Stock--Robert Farrell
4.5X	Warrant to Purchase Common Stock--Joseph Donahue
4.6X	Warrant to Purchase Common Stock--Hunter Singer
4.7X	Warrant to Purchase Common Stock--May Davis
4.8X	Common Stock Purchase Warrant
4.9X	Callable Warrant
10.1*	Amendment to Registration Rights dated as of February 14, 1992 among the Registrant and certain of its stockholders.
10.2*	Form of at-will Employment Agreement between the Registrant and most of its employees.
10.3*	Form of Agreement for Consulting Services between the Registrant and members of its Scientific Advisory Board.
10.4*	Form of Nondisclosure Agreement between the Registrant and its Contractors.
10.5*	Master Lease and Warrant Agreement dated April 23, 1991 between the Registrant and PacifiCorp Credit, Inc.
10.6*	1988 Stock Option Plan.
10.7*	1992 Equity Incentive Plan.
10.8*	1992 Stock Option Plan for Non-Employee Directors.
10.9**!!!!	1992 Employee Stock Purchase Plan.
10.12++	Research Agreement dated as of March 16, 1994 between NeuroSpheres, Ltd. and Registrant.
10.13++	Term Loan Agreement dated as of September 30, 1994 between The First National Bank of Boston and Registrant.
10.14++	Lease Agreement between the Registrant and Rhode Island Industrial Facilities Corporation, dated as of August 1, 1992.

EXHIBIT NO.	TITLE OR DESCRIPTION
10.15++	First Amendment to Lease Agreement between Registrant and The Rhode Island Industrial Facilities Corporation dated as of September 15, 1994.
10.17**++++	Development, Marketing and License Agreement, dated as of March 30, 1995 between Registrant and Astra AB.
10.18++++	Form of Unit Purchase Agreement to be executed by the purchasers of the Common Stock and Warrants offered in April 1995.
10.19+++	Form of Common Stock Purchase Agreement to be executed among the Registrant and certain purchasers of the Registrant's Common Stock.
10.22###	Lease Agreement dated as of November 21, 1997 by and between Hub RI Properties Trust, as Landlord, and CytoTherapeutics, Inc., as Tenant.
10.24!!	CTI individual stockholders option agreement dated as of July 10, 1996 among the Company and the individuals listed therein.
10.25!!	CTI Valoria option agreement dated of July 10, 1996 between the Company and the Societe Financiere Valoria SA.
10.26!!!	Term Loan Agreement dated as of October 22, 1996 between The First National Bank of Boston and the Registrant.

10.27***	Agreement and Plan of Merger dated as of August 13, 1997 among StemCells, Inc., the Registrant and CTI Acquisition Corp.
10.28***	Consulting Agreement dated as of September 25, 1997 between Dr. Irving Weissman and the Registrant.
10.29###	Letter Agreement among each of Dr. Irving Weissman and Dr. Fred H. Gage and the Registrant.
10.32****	StemCells, Inc. 1996 Stock Option Plan.
10.33****	1997 StemCells Research Stock Option Plan (the "1997 Plan")
10.34****	Form of Performance-Based Incentive Option Agreement issued under the 1997 Plan.
10.35###	Employment Agreement dated as of September 25, 1997 between Dr. Richard M. Rose and the Registrant.
10.38[*]	Rights Agreement, dated as of July 27, 1998 between Bank Boston, N.A. as Rights Agent and the Registrant.
10.40Section**	Consulting Services Agreement dated as of July 27, 1998, as amended December 19, 1998 between Dr. John J. Schwartz and the Registrant.
10.41Section**	Letter Agreement dated as of December 19, 1998 between John J. Schwartz and the Registrant.
10.42Section**	License Agreement dated as of October 27, 1998 between The Scripps Research Institute and the Registrant.
10.43Section**	License Agreement dated as of October 27, 1998 between The Scripps Research Institute and the Registrant.
10.44Section**	License Agreement dated as of November 20, 1998 between The Scripps Research Institute and the Registrant.
10.45SectionSection**	Purchase Agreement and License Agreement dated as of December 29, 1999 between Neurotech S.A. and the Registrant.

EXHIBIT NO.	TITLE OR DESCRIPTION
10.46**	License Agreement dated as of June 1999 between The Scripps Research Institute and the Registrant.
10.47**	License Agreement dated as of June 1999 between The Scripps Research Institute and the Registrant.
10.48X	Form of Registration Rights Agreement dated as of July 31, 2000 between StemCells, Inc. and investors.
10.49X	Subscription Agreement dated as of July 31, 2000 between StemCells, Inc. and Millennium Partners, L.P.
10.50	License Agreement dated as of October 30, 2000 between StemCells, Inc. and NeuroSpheres Ltd.
10.51	Letter Agreement dated January 2, 2001 between StemCells, Inc. and Martin McGlynn.
10.52	Lease dated February 1, 2001 between the Board of Trustees of Stanford University and StemCells, Inc.
21X	Subsidiaries of the Registrant.
23.1	Consent of Ernst & Young LLP, Independent Auditors.
99.1	Cautionary Factors Relevant to Forward-Looking Information.
99.2	Side Letter dated March 17, 2001 between StemCells, Inc. and Oleh S. Hnatiuk regarding NeuroSpheres License Agreement dated October 30, 2000.

++ Previously filed with the Commission as Exhibits to, and incorporated herein by reference to, the Registrant's Registration Statement on Form S-1, File No. 33-85494.

+++ Previously filed with the Commission as Exhibits to, and incorporated herein by reference to, the Registrant's Registration Statement on Form S-3, File No. 33-97272.

++++ Previously filed with the Commission as Exhibits to, and incorporated herein by reference to, the Registrant's Registration Statement on Form S-1, File No. 33-91228.

* Previously filed with the Commission as Exhibits to, and incorporated herein by reference to, Registration Statement on Form S-1, File No. 33-45739.

Previously filed with the Commission as Exhibits to, and incorporated herein by reference to, the Registrant's Annual Report on Form 10-K for fiscal year ended December 31, 1992 and filed March 30, 1993.

** Confidential treatment requested as to certain portions. The term "confidential treatment" and the mark "**" as used throughout the indicated Exhibits mean that material has been omitted and separately filed with the Commission.

Previously filed with the Commission as Exhibits to, and incorporated herein by reference to, the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1994 and filed on May 14, 1994.

+ Previously filed with the Commission as Exhibits to, and incorporated herein by reference to, the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1993 and filed on March 30, 1994.

! Previously filed with the Commission as an Exhibit to and incorporated by reference to, the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1996.

!! Previously filed with the Commission as an Exhibit to and incorporated by reference to, the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1996.

!!! Previously filed with the Commission as an Exhibit to, and incorporated herein by reference to, the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 and filed on March 31, 1997.

!!!! Previously filed with the Commission as an Exhibit to, and incorporated herein by reference to, the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1995.

*** Previously filed with the Commission as Exhibits to, and incorporated herein by reference to, the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1997 and filed on November 14, 1997.

**** Previously filed with the Commission as Exhibits to, and incorporated herein by reference to, the Registrant's Registration Statement on Form S-8, File No. 333-37313.

Previously filed with the Commission as an Exhibit to, and incorporated herein by reference to, the Registrant's annual report on Form 10-K for the fiscal year ended December 31, 1997 and filed on March 30, 1998.

[*] Previously filed with the Commission as an Exhibit to, and incorporated herein by reference to, the Registrant's current report on Form 8-K filed on August 3, 1998.

Section Previously filed with the Commission as an Exhibit to, and incorporated herein by reference to, the Registrant's annual report on Form 10-K for the fiscal year ended December 31, 1998 and filed on March 31, 1999.

SectionSection Previously filed with the Commission as an Exhibit to, and incorporated herein by reference to, the Registrant's current report on Form 8-K on January 14, 2000

X Previously filed with the Commission as an Exhibit to, and incorporated herein by reference to, the Registrant's Registration Statement on Form S-1, File No. 333-45496.

(B) CURRENT REPORTS ON FORM 8-K.

None

SIGNATURES

STEMCELLS, INC.

By: /s/ MARTIN MCGLYNN

Martin McGlynn
PRESIDENT AND CHIEF EXECUTIVE OFFICER

Dated: March 31, 2001

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

SIGNATURES	CAPACITY	DATE
/s/ MARTIN MCGLYNN Martin McGlynn	President and Chief Executive Officer and Director (principal executive officer)	March 31, 2001
/s/ GEORGE KOSHY George Koshy	Controller and Acting Chief Financial officer (prinipal financial officer and principal accounting officer)	March 31, 2001
/s/ MARK J. LEVIN Mark J. Levin	Director	March 31, 2001
/s/ ROGER PERLMUTTER, M.D. Roger Perlmutter, M.D.	Director	March 31, 2001
/s/ JOHN J. SCHWARTZ, PH.D. John J. Schwartz, Ph.D.	Director, Chairman of the Board	March 31, 2001
/s/ IRVING L. WEISSMAN, M.D. Irving L. Weissman, M.D.	Director	March 31, 2001

Exhibit 10.50

LICENSE AGREEMENT

This license agreement is between STEMCELLS, INC. ("SCI"), a Delaware corporation and NEUROSPHERES LTD., ("NS"), an Alberta corporation, and NEUROSPHERES HOLDINGS LTD., ("NHL"), an Alberta corporation and is dated effective as of October 30 2000.

RECITALS:

A. SCI (formerly known at that time and subsequently until May 23, 2000 as CytoTherapeutics, Inc. ("CTI")) and Dr. Samuel Weiss ("Dr. Weiss") and Dr. Brent A. Reynolds ("Dr. Reynolds") entered into an evaluation & option agreement dated July 6, 1992 relating to the evaluation of certain cells and a consulting agreement. Drs. Weiss and Reynolds subsequently transferred all of their rights under these agreements to NS. These agreements were terminated on execution of the Contract Research and License Agreement.

B. On March 14, 1994 NS and NHL entered into an assignment agreement under which NS transferred intellectual property rights to NHL (the "Assignment Agreement") and a simultaneous license agreement from NHL to NS providing the exclusive rights to use such assigned intellectual property rights (the "NS/NHL License").

C. SCI and NS entered into a certain Contract Research and License Agreement (the "1994 License Agreement") and SCI and NHL entered into a backup license agreement on substantially the same terms as the License Agreement (the "BackUp License") both dated March 15, 1994.

D. SCI and NS and NHL disagreed on the scope of the 1994 License Agreement and the manner in which they would collaborate and on other matters and, in order to clarify the rights and obligations of the parties, they entered into a 1997 License Agreement dated as of April 1, 1997 (the "1997 License Agreement") pursuant to which, among other things, NS licensed the Existing Patent Rights and rights to the Existing Cell Technology to SCI (as those terms are defined herein)..

E. The parties now desire to enter into a new agreement, to expand the scope of the rights licensed by NS to SCI, on the terms set forth herein, in addition to the rights granted to SCI and the obligations of SCI in the 1997 License Agreement, but except as expressly provided herein, NOT to supercede or replace the 1997 License Agreement, which shall remain in full force and effect.

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.

*Confidential Treatment has been requested for the marked portion.

1.01 "Affiliate" shall mean any corporation, company, partnership, joint venture and/or firm which 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 corporate entities, direct or indirect ownership

of more than 50% of the stock or shares entitled to vote for the election of directors; 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 "Agent" shall mean ***** .

1.03 "Cells" shall mean ***** ; and

An EGF-responsive neuronal stem cell includes:

***** .

1.04 "Cell Replacement Therapy" shall mean ***** .

1.05 "Cell Technology" shall mean ***** .

1.06 "Confidential Information" shall mean any and all information of or about a Person 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). Notwithstanding the foregoing, information shall not be considered "Confidential Information" with respect to such Person to the extent that any other Person possessing such information can demonstrate by written record or other suitable physical evidence that:

(a) such specific information was lawfully in such other Person's possession or control prior to the time such information was disclosed to such other Person by the Person to whom the information relates;

(b) such specific information was developed by one or more employees of such other Person without such employee having access to the Confidential Information;

(c) such specific information was lawfully obtained by such other Person from a third party under no obligation of confidentiality to the Person to whom such information relates; or

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

*Confidential Treatment has been requested for the marked portion.

1.07 "SCI Sublicensee" or "Sublicensee" shall mean any Person, including an Affiliate of SCI, to whom SCI shall have licensed any or all of its rights under this Agreement.

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

1.09 "Effective Date" shall mean October 30, 2000.

1.10 "E.g." shall mean, for example, but not in limitation.

1.11 "Existing Cell Technology" shall mean the entire portion of Cell Technology that existed and was provided to CTI as of April 1, 1997.

1.12 "Existing Patent Rights" shall mean those Patent Rights described in the 1997 License Agreement, including the patents and patent applications listed on Exhibit A in the 1997 License Agreement and any inventions made by NS or NHL as of April 1, 1997, to the extent they applied to the making, use or sale of Products or performance of Services in the Existing Field.

1.13 "Existing Field" shall mean ***** .

The Existing Field does not include:

***** .

The foregoing exclusions from the Existing Field define exclusions from the Existing Field, and shall have no other meaning (e.g., they are not a contractual prohibition against SCI from engaging in any activity it would be otherwise entitled to engage in).

1.14 "New Field" shall mean ***** .

1.15 "Gross Revenues" shall mean ***** .

1.16 "Improvement" shall mean any enhancement of, improvement to, or technology related to, the intellectual property licensed to SCI hereunder that is made after the Effective Date.

1.17 "Net Sales" means ***** .

1.18 "New Cell Technology" shall mean all Cell Technology, exclusive of and not including Existing Cell Technology.

1.19 "New Patent Rights" shall mean any and all Patent Rights, including those listed on Ex. B, that are exclusive of and not included in Existing Patent Rights.

*Confidential Treatment has been requested for the marked portion.

1.20 "Patent Rights" shall mean (i) any patents and patent applications throughout the world that NS or NHL owns or has rights to as of the Effective Date of this Agreement (which shall include, without limitation, patent and patent applications as set forth on Exhibit A), which without the license to SCI hereunder would be infringed by the making, using or selling of Products or performing of Services, (ii) all foreign counterparts of such patents and patent applications, (iii) all substitutions, extensions (including patent term extensions), reissues, renewals, divisions, continuations, and continuations-in-part in respect of the foregoing; (iv) any inventions conceived or reduced to practice that NS or NHL owns or has rights to. Patent Rights shall include, without limitation, Existing Patent Rights and New Patent Rights as listed in Exhibits A and B.

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

1.22 "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.

1.23 "Phase II Clinical Trial" shall mean a human clinical trial in any country that is intended to evaluate the 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.

1.24 "Phase III Clinical Trial" shall mean a pivotal human clinical trial in any country the results of which could be used to establish safety and efficacy of a product as a basis for a marketing approval application submitted to FDA, or that would otherwise satisfy the requirements of 21 CFR 312.21(c), or its foreign equivalent.

1.25 "Product" shall mean any product or method utilizing Cells or Cell Technology and the manufacture, use, or sale of which, but for the license granted to SCI hereunder, would infringe any valid claim of the Patent Rights or of any Cell Technology.

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

1.27 "Sale" or "Sell" shall mean any sale, lease or other commercial disposition of the Product in an arms-length transaction with an unaffiliated third party.

1.28 "Services" shall mean any use of Cells or Cell Technology to perform a service for a third party for compensation, where such use would, but for the license granted to SCI hereunder, infringe any valid claim of the Patent Rights.

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

1.30 "Transplantation" shall mean ***** .

*Confidential Treatment has been requested for the marked portion.

1.31 "NL Licensed Technology" shall mean ***** .

2. LICENSE AGREEMENT

2.01 EXCLUSIVE LICENSE

NS hereby grants to SCI ***** .

2.02 NOTICE OF SUBLICENSEE

SCI shall notify NS in writing within thirty (30) days of the grant by SCI to a SCI Sublicensee of any of its rights hereunder. Such notice shall include a summary of the terms of the sublicense and verbatim copies of all clauses necessary for NS to determine and enforce SCI's financial obligations to NS pursuant to Section 3.12 hereof with respect to such grant of rights. If a serious question should arise as to the accuracy or adequacy of such notice, a full copy of such grant shall be provided by SCI to counsel for NS, PROVIDED, HOWEVER, that (1) only counsel, and not any individuals otherwise associated with NS, shall have access to the copy so provided unless necessary for NS to enforce the obligations of SCI in relation to such sublicense; (2) any text disclosing the confidential information of the grantee shall first have been deleted; and (3) the copy shall not be further reproduced, except as may be required by law, and shall be destroyed after the question has been resolved. All disclosures pursuant to this Section, unless otherwise publicly disclosed by SCI, shall be Confidential Information.

2.03 RIGHTS LIMITED TO THOSE EXPRESSED

The rights granted to SCI and NS hereunder shall be limited to the rights expressly stated to be granted hereunder and no additional rights or licenses are implied. For greater certainty, the Parties agree that any payments contemplated under this Agreement (such as, for example, Royalties, milestone payments, sublicensing fees, etc.) shall be paid by SCI to NS on any uses of the New Patent Rights or New Cell Technology on the basis provided in this Agreement.

3. PAYMENTS

3.01 ROYALTIES

(a) SCI shall pay to NS a ***** royalty on any and all Net Sales made, directly or indirectly, by any of SCI and/or any SCI Affiliates, regardless of where the Sales are made, and regardless of the number of valid claims, if any, within Patent Rights that are applicable to the NL Licensed Technology. Any Affiliate shall be obligated to make royalty payments to NS to the extent SCI does not do so; SCI, however, remains primarily liable to NS for the payment of all royalties including royalties which may be paid by any Affiliate or Sublicensee hereunder. SCI

*Confidential Treatment has been requested for the marked portion.

shall pay to NS a royalty on any and all Net Sales made, directly or indirectly, by any of SCI Sublicensees, regardless of where the Sales are made, and regardless of the number of valid claims (provided there is at least one valid issued claim) within Patent Rights that are applicable to the NL Licensed Technology for the term, on a country by country basis, as set out in Section 10.02. The form of royalties payable by any Sublicensee is set out in Section 3.12.

(b) SCI shall also pay to NS a ***** royalty on any and all Net Sales made, directly or indirectly, by SCI or StemCells California, Inc., an SCI subsidiary, on any product (a "Screening Product") owned or controlled by SCI or StemCells California, Inc., and which is discovered or validated by SCI or StemCells California, Inc. directly through the use of in house Drug Screening Services, or of any amounts received by SCI or StemCells California from a third party on account of such a Screening Product. For purposes of this Section 3.01(b) only, Screening Products are hereby deemed to be Products solely for purposes of calculating the royalty due hereunder.

All royalties payable under this Section 3.01 are hereinafter referred to collectively as "Royalties".

3.02 COMBINATION PRODUCTS

In the event a royalty under Section 3.01 is due on Sales of a Product which is in the form of a combination product containing one or more active ingredients that are not themselves Products (a "Combination Product"), the Net Sales of the Combination Product shall be adjusted by multiplying the Net Sales of the Combination Product calculated in accordance with Section 1.16 hereof by a fraction A/(A+B) where A is the fair market value of the Combination Product without the other active ingredients, and B is the fair market value of a product containing only

the other active ingredients. The Net Sales as so adjusted shall be the basis for calculating any Royalty payable on a Combination Product, provided that the effect of such an adjustment to Net Sales shall be limited such that it cannot reduce the Royalty rate on a Combination Product to less than ***** of Net Sales of such Combination Product.

If a Product or Service is based, in part, on rights licensed under the 1997 License Agreement, and, in part, under rights licensed under this Agreement, then the royalty on such Product or Service shall be ***** on any and all Net Sales of such Product or Service made, directly or indirectly, by any of SCI, any SCI Affiliates and/or by any SCI Sublicensee and the provisions of the above paragraph shall not apply.

3.03 REPORTS AND PAYMENTS

Beginning with the calendar quarter commencing on the Effective Date, SCI shall deliver to NS within sixty (60) days after the end of each such calendar quarter, a written report showing all Royalties due under this Agreement. Each report shall include the rates of

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exchange used to convert such Royalties to U.S. Dollars from the currency in which Net Sales were made. Each report shall also identify the amount of Royalties attributable to Sales or the performance of Services. For the purposes hereof, the rates of exchange to be used for converting Royalties hereunder to U.S. Dollars shall be those in effect for the purchase of U.S. dollars at New York, New York at the exchange rate quoted in the Wall Street Journal on the day five (5) business days prior to the date on which payment in U.S. Dollars of all Royalties shown to be due thereon, except as provided in Section 3.04. Royalties on Net Sales earned by SCI, its Affiliates or SCI Sublicensees in Canadian dollars in Canada may be paid to NS in Canadian dollars without requirement of first converting to U.S. Dollars.

In addition, where the royalties for a specific Product or Service is based on in situ modification and manipulation of CNS stem cells as claimed in under any of the following patent applications then SCI shall specifically advise NS in writing of the amount of royalties based on any of these patent applications. The patent applications to which this paragraph applies are ***** .

3.04 FOREIGN ROYALTIES

Where Royalties are due hereunder for 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 Royalty payments out of such country for Net Sales in that country, such Royalties shall be deposited in a currency that is permitted for the Person not able to make the transfer for the benefit or credit of the party entitled to receive such payments.

3.05 WITHHOLDING TAXES

If a party is required to withhold tax on Royalties 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 Sublicensee(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 payable hereunder. During the term of this Agreement and for a period of ***** following its termination, the receiving party shall have the right from time to time (not to exceed twice during each calendar year), to have an accountant or other nonaffiliated (with the receiving party) representative 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 due to the receiving party, then the paying party shall pay to the receiving party any shortfall in royalties payable plus interest thereon at the prime rate of the Royal Bank of Canada Calgary Branch in

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effect in the last day of the calendar year for which such royalties were due, plus *****, or if the paying party has overpaid royalties, the receiving party shall promptly refund the excess. If a shortfall greater than ***** of the royalties payable in any year should be found to be due, SCI shall pay the reasonable costs of the audit or inspection. Unless challenged within ***** after a statement is rendered, Royalties 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 Sublicensee(s), unless the paying party shall have had an audit of such Affiliate or its Sublicensee(s) performed within the preceding 3 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 Sublicensee(s) has under reported Net Sales by more than 10%.

3.07 NO MULTIPLE ROYALTIES

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

3.08 ANNUAL PAYMENTS

SCI shall make annual payments to NS ***** during the term hereof (the "Annual Payments"), beginning with the first of the following years: (i) the first full year of commercial sales of any licensed Product are made, and (ii) the year 2004. Each Annual Payment due hereunder shall be payable on or before the last day of the year for which it is due. The Annual Payment in this section 3.08 shall be fully creditable on an accumulated basis against any royalty income due to NS under section 3.01 or 3.02. Annual Payments are not refundable.

3.09 SCREENING SERVICES FEE

It is hereby acknowledged that under the license granted in Section 2.01, SCI and StemCells California, Inc. have the right to perform, amongst other services, in house drug-screening services (i.e., screening of drug candidates whether proteins or small molecules) for third parties using one or more techniques which are claimed in Patent Rights ("Drug Screening Services"). SCI shall be obligated to pay an annual fee to NS

***** for any year or portion thereof during the term hereof in which either SCI or StemCells California, Inc. performs directly or indirectly Drug Screening Services for third parties (the "Screening Payment"). Each Screening Payment due hereunder shall be payable on or before the last day of the year for which it is due. The Screening Payment is creditable against Royalties payable under Section 3.01(b) of this Agreement and is otherwise not refundable.

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3.10 UPFRONT PAYMENTS

(a) SCI shall, within ninety (90) days of the date hereof, pay to NS ***** as a non-creditable, non-refundable fee.

(b) SCI shall, on the execution date of this Agreement, issue to NS ***** shares (the "Shares") of SCI's common stock, $.01 par value per share (the "Common Stock"). Upon issuance, the Shares shall be duly authorized, validly issued, fully-paid and non-assessable. Within forty-five (45) days of the execution date of this Agreement, SCI shall file a registration statement with the Securities and Exchange Commission in respect of the resale of the Shares, provided that, SCI shall include the Shares in any registration statement pertaining to the sale of shares of the Common Stock of SCI filed by SCI before the expiration of such forty-five (45) day period. SCI agrees that it shall keep current and effective any registration statement which relates to the sale of Shares until such time as all of the Shares have been sold by NS or two years from the date hereof, whichever is earlier. If SCI is filing another registration statement after this two year period then, at the option of NS, it shall add the NS Shares, if any, in such statement. NS shall advise SCI in writing when NS no longer holds any of the Shares.

The Upfront payments in this section 3.10 shall be non-cancelable, non-refundable and non-creditable against earned royalties.

3.11 MILESTONE PAYMENTS

Within thirty (30) days following the achievement of each of the following milestones with respect to each Product developed by SCI or an Affiliate on a Product by Product basis, SCI shall give written notice thereof to NS and shall pay to NS the corresponding milestone payments described below. All amounts are in U.S. Dollars.

***** upon the discovery or identification of a Product candidate, provided that each such Product candidate enters pre-clinical development for a specified disease target in a non-rodent model;

***** upon acceptance of an Investigational New Drug Application or substantial equivalent application as may exist from time to time with the US Food and Drug Administration ("FDA") or its successor organization of a Product candidate and the commencement of clinical trials in human patients;

***** upon successful completion of Phase II Clinical Trials (i.e., statistically significant demonstration of clinical efficacy such that it is commercially reasonable to proceed to Phase III) of a Product candidate;

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***** upon successful completion of Phase III Clinical Trials (i.e., statistically significant demonstration of efficacy for the primary efficacy variable(s) of the study and demonstration of product safety such that it is commercially reasonable to proceed to market) of a Product candidate;

***** for the first approval to market each Product granted in any country by that country's applicable government authority that regulates marketing of Products in that country.

3.12 SUBLICENSING FEE

SCI shall pay to NS ***** and ***** of any securities of a third party, including upfront, milestone and royalty cash payments, that SCI shall receive in respect of its issuance of sublicenses of rights in the New Patent Rights and/or the New Cell Technology. Notwithstanding the foregoing, SCI shall have no obligation to make any payment to NS based on its receipt of funds for equity investments in SCI, loans to SCI, including without limitation loans which are convertible into equity in SCI, or research and development or sponsored research funding, whether or not paid to SCI in connection with such a sublicense, including any product candidate utilizing New Patent Rights and/or the New Cell Technology. For the purposes of this Section 3.12 reference to any cash payment shall, to the extent consistent with the preceding sentence hereof, include any cheque, money order or other negotiable instrument that may be provided in lieu of cash.

4. IMPROVEMENTS

4.01 IMPROVEMENTS

If after the date this Agreement is signed SCI makes or acquires any Improvement to the Patent Rights or Cell Technology SCI shall own such Improvement for its own account and NS shall have no rights therein. The rights granted hereunder shall be limited to the rights expressly stated to be granted hereunder and no additional rights or licenses are implied.

5. CONFIDENTIAL INFORMATION

5.01 DISCLOSURE OF CONFIDENTIAL INFORMATION

The following provisions apply to such confidential information either party has passed to the other party prior to the Effective Date, information provided pursuant to Section 2.02 to the extent it has not been made public by SCI, information provided pursuant to Section 6 hereof, and any other Confidential Information that one party may agree, in writing, to receive from the other party after the Effective Date. Information on patents, as provided in Section 6, shall be considered Confidential Information.

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5.02 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, sublicensees or agents.

5.03 RELEASE FROM RESTRICTIONS

The provisions of Section 5.02 shall not apply to any Confidential Information disclosed hereunder which is: required to be disclosed by the receiving party to comply with applicable laws, or to comply with 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; or by a party, its Affiliates and its Sublicensee reasonably necessary for the marketing of a Product or Service.

5.04 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 sublicensees, consultants, agents or others who have access to any of such information to execute confidentiality agreements covering all Confidential Information subject to Article 5 and will exercise its reasonable best efforts to obtain compliance therewith.

6. PRODUCT DEVELOPMENT EFFORTS

6.01 PRODUCT DEVELOPMENT PLANNING AND REPORTING

SCI shall develop annual plans for the development of Products which will contain such descriptions of Product development efforts to be undertaken and what resources shall be brought to bear in those efforts, including human resources and whether such efforts shall be conducted by SCI alone or through collaborations or partnerships (the "R&D Plans"). On each anniversary date of this agreement during its term, SCI shall provide to NS an executive summary report of its R&D Plans for the following year, and additionally, on the same date, SCI shall also provide to NS an executive summary report of its Product development efforts during that preceding year (the R&D Reports"). The R&D Reports shall each include a description of the expenditures that SCI believes should be included

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in determining whether SCI has spent the Research Baseline Amount, as defined below, for that preceding year.

6.02 PRODUCT DEVELOPMENT EFFORTS

During the term of this agreement, SCI, its Affiliates, partners, collaborators, Sublicensees, and others whose expenditures benefit SCI's Product development efforts, shall, in total, spend no less than ***** per calendar year in direct and indirect costs to develop Products (such amount is hereinafter the "Research Baseline Amount") in a timely manner until commercialization. Appropriate expenses falling within the Research Baseline Amount include all direct and indirect costs of the research personnel allocated to develop Products, including but not limited to the costs of all raw materials, labor, outsourcing, clinical trials, and any

overhead amounts allocable to such research group, such as, e.g., appropriately amortized equipment costs. In the event that the expenditure of the Research Baseline Amount is not met, absent reasons of the kind mentioned in section 12.06 hereof, NS shall give SCI a sixty (60) day period to correct any deficiency in such expenditure. Following such sixty (60) day period, in the event the parties agree that SCI has not met its obligation to spend the Research Baseline Amount, then NS shall have the right to terminate this Agreement, and the license to SCI shall revert to the 1997 License Agreement (including all rights to Existing Patents and Existing Cell Technology) and any rights in New Patent Rights and the New Cell Technology shall revert to NS. In the event of such a termination, SCI shall and does hereby grant a non-exclusive worldwide royalty bearing right and license to NS under the Existing Patent Rights and the Existing Cell Technology to the extent required to allow NS to practice the Existing Patent Rights and the Existing Cell Technology outside of the Existing Field and the New Patent Rights and the New Cell Technology outside of the Existing Field, including a right to grant sublicenses of such right, and such license shall survive such termination. For illustrative purposes, in the event of such a license NS would be able to use any Existing Patent Rights and Existing Cell Technology which may be necessary and incidental to properly exercise the New Patent Rights or New Cell Technology rights outside the Existing Field but not in the Existing Field. The royalty rate payable by NS to SCI in the event of exercise of any Existing Patent Rights and Existing Cell Technology under the license granted to NS under this Section 6.02 would be ***** of Net Sales and ***** of sublicense revenue as set forth in Section 3.01 and 3.12 hereof respectively. In the event the parties cannot agree as to whether SCI met its obligation to expend the Research Baseline Amount, then the issue shall be resolved in accordance with the section hereof entitled "Resolution of Disputes." The parties acknowledge that the license rights provided to NS under this Section 6.02 would survive any termination of this Agreement.

7. FILING OF PATENTS: PROSECUTION OF INFRINGERS

7.01 FILING, PROSECUTION, AND MAINTENANCE OF PATENTS

SCI shall be responsible for filing, prosecution, maintenance and enforcement of all patents or patent applications which are part of the Patent Rights. NHL shall be and

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remain the owner of all Patent Rights, including any New Patent Rights. SCI shall be entitled to engage its own patent counsel and in all respects control the prosecution of Patent Rights (with opportunity for reasonable input from NS), at SCI's cost, and NS and/or NHL shall transfer or authorize transfer of all files related to Patent Rights to SCI's counsel, at SCI's cost, within fifteen (15) days from the Effective Date of this Agreement. SCI shall conduct all dealings with the Patent Rights in good faith and with the objective of seeking to extend the scope and duration of the Patent Rights to the extent commercially reasonable. SCI shall reimburse NS for reasonable out-of-pocket costs and expenses previously paid to outside counsel and/or outside patent agents in respect of preparation, filing, prosecution and maintenance of all such patents and patent applications that are part of Patent Rights *****.

7.02 DOCUMENTS TO BE PROVIDED.

NS shall promptly provide SCI with copies of all material papers, specifications, amendments, replies, official actions, and other

documents relating to the filing, prosecution, and maintenance of patent applications and patents which form part of the Patent Rights. SCI shall promptly provide NS with copies of all material papers, specifications, amendments, replies, official actions, and other documents relating to the filing, prosecution, and maintenance of patent applications and patents which form part of the Patent Rights in a timely manner and provide NS with a reasonable period of time in which to provide input and suggestions to SCI in respect of actions to be taken in relation to the filing, prosecution, and maintenance of patent applications and patents which form part of the Patent Rights. SCI shall act reasonably and shall consider and use such input in any such actions. NS shall be responsible for the costs of providing its input to SCI.

7.03 INFRINGEMENT OF PATENTS BY THIRD PARTIES.

(a) NOTICE OF INFRINGEMENT.

Each party shall notify the other of any infringement of Patents Rights by third parties of which it becomes aware.

(b) PROSECUTION OF INFRINGERS.

SCI shall have the sole right to pursue actions against infringers. SCI may, at its option, pursue action against infringers of the Patent Rights to an extent and degree as it deems appropriate provided that if SCI chooses not to pursue any case or cases of infringement then it shall compensate NS as provided in this Section 7.03 (b), below. NS will co-operate in the prosecution of such infringers and allow SCI to use its name in any such suit, sue in NS' name or join NS if legally required provided that SCI will indemnify and hold harmless NS from any costs, damage or expenses incurred by NS in respect of any such acts or co-operation. Any damages or settlement amounts recovered in any such infringement action shall be considered Net Sales for the purposes of royalty calculations under this Agreement provided that SCI shall be permitted to first deduct from such amount the reasonable legal fees and disbursement incurred in bringing the infringement

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action. The parties recognize and agree that there may be instances where SCI has compelling reasons for not bringing suit, that in some such cases SCI may derive a direct or indirect economic benefit, and that in some such cases SCI may not derive a direct or indirect economic benefit. Regardless of the reason for not pursuing the case or cases of infringement SCI shall compensate NS for the losses, if any, attributable to not bringing the action. In the event the parties cannot agree on the amount of compensation to NS, then the issue shall be resolved in accordance with the section hereof entitled "Resolution of Disputes.

Should it become necessary for the initiation or maintenance of an SCI action against an infringer, NHL hereby agrees to assign to SCI a limited right and undivided fractional interest under the Patent Rights to take such actions against infringers. As consideration for such assignment SCI shall not exercise any such rights for any purpose other than to permit SCI to take said action and SCI specifically shall not use any rights other than those expressly provided to SCI under this Agreement (excluding this Section 7.03). Nothing in this Section shall relieve SCI or any Affiliate or Sublicensee(s) from any obligations hereunder, including, without limitation, any obligation to make Royalty or other payments under this Agreement. SCI shall hold any such right in trust for the benefit of NHL and shall reassign any such right and interest (and does so hereby) in the event of a termination of this Agreement or the

license granted hereunder to SCI or upon settlement, discontinuance or the conclusion of such action.

8. REPRESENTATIONS AND WARRANTIES

8.01 CORPORATE REPRESENTATIONS.

Each party represents and warrants to the other that:

(a) it has all requisite right, power, authority and capacity to enter into this Agreement and to consummate the transactions contemplated hereby, and has taken all necessary action to authorize the execution, delivery and performance of this Agreement; and

(b) the entering into of this Agreement and the performance of its obligations hereunder does not contravene any agreements to which such party is a party or its charter documents; and

(c) when executed and delivered by it, this Agreement will constitute the legal, valid and binding obligation of it.

8.02 INTELLECTUAL PROPERTY REPRESENTATIONS.

NS and NHL represents and warrants as follows:

(a) to NS' and NHL's current knowledge, the patents/patent applications listed in Ex. A and B are subsisting and no challenge has been taken to them;

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(b) NS and/or NHL has full right, power and authority to grant the license in the intellectual property herein granted to the extent of NS/NHL patent position;

(c) As of the Effective Date, neither NS nor NHL is conducting or sponsoring any scientific research, development or investigation, alone, with or through any Affiliate or agent that relates in any way to Cells or Cell Technology (including Existing Cell Technology or New Cell Technology);

(d) The Existing Patent Rights listed in Exhibit A and the New Patent Rights listed in Exhibit B is a complete and accurate list of all patents, patent applications and inventions conceived or reduced to practice that NS or NHL owns or has rights to, as of the Effective Date, and that as of the Effective Date hereof, neither NHL nor NS has granted any right to another Person inconsistent with the rights to be exercised by the parties hereunder, and further NHL and NS represent and warrant that there has been no violation of section 9.04 of the 1997 License Agreement.

Except as otherwise expressly set forth in Sections 8.01 and 8.02, NS, NHL, their directors, officers, Affiliates, employees and agents make no representations and extend no warranties of any kind in relation to the matters addressed under this Agreement. NS, NHL, their directors, officers, Affiliates, employees and agents 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 NS Licensed Technology, will violate the rights of any third party. Neither NS nor NHL has conducted any infringement analysis on potential Products or Services that may be developed under the NS Licensed Technology. THE REPRESENTATIONS AND WARRANTIES IN SECTION 8.01 AND 8.02 ARE IN LIEU OF

ALL OTHER REPRESENTATIONS, WARRANTIES AND CONDITIONS, EXPRESS OR IMPLIED OR ARISING UNDER ANY LEGAL THEORY, CONCERNING THE NS 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.

8.03 INDEMNITY

SCI and NS acknowledge that NS has no involvement in the design, manufacture, sale or distribution of Products or Services. As a result SCI agrees that it will defend, indemnify, and hold harmless NS, at SCI's own expense, from and against all claims, actions, causes of action, liabilities, claims, suits, judgments, liens, awards, and damages of any kind and nature whatsoever (hereinafter called "Claims") and expenses, costs of litigation and attorney's fees related thereto, or incident to establishing the right to indemnification, to the extent such Claims arise out of the design, manufacture, sale or distribution of Products or Services by SCI, any Affiliate or any Sublicensee or on any of there behalf; provided, however, that NS gives SCI prompt notice in writing of the Claim and/or institution of such Claim. SCI shall have control of the defense of any such suit, including appeals, negotiations, and the right to effect a settlement or compromise

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thereof. NS shall cooperate with SCI (at SCI's expense) in defense of or settlement of any such Claim.

9. ASSIGNMENT

9.01 LIMITED RIGHT TO ASSIGN.

Either party shall have the right, in connection with its merger or consolidation or with the sale of substantially all of its assets utilized in the business to which this Agreement relates, to assign all of the rights and licenses herein granted, but only to a party who expressly assumes and agrees to perform all of the obligations of the assigning party. Such assigning party shall remain liable to the other party for the due performance of all of its obligations under this Agreement. Except as set forth in the preceding sentence, neither party may assign this Agreement or any rights hereunder without the consent of the other, which consent shall not be unreasonably withheld. In the event of the assignment hereof, the assigning party shall notify the other party at least thirty (30) days prior to such transfer.

9.02 PERFORMANCE BY SUBCONTRACTORS

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

10. TERM AND TERMINATION

10.01 TERM OF LICENSE.

This Agreement shall continue, unless earlier terminated in accordance with this Section, until the expiration of all Patent Rights which are or may be licensed to SCI and the becoming public of all material Cell Technology (without such publication arising from a breach of the provisions of Article 5).

10.02 TERM OF ROYALTIES.

The obligation of SCI to pay royalties on Net Sales in any country ***** . Royalties shall begin to accrue if and when a patent under the Patent Rights which covers any part of a Product or Service shall issue in such country. Notwithstanding the foregoing, if SCI has made Sales or provides Services in a country before any patent under the Patent Rights which covers any part of a Product or Service shall issue in that country and if such patent shall subsequently then issue in that country, SCI shall, in addition to its obligation to make ongoing Royalty payments under this Agreement, make an adjusting Royalty payment to NS for all such Sales and provision of Services during the period from the date of such first Sales or provision of Services until the said patent issued in that country, provided that in the event of significant competitive sales of Products by third parties in that country using any of the NL Licensed Technology prior to the issue of the applicable Patent Rights the adjusting Royalty payment will be modified to reflect

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the actual and reasonable impact of those competitive sales in that country prior to the issue of Patent Rights. In the event the parties cannot agree on the amount that any adjusting Royalty payment should be modified to reflect such prior competitive sales, then the issue shall be resolved in accordance with the section hereof entitled "Resolution of Disputes."

10.03 DEFAULTS.

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

10.04 BANKRUPTCY.

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 sixty (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.

Until such time as the restrictions on NHL may be removed under the BackUp License, NS shall:

(a) abide by the terms of, and fulfill all of its obligations under, each of the NS/NHL License and Assignment Agreement, and take all action necessary to maintain each such agreement in full force and effect; and

(b) NS shall pay in full when due any and all expenses, payables and other liabilities of NHL, whether such expenses, payables, or liabilities arise in the ordinary course of business or otherwise.

(c) NS will not create or incur or suffer to be created or incurred or to exist any encumbrance, pledge, lien, charge (floating or fixed) or other security interest of any kind (each a "lien") upon the license rights granted to NS pursuant to the NS/NHL License, the Cell Technology and the Patent Rights, provided, NS shall be permitted to grant a lien on its intellectual property, including the Cell Technology and Patent Rights, to a third party (the "Other Lien Holder") if (i) NHL is amalgamated with and into NS (in an amalgamation the surviving

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corporation of which is NS) or substantially all of the assets of NHL (including all of NHL's intellectual property rights) are acquired by NS, (ii) NS grants a first priority security interest (the "Security Interest") in the Cell Technology and Patent Rights and essentially all other intellectual property of NS licensed to a third party (including all patent and patent applications claiming any such intellectual property) (collectively, the "Collateral") to a person or entity (the "Collateral Agent") for the benefit of all licensees of NS' intellectual property including, without limitation, SCI (the "Licensees") to secure each Licensee's license rights in the Collateral, and (iii) the Other Lien Holder agrees to subordinate its security interest in such intellectual property (including an agreement not to foreclose on such intellectual property) to the Security Interest upon terms reasonably satisfactory to the Licensees. The Collateral Agent shall be selected by the Licensees (with the approval of NS, which approval shall not be unreasonably withheld) and the Security Interest shall be granted pursuant to a Security Agreement among NS, the Collateral Agent, and the Licensees in a form thereof to be negotiated among SCI, NS and the other Licensees, and shall provide, among other things, upon the occurrence of an Event of Default (as defined below) that the Collateral Agent shall, subject to the rights of the Licensees to continue to exercise their license rights in the Collateral, have all the rights of a holder of a first fixed charge and secured party under the Personal Property Security Act, and any other law or statute governing the rights of holder's of first fixed charges or security interests. The Security Agreement shall also provide for the filing of all financing statements, assignments and other instruments and documents the Collateral Agent deems reasonably necessary to perfect the Security Interest. For purposes of the Security Agreement, each of the following shall constitute an Event of Default: (a) the termination or limitation of the license granted to SCI pursuant to Section 2 of this Agreement (other than a termination of such license by NS, in accordance with the terms hereof, as a result of a breach of this Agreement by SCI); (b) if NS passes a resolution or institutes proceedings for its winding-up, liquidation, or dissolution or consents to the filing of any petition with respect thereto or files a petition or answer or consent seeking readjustment, arrangements, composition or similar relief under any Canadian or other applicable law or consents to the filing of any such petition or to the appointment of a receiver, liquidator, trustee or similar officer of itself or any part of its property or makes an assignment for the benefit of creditors or if NS takes any action pursuant to the Winding-Up Act (Canada) or the Bankruptcy and Insolvency Act (Canada); (c) any application is made with respect to NS under the Companies Creditors Arrangement Act (Canada), Bankruptcy and Insolvency Act (Canada) or similar legislation seeking readjustment, arrangement, composition or similar relief for NS under any Canadian or other applicable law, or

if a proceeding is instituted for the winding up, liquidation or dissolution of NS or seeking an order adjudging NS insolvent or the appointment of any receiver, liquidator, trustee or similar officer of NS or over all or any part of its property or a petition in bankruptcy is presented against NS under a bankruptcy or similar statute and if in any such case such application, proceeding or petition is not dismissed, stayed or withdrawn within 45 days after the making of such

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application, institution of such proceeding or filing of such petition (provided that if in any such proceeding, NS is adjudged bankrupt or insolvent by a court of competent jurisdiction or any receiver, liquidator or trustee is appointed for NS or any substantial portion of NS assets, an Event of Default shall be deemed to have occurred); (d) the breach by NS of any of its material obligations under the said license agreement, which breach is not cured within the time allotted under the terms hereof to cure such breach; and (e) such other Events of Default to which NS and the Licensees reasonably agree. Upon receipt of a notice (the "Notice") from NS that it intends to exercise its rights under this Section 9.04 (c), which notice shall set forth the identity and address of each Licensee and the proposed Other Lien Holder, (x) the Licensees shall select a Collateral Agent and negotiate the terms of the Collateral Agent's appointment and the voting mechanism governing the Collateral Agent's actions (the "Collateral Agent Agreement"), (y) the Licensees, NS and the Collateral Agent shall negotiate the terms of a Security Agreement consistent with the terms set forth in this Section 9.04(c), and (z), upon agreement on the terms of the Security Agreement, the Licensees and the Other Lien Holder shall negotiate the terms of an agreement (the "Subordination Agreement") pursuant to which the Other Lien Holder agrees to subordinate its security interest in the Collateral to the Security Interest consistent with the terms set forth above. If after 30 days from the receipt of the Notice by the last of the Licensees to receive the Notice, the Licensees are unable to agree on a Collateral Agent or the terms of the Collateral Agent Agreement, any Licensee may submit the matter to binding arbitration in accordance with the procedures set forth below, which arbitration shall be binding upon all of the Licensees. If after 60 days from receipt of the Notice by the last of the Licensees to receive the Notice, the Licensees, the Collateral Agent and NS are unable to agree on the terms of a Security Agreement, any Licensee or NS may submit the matter to binding arbitration in accordance with the procedures set forth below. If after 90 days from receipt of the Notice by the last of the Licensees to receive the Notice, the Licensees and the Other Lien Holder are unable to agree upon the terms of a Subordination Agreement, any Licensee or the Other Lien Holder (if the Other Lien Holder chooses) may submit the matter to binding arbitration in accordance with the procedures set forth below. Each such arbitration shall be conducted in accordance with the rules of, and under the auspices of the International Chamber of Commerce and the location of the arbitration shall be San Francisco, California. The person requesting such arbitration shall send notice to all parties of its intention. A single arbitrator shall preside and shall be appointed by the International Chamber of Commerce and shall not be an employee, consultant, officer, director, shareholder of or otherwise associated with any party or an Affiliate of any party. Each party shall consent to the consolidation of a single arbitration to decide all issues in dispute.

Within 15 days after the designation of the arbitrator, the arbitrator and the parties shall meet at which time each party shall be required to set forth in writing the issues which need to be resolved and a proposed ruling on each such issue. The arbitrator shall set a date for a hearing, which shall be no later than 15 days after

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the submission of written proposals, to discuss each of the issues identified by the parties. Each party shall have the right to be represented by counsel. The arbitrator shall have sole discretion with regard to the admissibility of any evidence. The arbitrator shall use his or her best efforts to rule on each disputed issue within 10 days after the completion of such hearings. The arbitrator's ruling shall be, in the absence of fraud or manifest error, binding and conclusive upon the parties and may be enforced in a court of competent jurisdiction. The arbitrator may not award punitive, consequential or exemplary damages.

Each party shall bear its own expenses, including legal expenses, in connection with the legislation, drafting and execution of any transaction or agreement contemplated above or in connection with any arbitration. The filing fees associated with the perfection of the Security Interest shall be split evenly among each Licensee and NS.

The parties acknowledge that it will be impossible to measure the damages that would be suffered by SCI if NS fails to comply with the covenants in this Section 10.04 and that in the event of such failure, SCI will not have an adequate remedy at law. SCI shall, therefore, be entitled in addition to any other rights and remedies to obtain specific performance of NS' obligations hereunder and to obtain injunctive relief without having to post a bond. NS shall not urge, as a defense to any proceeding for such specific performance or injunctive relief, that SCI has an adequate remedy at law.

NS may, at its sole option, terminate the Back Up License, remove the corporate restrictions on NHL's ability to do business and amalgamate with NHL (or with NHL and another entity), on giving written notice to SCI provided that (a) the amalgamated entity is the owner of all of the NL Licensed Technology, and (b) NHL either ceases to exist or has no further rights to any NL Licensed Technology, and (c) the amalgamated entity confirm to SCI in writing that it continues to be bound under the 1997 License Agreement and under this Agreement. In such a case the terms of this Section 10.04, apart from the first paragraph and this paragraph, shall be of no further force or effect. For greater certainty the 1997 License Agreement is amended by inserting this and the following paragraph in the section entitled "Bankruptcy".

Upon such an amalgamation, SCI may, at its option, require registration of a security interest in favor of SCI against the NL Licensed Technology for the purpose of protection of SCI's interest as a licensee under this and the 1997 License Agreement, in a form acceptable to NS and SCI.

10.05 EFFECT OF TERMINATION: SURVIVAL

Upon termination of this Agreement for any reason, nothing herein shall be construed to release either party from any obligation that matured prior to the effective date of such termination. SCI and any SCI

Sublicensee may, however, after the effective date of such

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termination, sell Products in the process of manufacture at the time of such termination, provided that SCI shall pay to NS the royalties thereon as required of this Agreement and shall submit the reports required by Section 3 hereof on the Sales of such Products or provision of Services. The provisions of Sections 5, 10 and 11 of this Agreement shall survive termination or expiration of this Agreement for any reason. Notwithstanding any termination of this Agreement under this, or any other, section of this Agreement, the 1997 License Agreement shall remain in full force and effect.

10.06 EFFECT OF TERMINATION

The termination of this Agreement for any reason shall result in the immediate termination of any license granted hereunder, subject to Sections 6.02 and 10.05 above. SCI shall immediately cease and desist from practicing the New Patents and the New Cell Technology or performing or authorizing any act which infringes any Patent Right or right to any Cell Technology. No termination of this Agreement shall preclude SCI from practicing Existing Patents or Existing Cell Technology under the 1997 Agreement. In the event of a termination, any existing sublicensee shall have the same rights and license directly from NS as it was granted by SCI, provided that such sublicensee shall confirm in writing to NS that NS may enforce the terms and conditions of the sublicense against such sublicensee.

11. RESOLUTION OF DISPUTES

11.01 GENERAL

In the event that any dispute should arise between the parties with respect to any matter relating to this Agreement, the Parties shall resolve such dispute in accordance with the procedures set forth in this Section 11.

11.02 DISPUTE RESOLUTION PROCESS

(a) Mediation

In the event of any dispute between the parties with respect to any matter relating to this Agreement, the Parties shall first use their best efforts to resolve such dispute among themselves. Prior to seeking any third party to resolve a dispute, the Chief Executive Officers of SCI and NS shall meet in private meeting for at least one-half (1/2) of a day to attempt to resolve the dispute. If the parties are unable to resolve the dispute within 30 days after the Chief Executive Officers have met, the parties will then seek the assistance of one or more unaffiliated third parties to assist in mediating the dispute.

(b) SELECTION OF ARBITRATORS

In the event that the parties are unable to resolve a dispute within 30 days after the commencement of mediation efforts under Section 11.02 (a), either party may submit the matter to binding arbitration in accordance with the procedures set forth in this Section

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11.02. If a party intends to commence arbitration to resolve a dispute, such party shall provide written notice to the other party of such intention, and shall designate one arbitrator. Within 10 days of receipt of such notice, the other party shall designate in writing a second arbitrator. The two arbitrators so designated shall, within 10 days thereafter, designate a third arbitrator. The arbitrators so designated shall not be employees, consultants, officers, directors or shareholders of or otherwise associated with either party or an Affiliate of either party. The arbitration shall be conducted in accordance with the rules of, and under the auspices of, the International Chamber of Commerce and the location of the arbitration shall be San Francisco, California.

(c) WRITTEN PROPOSALS

Within 15 days after the designation of the third arbitrator, the arbitrators and the parties shall meet at which time each party shall be required to set forth in writing the issues which need to be resolved and a proposed ruling on each such issue. Each party shall provide such written summary of issues to the arbitrator and the other party no later than 5 business days prior to the first arbitration meeting.

(d) HEARING

The arbitrators shall set a date for a hearing, which shall be no later than 30 days after the submission of written proposals, to discuss each of the issues identified to the parties. Each party shall have the right to be represented by counsel. The arbitrators shall have sole discretion with regard to the admissibility of any evidence.

(e) Ruling

The arbitrators shall use their best efforts to rule on each disputed issues within 30 days after the completion of the hearings described in subsection (d) above. 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.

12. MISCELLANEOUS

12.01 PUBLICITY.

Neither party may originate any publicity, news release or other public announcement, written or oral, relating to this Agreement or the existence of an arrangement between the parties, without the prior written approval of the other party except as otherwise required by law or the rules of stock exchanges and similar organizations.

Neither party will communicate, comment or originate any publicity, news release or other public announcement, written or oral, relating to the dispute between the parties or the allegations made by either party in respect of that dispute, without the prior written

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approval of the other party except as otherwise required by law or the rules of stock exchanges and similar organizations.

12.02 GOVERNING LAW.

This Agreement shall be governed by and interpreted in accordance with the laws of the Province of Alberta.

12.03 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; 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 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.

12.04 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.

12.05 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 listed below or such other address as the addressee shall have specified in a notice actually received by the addressor.

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If to NS or NHL:

(Addressed to NS or NHL, as applicable)
C/o University Technologies International Inc.
Suite 130, 3553 - 31 St. N.W.
Calgary Technology Centre
Calgary, Alberta
T2L 2K7
Canada
Attention: Oleh S. Hnatiuk
Fax: 403 270 2384

With a contemporaneous copy to:

Bennett Jones LLP

4500,855-2nd Street S.W.
Calgary, Alberta
T2P 4K7
Canada
Attention: Martin P.J. Kratz
Fax: 403 265 7219

If to SCI:

StemCells, Inc.
525 Del Ray Avenue
Suite C
Sunnyvale, CA 94085
USA
Attention: Iris Brest, Esq.
Fax: 408.731.8674

With a copy to:

Mintz Levin Cohn Ferris Glovsy & Popeo, P.C.
One Financial Center
Boston, MA 02111
USA
Attn.: Ivor Elrifi
Fax; 617.542.2241

12.06 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

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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.

12.07 ENTIRE AGREEMENT

This Agreement and the Exhibits and Schedules hereto (which Exhibits and Schedules are deemed to be part of this Agreement for all purposes) contain the full understanding of the parties with respect to the subject matter hereof. Except as provided in Sections 6.02 or 10.04 herein, nothing in this Agreement affects the terms, scope or operation of the 1997 License Agreement. 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.

12.08 HEADINGS.

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

12.09 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.

12.10 USE OF NAME.

Neither party shall use the name of the other party in any advertising or promotions without the consent of the other unless required by law bodies regulating securities.

12.11 NO CONSEQUENTIAL DAMAGES.

No party shall be liable to the other hereunder for indirect consequential, special, speculative, remote or similar such damages or economic loss.

12.12 SUCCESSORS AND ASSIGNS.

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

12.13 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.

*Confidential Treatment has been requested for the marked portion.

12.14 RECORDATION.

SCI shall have the right, at its cost, at any time, to record, register, or otherwise notify this Agreement in any applicable patent office or other appropriate facility, and NS shall provide reasonable assistance to SCI in effecting such recording.

12.15 JOINT DRAFTING.

This Agreement was jointly drafted and prepared by all 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.

12.16 Back Up License

For the purposes of this Agreement the BackUp License is hereby amended as follows (all references are to Section numbers in the BackUp License):

(a) NHL grants to SCI a license, subject to section 2.3, upon the same terms and conditions set forth in this Agreement, as such terms and conditions would read if "NHL" were substituted for and in place of "NS".

(b) Any reference in the BackUp License to "Research and License Agreement" or the 1997 License Agreement shall be deemed to include a reference also to this Agreement.

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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.

NEUROSPHERES LTD.

By: _____

Title: _____

NEUROSPHERES HOLDINGS LTD.

By: _____

Title: _____

STEMCELLS, INC.

By: _____

Title: _____

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EXHIBIT "A"

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EXHIBIT "B"

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EXHIBIT 10.51

[STEMSCELLS INC. LETTERHEAD]

January 2, 2001

Martin McGlynn
11812 South October Cove
Sandy, Utah 84092

Dear Martin:

On behalf of StemCells, Inc. (the "Company"), I am pleased to offer you the position of President and Chief Executive Officer under the terms and conditions that follow:

1. STARTING DATE. The date on which your full-time employment with the Company will start is January 15, 2001.

2. POSITION AND DUTIES. As President and Chief Executive Officer, you will be expected to exert your full-time best efforts to promote and protect the business interests of the Company. Specifically, but not exclusively, your responsibilities will be to manage the operations of the Company, to build and maintain an outstanding and harmonious working team of both scientific and professional employees, to secure, promote and maintain the appropriate financing and capital structure of the Company, to manage and direct the strategic development of the Company's business plan and its implementation and to oversee the overall scientific affairs of the Company. You will report directly to the Board. In addition, and without further compensation, you agree to service as a member of the Board of Directors of the Company (the "Board") and as a director or officer of one or more of the Company's Affiliates, if so elected or appointed from time to time. For the purposes of this agreement, "Affiliates" means all persons and entities directly or indirectly controlling, controlled by or under common control with the Company, where control may be by management authority, equity interest or otherwise. It is understood that your membership on the Board, and on the board of any Affiliate of the Company, will not continue past your tenure as President and Chief Executive Officer, and you agree to resign, effective on termination of your employment, from any such directorships you may then hold.

3. SALARY. For all services that you perform for the Company and its Affiliates, your base salary will be at the rate of Two Hundred Seventy-Five Thousand Dollars ($275,000) per year. Your performance and compensation will be reviewed at least annually by the Compensation Committee of the Board. In addition, the Board, in its sole discretion, may award you a cash bonus of up to twenty-five percent of your base salary, based on the Board's review of your performance.

4. STOCK OPTIONS. Through the StemCells, Inc. 1992 Equity Incentive Plan (the "Incentive Plan"), and subject to the terms and conditions of such Plan, you will be granted an option to acquire Four Hundred Thousand (400,000) shares

of the common stock of the Company (the "Time-Based Option") at the then-current fair market value of such shares, as reasonably determined by the Board, on January 15, 2001. Subject to your continued employment by the Company, the Time-Based Option will vest over forty-eight (48) months as follows: (i) one quarter of the shares will vest on the first anniversary of the date on which your employment with the Company begins and (ii) the remaining shares shall vest at the rate of one forty-eighth (1/48) per month on the last day of each month during the ensuing thirty-six months. Except as otherwise expressly provided herein, the Time-Based Option shall be governed by the terms of the Incentive Plan, as in effect from time to time. A copy of the Incentive Plan as currently in effect is attached as Exhibit A. In addition, the Board, in its sole discretion, may award you a bonus option of up to 25,000 shares of the Company's common stock, depending on the Board's review of your performance. Any Change in Control will result in the accelerated vesting of the option to acquire 100% of such shares. A Change in Control shall mean any consolidation or merger in which the Company is not the surviving corporation, a transaction or series of related transactions that result in the acquisition of all or substantially all of the Company's outstanding Common Stock by a single person or entity or by a group of persons or entities acting in concert, or the sale or transfer of all or substantially all of the Company's assets.

5. RELOCATION AND RELOCATION ALLOWANCE. No later than the date on which your employment with the Company begins, you will establish your principal office at the Company's offices in Sunnyvale and a temporary residence for yourself within driving distance of such office, and will spend, on average, at least five days per week in residence there. The Company will reimburse you, up to a reasonable amount to be agreed upon, for the cost of the temporary residence. When you relocate permanently to the area where the Company maintains its offices, the Company will pay you a relocation bonus in the amount of Fifty Thousand Dollars ($50,000). In addition the Company will reimburse you for your reasonable expenses associated with relocation, such as the realtor's commission on the sale of your Utah home, closing costs in connection with the purchase of a new home, moving and, if necessary, storage of household goods, and transportation for you and your wife, provided that the reimbursed amount shall not exceed Twenty-Five Thousand Dollars ($25,000) exclusive of the realtor's commission. Further, the Company will negotiate with you in good faith concerning an amount to be provided by the Company to assist in your purchase of a home within driving distance of the Company's offices, and the method of its provision. Such assistance may include, without limitation, a bridge loan should one be appropriate.

6. BENEFITS. You will be entitled to participate in any and all employee benefit plans from time to time in effect for senior management of the Company generally, except to the extent that such plans are duplicative of benefits otherwise provided to you under this Agreement. Such participation shall be subject to (i) the terms of the applicable plan documents, (ii) generally applicable policies of the Company and (iii) the discretion of the Board and plan administrators, as provided for in or contemplated by such plan. I am enclosing a summary of current employee benefits for your information, and of course the agreements with providers are available to you. The Company will provide you with a leased automobile, the cost of which, including insurance, gas and maintenance, will be paid by you and the Company in proportion to your business and personal use of such automobile. Prior to your permanent relocation to within driving distance of the Company's principal offices, the Company will reimburse you and your wife for the cost of one round trip per month to Utah. The Company will provide you with three weeks vacation per year. The Company shall reimburse you for all expenses reasonably incurred by you in connection with your performance of your duties hereunder on a basis consistent with Company policies.

7. EMPLOYMENT AGREEMENT: CONFIDENTIALITY AND RESTRICTED ACTIVITIES. As a condition of accepting this offer of employment, you will be required to complete, sign and return the Company's standard form of Employment Agreement, a copy of which is attached hereto as Exhibit B and by this reference incorporated. You hereby represent that you are not now bound by any employment agreement, confidential or proprietary information agreement or similar agreement, with any person or entity including without limitation any current or previous employer, that would impose any restriction on your acceptance of this offer or that would interfere with your ability to fulfill the responsibilities of your position with the Company.

8. AT WILL EMPLOYMENT; TERMINATION AND TERMINATION BENEFITS. Your employment with the Company is "at will," which means that either you or the Company may terminate your employment at any time, with or without cause or good reason.

a. The Company may terminate your employment other than for "cause" at any time upon written notice to you and, in that event, (i) the Company will continue to pay you your base salary for one year following the date of such termination. To the maximum extent permitted by the Company's benefit plans, all healthcare benefits provided to you hereunder shall continue for one year following the date of such termination other than for cause, but the Company shall not be obligated to purchase any special insurance or other coverage in order to satisfy the foregoing obligation.

b. The Company may terminate your employment upon written notice to you in the event that you become disabled during your employment through any illness, injury, accident or condition of either physical or psychological nature and, as a result, you are unable to perform substantially all of your duties and responsibilities

hereunder for ninety (90) days during any three hundred and sixty-five (365) calendar days. In that event, the Company will continue to pay you your base salary (i) for a period of six (6) months following such termination or (ii) until you obtain other full time employment or (iii) until you become eligible for disability income under any disability income plan provided by the Company, whichever of these events shall first occur.

c. The Company may terminate your employment hereunder for cause at any time upon written notice to you setting forth in reasonable detail the nature of such cause. The following, as determined by the Company in its reasonable judgment, shall constitute "cause" for termination: (i) your willful failure to perform your material duties and responsibilities to the Company and its Affiliates (including, without limitation, those duties and responsibilities described in Section 1) and; (ii) your material breach of Paragraph 7 of this Agreement or of Exhibit A incorporated thereby; (iii) fraud, embezzlement or other material dishonesty with respect to the Company or any of its Affiliates; or (iv) your conviction of, or plea of nolo contendere to, a felony.

d. You may terminate your employment at any time, with or without good reason, upon written notice to the Company. If you decide to terminate your employment without good reason, you agree to give the Company three months' notice of termination. You may terminate your employment hereunder with good reason at any time upon written notice to the Company. The following shall constitute "good reason" for termination: material breach by the Company of any provision of this Agreement, including, without limitation, any material diminution in your authority or responsibilities from that contemplated by Section 1 hereof, which breach continues for more than ten (10) business days

following receipt by the Company of written notice from you setting forth in reasonable detail the nature of such breach. If you terminate your employment with good reason, the Company will be obligated to you under Paragraph 8.a hereof as if the Company had terminated your employment other than for cause.

e. If you resign without good reason or your employment is terminated by the Company for cause, the Company shall have no further obligation to you other than for base salary earned through the date of termination. No severance pay or other benefits of any kind will be provided.

9. WITHHOLDING. All payments and reimbursements made by the Company under this Agreement shall be reduced by any tax or other amounts required to be withheld by the Company under applicable law.

10. EMPLOYMENT ELIGIBILITY VERIFICATION. As you know, all people employed in the United States are required to complete an Employment Eligibility Verification Form on the first day of employment and submit an original document or documents that establish identity and employment eligibility within three business days of employment. The employment offered in this letter is contingent on your doing so.

11. ASSIGNMENT. Neither you nor the Company may make any assignment of this Agreement or any interest herein, by operation of law or otherwise, without the prior written consent of the other; provided, however, that the Company may assign its rights and obligations under this Agreement without your consent to one of its Affiliates or to any Person with whom the Company shall hereafter affect a reorganization, consolidation or merger or to whom the Company transfers all or substantially all of its properties or assets. This Agreement shall inure to the benefit of and be binding upon you and the Company and each of your respective successors, executors, administrators, heirs and permitted assigns.

12. WAIVER. Except as otherwise expressly provided in this Agreement, no waiver of any provision hereof shall be effective unless made in writing and signed by the waiving party. The failure of either party to require performance of any term or obligation of this Agreement, or the waiver by either party of any breach of this Agreement, shall not prevent any subsequent enforcement of such term or obligation or be deemed a waiver of any subsequent breach.

13. SEVERABILITY. If any portion or provision of this Agreement shall to any extent be declared illegal or unenforceable by a court of competent jurisdiction, then the remainder of this Agreement, or the application of such portion or provision in circumstances other than those as to which it is so declared illegal or unenforceable, shall not be affected thereby, and each portion and provision of this Agreement shall be valid and enforceable to the fullest extent permitted by law.

14. NOTICES. Except as otherwise expressly provided herein, any notices, requests, demands and other communications provided for by this Agreement shall be in writing and shall be effective when delivered in person or deposited in the United States mail, postage prepaid, registered or certified, and addressed to you at your last known address on the books of the Company or, in the case of the Company, at its main office, attention of the Chairman of the Board.

15. CAPTIONS. The captions and headings in this Agreement are for convenience only and in no way define or describe the scope or content of any provision of this Agreement.

16. ENTIRE AGREEMENT. This Agreement sets forth the entire agreement and understanding between you and the Company and supersedes all prior

communications, agreements and understandings, written and oral, with respect to the terms and conditions of your employment. This Agreement may not be amended or modified, except by an agreement in writing signed by you and the Chairman of the Board or other specifically authorized representative of the Company.

17. GOVERNING LAW. This Agreement shall be governed, construed and enforced in accordance with the laws of California, without regard to the conflict of laws principles thereof.

18. NO CONFLICTING AGREEMENTS. You hereby represent to the Company that neither your execution and delivery of this Agreement nor your acceptance of employment with the Company nor your performance under this Agreement will conflict with or result in a breach of any of the terms, conditions or provisions of any agreement to which you are a party or are bound or any order, injunction, judgment or decrees of any court or governmental authority or any arbitration award applicable to you.

19. COMPLIANCE WITH AGREEMENT. The Company's obligations under this Agreement and its obligation to deliver stock under the terms of the stock options granted pursuant to the terms of this Agreement (or otherwise granted you during the course of your employment) are conditioned on your compliance with the terms and conditions of this Agreement and the accuracy of the representations made to the Company by you herein.

If the foregoing is acceptable to you, please sign the enclosed copy of this letter in the space provided below and return it to me, whereupon this letter and such copy will constitute a binding agreement between you and the Company on the basis set forth above as of the date first above written.

Sincerely yours,
STEMCELLS, INC.

By: _____
John J. Schwartz, Ph.D.
Chairman

Accepted and agreed:

_____
Martin McGlynn

Date: _____

EXHIBIT 10.52

LEASE

BETWEEN

THE BOARD OF TRUSTEES
OF THE LELAND STANFORD JUNIOR UNIVERSITY

(LANDLORD)

AND

STEMCELLS, INC.

(TENANT)

FEBRUARY 1, 2001

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LEASE

THIS LEASE is entered into as of February 1, 2001 (the "COMMENCEMENT DATE"), by and between THE BOARD OF TRUSTEES OF THE LELAND STANFORD JUNIOR UNIVERSITY, a body having corporate powers under the laws of the State of California ("LANDLORD"), and STEMCELLS, INC., a Delaware corporation ("TENANT").

1. BASIC LEASE INFORMATION. The following is a summary of basic lease information. Each item in this Article 1 incorporates all of the terms set forth in this Lease pertaining to such item and to the extent there is any conflict between the provisions of this Article 1 and any more specific provisions of this Lease, the more specific provisions shall control. Any capitalized term not defined in this Lease shall have the meaning set forth in the Glossary which appears at the end of this Lease.

Description of Premises:	41,070 square feet of Rentable Area, as more particularly described on EXHIBIT A.

Address of Premises:	3155 Porter Drive Palo Alto, California 94304
Rentable Area of Building:	69,312 square feet of Rentable Area
Term:	Five (5) years
Commencement Date:	February 1, 2001
Expiration Date:	The last day of the calendar month in which the fifth (5th) anniversary of the Commencement Date occurs
Initial Base Rent:	$3.19 per sq. ft. of Rentable Area per month, subject to the provisions of Section 4.2
Base Rent Adjustments:	Three percent (3%) per year, subject to Section 4.2
Tenant's Share of Operating Expenses:	59.25%
Security Deposit:	Equal to two (2) months Base Rent
Parking:	3.3 spaces per 1,000 sq. ft. of Rentable Area
Use:	Research and development, including research using animal facilities, and associated office and administrative use

Addresses for Notice:

Landlord:	The Board of Trustees of the Leland Stanford Junior University Stanford Management Company 2770 Sand Hill Road Menlo Park, CA 94025 Attention: Research Park Director
Tenant:	To the Premises
Brokers:	None

2. PREMISES

2.1 PREMISES. Subject to the terms, covenants and conditions set forth

in this Lease, Landlord hereby leases to Tenant and Tenant hereby leases from Landlord those premises (the "PREMISES") shown on the building plan attached as EXHIBIT A, which are located within the building shown on EXHIBIT A and identified in Article 1 (the "BUILDING"). The approximate total Rentable Area of the Premises and the Building are specified in Article 1. Together, the Building, any other buildings located in the vicinity of the Building and operated as a common project with the Building, and all Common Areas for the joint operation of the Building and such other buildings, are referred to as the "PROPERTY".

2.2 COMMON AREA. Landlord hereby grants to Tenant and its employees, agents, contractors and invitees (collectively, "TENANT'S AGENTS") a non-exclusive license during the Term in common with other tenants of the Property to use the lobbies, hallways, stairways, elevators, restrooms, sidewalks, driveways, parking areas and other public amenities (the "COMMON AREA"). Tenant's rights to the Common Area shall be subject to the Rules and Regulations described in Section 23.1 and to Landlord's reserved rights described in Article 16.

2.3 PARKING. At no additional cost to Tenant, Landlord hereby grants to Tenant and Tenant's Agents a non-exclusive license in common with other tenants of the Property to use parking areas located on the Property for parking and for ingress to and egress from the Property. Tenant shall have the right to use the number of parking spaces specified in Article 1. Tenant's license shall not be assigned, sublet or otherwise transferred separately from the Premises. Tenant agrees that neither Tenant nor Tenant's Agents shall use parking spaces in excess of the number of spaces allocated to Tenant or in areas not designated for Tenant's use. Landlord shall have the right, at Landlord's sole discretion, to specifically designate the location of Tenant's parking spaces within the parking areas of the Common Area. Tenant's parking spaces (if any) may be relocated by Landlord within the Common Area from time to time upon written notice. Tenant shall not, at any time, park, or permit the parking of the trucks or vehicles of Tenant or Tenant's Agents in any portion of the Common Area not designated by Landlord for such use by Tenant. Tenant shall not park nor permit to be parked any inoperative vehicles or store any materials or equipment on any portion of the parking area or other areas of the Common Area. Tenant agrees to assume responsibility for compliance by Tenant's Agents with the parking provisions contained in this Section. Tenant hereby authorizes Landlord at Tenant's expense to attach violation stickers or notices to such vehicles not parked in compliance with this Section and to tow away any such vehicles. In addition, a specific section of the parking area may be set aside by Landlord for visitor parking for tenants of the Property.

3. TERM

3.1 TERM. The Premises are leased for a term (the "TERM") commencing on the Commencement Date and expiring on the Expiration Date. The Term shall end on the Expiration Date, or such earlier date on which this Lease terminates pursuant to its terms. The date upon which this Lease actually terminates, whether by expiration of the Term or in the event of default or surrender of the Premises is sometimes referred to in this Lease as the "TERMINATION DATE".

3.2 FAILURE TO DELIVER POSSESSION. In the event Landlord cannot deliver possession of the Premises to Tenant, Landlord shall have no liability to Tenant, the validity of this Lease and Tenant's obligations hereunder shall not be affected; provided, however, that if Landlord does not deliver possession within sixty (60) days after the Commencement Date, Tenant shall have the right to terminate this Lease by delivery to Landlord of a termination notice (the "TERMINATION NOTICE"). In the event Tenant elects to terminate this Lease, Tenant must deliver the Termination Notice to Landlord prior to the date the Premises are delivered to Tenant. Upon such termination, neither party shall

have any further obligation or liability to the other under this Lease; provided that Landlord shall promptly return to Tenant all sums paid by Tenant pursuant to this Lease.

4. RENT

4.1 BASE RENT. Commencing upon the Commencement Date, and thereafter during the Term, Tenant shall pay to Landlord the monthly Base Rent specified in Article 1 on or before the first day of each month, in advance, at the address specified for Landlord in Article 1, or at such other place as Landlord designates in writing, without any prior notice or demand and without any deductions or setoff whatsoever (except as provided in this Lease). If the Commencement Date occurs on a day other than the first day of a calendar month, or the Termination Date occurs on a day other than the last day of a calendar month, then the Base Rent for such fractional month will be prorated on the basis of the actual number of days in such month. The Rentable Area of the Premises and the Building shall be conclusively presumed to be as stated in Article 1, and shall not be subject to adjustment by either Landlord or Tenant during the Term.

4.2 PREPAYMENT OF BASE RENT; RENT ADJUSTMENTS. In addition to the payment of Base Rent described in Section 4.1, Tenant shall prepay a portion of the Base Rent (the "PREPAYMENT") for the period from the Commencement Date through December 31, 2002 (the "PREPAYMENT PERIOD"). Tenant shall deliver the prepayment in two installments of readily available funds, the first due no later than the Commencement Date in the amount of Five Hundred Ninety-Two Thousand Five Hundred Thirty-Eight Dollars ($592,538), and the second due no later than thirty (30) days after the Commencement Date in the amount of Five Hundred Ninety-Six Thousand Four Hundred Eighty-Eight Dollars ($596,488). The Base Rent due during the entire Prepayment Period shall be $3.19 per square foot of Rentable Area of the Premises. The Base Rent shall be adjusted to $7.43 per square foot of Rentable Area commencing January 1, 2003 and shall thereafter increase by three percent (3%) on January 1 of each calendar year throughout the remainder of the Term.

4.3 ADDITIONAL RENT. All sums due from Tenant to Landlord or to any third party under the terms of this Lease shall be additional rent ("ADDITIONAL RENT"), including without limitation the charges for Base Rent and Operating Expenses (described in Article 5) and all sums incurred by Landlord due to Tenant's failure to perform its obligations under this Lease. All Additional Rent which is payable to Landlord shall be paid at the time and place that Base Rent is paid. Landlord will have the same remedies for a default in the payment of any Additional Rent as for a default in the payment of Base Rent. Together, Base Rent and Additional Rent are sometimes referred to in this Lease as "RENT".

4.4 LATE PAYMENT. Any unpaid Rent shall bear interest from the date due until paid at the maximum interest rate allowed by law (the "INTEREST RATE"). In addition, Tenant

recognizes that late payment of any Rent will result in administrative expense to Landlord, the extent of which expense is difficult and economically impracticable to determine. Therefore, Tenant agrees that if Tenant fails to pay any Rent within five (5) days after its due date, an additional one-time late charge of five percent (5%) of the sums so overdue shall become immediately due and payable. Tenant agrees that the late payment charge is a reasonable estimate of the additional administrative costs and detriment that will be incurred by Landlord as a result of such failure by Tenant. In the event of nonpayment of interest or late charges on overdue Rent, Landlord shall have, in addition to all other rights and remedies, the rights and remedies provided in this Lease and by law for nonpayment of rent.

4.5 SECURITY DEPOSIT. On or before the Commencement Date, Tenant shall deliver to Landlord the Security Deposit described in Article 1 in the form of cash or a letter of credit in a form reasonably acceptable to Landlord and payable upon any default of Tenant under this Lease (the "LETTER OF CREDIT"). The Security Deposit shall be held by Landlord as security for the faithful performance of this Lease by Tenant of all of the terms, covenants and conditions of this Lease. If Tenant defaults with respect to any provisions of this Lease, including but not limited to the payment of Rent, Landlord may, without waiving any of Landlord's other rights and remedies under this Lease, apply the Security Deposit in whole or in part to remedy any failure by Tenant to pay any sums due under this Lease, to repair or maintain the Premises, to perform any other terms, covenants or conditions contained in this Lease, or to compensate Landlord for any loss or damages which Landlord may suffer due to Tenant's default. Should Landlord so apply any portion of the Security Deposit, Tenant shall replenish the Security Deposit to the original amount within ten (10) days after written demand by Landlord. Landlord shall not be required to keep the Security Deposit separate from its general funds, and Tenant shall not be entitled to interest on the Security Deposit. If Tenant elects to use a letter of credit as the Security Deposit, the Letter of Credit shall be issued by a bank (the "L-C BANK") approved by Landlord and shall be in a form that is reasonably acceptable to Landlord in Landlord's reasonable discretion. The L-C Bank shall be a bank that accepts deposits, maintains accounts, has a local Santa Clara County office that will negotiate the Letter of Credit or if no local office then the Letter of Credit shall provide for draws by Landlord upon delivery of the written draw request by courier or by fax (to be confirmed by telephone and with original to follow within three (3) business days) and payment to be made by wire transfer to Landlord's account as directed by Landlord upon receipt of the original or fax request. The deposits of the L-C Bank shall be insured by the Federal Deposit Insurance Corporation. Tenant shall pay all expenses, points, or fees incurred by Tenant in obtaining the Letter of Credit. The Letter of Credit shall be available by draft at sight, subject only to receipt by the bank of a notarized statement from Landlord requesting such draw. The Letter of Credit shall by its terms expire not less than one year from the date issued, and shall provide for automatic one (1) year extensions unless Landlord is notified in writing not less than ninety (90) days prior to such expiration from the L-C Bank that the Letter of Credit will not be extended. In any event, unless Tenant deposits with Landlord a comparable cash security deposit or a replacement letter of credit, said Letter of Credit shall be renewed by Tenant for successive periods of not less than one year throughout the Term. The bank's written renewal of the Letter of Credit shall in each case be delivered to Landlord not less than thirty (30) days prior to the expiration date of the then outstanding Letter of Credit. Tenant's failure to so deliver, renew (including specifically but not limited to the delivery to Landlord of such renewal not less than thirty (30) days prior to expiration of the Letter of Credit) and maintain such Letter of Credit, shall be a breach of this Lease.

5. OPERATING EXPENSES

5.1 NET LEASE. This Lease is intended to be a net lease, and the Base Rent and all Additional Rent are to be paid by Tenant and other tenants of the Property absolutely net of all costs and expenses relating to Landlord's ownership and operation of the Property. The provisions of this Article 5 for the payment of Tenant's Share of Operating Expenses are intended to pass on to Tenant its share of all such costs and expenses. 5.2 OPERATING EXPENSES. For purposes of this Article 5, the following terms shall have the meanings described below:

(a) "TENANT'S SHARE" means the percentage figure specified in Article 1.

(b) "OPERATING EXPENSES" means the total costs and expenses paid

or incurred by Landlord in connection with the ownership, management, operation, maintenance and repair of the Building and the Common Area, including, without limitation, all costs of:

(i) taxes, assessments and charges levied upon or with respect to the Property or any personal property of Landlord used in the operation of the Property, or on Landlord's interest in the Property or its personal property ("REAL ESTATE TAXES"). Real Estate Taxes shall include, without limitation, all general real property taxes and general and special assessments, charges, fees, or assessments for transit, housing, police, fire, or other governmental services or purported benefits to the Property or the occupants thereof, service payments in lieu of taxes that are now or hereafter levied or assessed against Landlord by the United States of America, the State of California or any political subdivision thereof, or any other political or public entity, and shall also include any other tax, assessment or fee, however described, that may be levied or assessed as a substitute for, or as an addition to, in whole or in part, any other Real Estate Taxes, whether or not now customary or in the contemplation of the parties as of the Commencement Date. Real Estate Taxes shall also include reasonable legal fees, costs, and disbursements incurred in connection with proceedings to contest, determine, or reduce Real Estate Taxes; provided that Landlord shall promptly refund to Tenant its Share of any refund which Landlord receives as a result of such proceedings. Real Estate Taxes shall not include franchise, transfer, succession, gift, inheritance, excess profits, gross receipts or capital stock taxes or income taxes measured by the net income of Landlord unless, due to a change in the method of taxation, any of such taxes is levied or assessed against Landlord as a substitute for, or as an addition to, in whole or in part, any other tax that would otherwise constitute a Real Estate Tax, nor shall they include any penalties assessed against Landlord for late payment of Real Estate Taxes;

(ii) repair, maintenance, replacement and supply of HVAC, electricity, steam, water, mechanical, telephone and telecommunications systems, escalator and elevator systems, sanitary and storm drainage systems and all other utilities and mechanical systems which are commonly used by all Building tenants (collectively, the "BUILDING SYSTEMS");

(iii) landscaping and gardening of the Common Area;

(iv) repaving, repairing, maintaining and restriping of Common Area parking areas, including any shared costs reasonably allocated between the Property and the adjacent property owned by Landlord at 3145 Porter Drive;

(v) repairs and maintenance to the Property, including janitorial services, and all labor and material costs related thereto;

(vi) security and fire protection to the Building as a whole;

(vii) trash removal;

(viii) all commercially reasonable insurance carried by Landlord on the Building, the Common Area and the Property, or in connection with the use or occupancy thereof, including fire and extended coverage, vandalism and malicious mischief, public liability and property damage, worker's compensation insurance, rental income insurance and any other insurance commonly carried by prudent owners of comparable buildings in the Palo Alto area;

(ix) wages, salaries, payroll taxes and other labor costs and employee benefits for all persons engaged in the operation, management, maintenance and security of the Property;

(x) management fees at commercially reasonable rates, given the

level of services being provided;

(xi) fees, charges and other costs of all independent contractors engaged by Landlord to provide services to the Property;

(xii) license, permit and inspection fees for the Property;

(xiii) charges on or surcharges imposed by any governmental agencies on or with respect to transit or automobile usage or parking facilities;

(xiv) the allocated cost of supplies, tools, machines and equipment used in operation and maintenance of the Common Area;

(xv) any utility costs that are not separately metered to tenants of the Building, including a reasonable allocation of any utility costs that are shared by the Property and the adjacent property owned by Landlord at 3145 Porter Drive.

(xvi) any capital improvements to the Building and Common Area; provided that the cost of any such capital improvements shall be amortized over the useful life of the improvement in question, together with interest on the unamortized balance at the interest rate publicly announced from time to time by the largest (as measured by deposits) state chartered bank operating in California, as its prime rate or its reference rate or other similar benchmark, plus two percent (2%);

(xvii) the cost of contesting the validity or applicability of any governmental enactments which may materially affect Operating Expenses;

(xviii) audit and bookkeeping fees, legal fees and expenses, financing expenses; and

(xix) any other expenses of any kind whatsoever reasonably incurred in connection with the management, operation, maintenance, repair and replacement of the Building and the Common Area which is not specifically excluded under this Section.

Notwithstanding anything in the definition of Operating Expenses to the contrary, Operating Expenses shall not include the following:

(A) Costs actually reimbursed to Landlord by insurance proceeds for the repair of damage to the Building;

(B) Marketing costs, including without limitation, leasing commissions, attorneys' fees, tenant improvement costs, space planning costs, and other costs and expenses incurred in connection with lease, sublease and/or assignment negotiations and transactions with Tenant or present or prospective tenants of the Building;

(C) Overhead and profit increment paid to Landlord or to subsidiaries or affiliates of Landlord for goods and/or services in or to the Building to the extent the same exceeds the costs of such goods and/or services rendered by unaffiliated third parties on a competitive basis;

(D) Interest, principal, points and fees on debts or amortization on any mortgage or mortgages or any other debt instrument encumbering the Building or the Property;

(E) Costs paid directly by any tenant of the Building for services provided directly or exclusively to that tenant; and

(F) Landlord's general corporate overhead and general administrative expenses;

5.3 PAYMENT OF OPERATING EXPENSES. Commencing on the Commencement Date, Tenant shall pay to Landlord as Additional Rent one twelfth (1/12) of Tenant's Share of Operating Expenses for each calendar year or portion thereof during the Term, in advance, on or before the first day of each month in an amount estimated by Landlord as stated in a written notice to Tenant. Landlord may by written notice to Tenant reasonably revise such estimates from time to time and Tenant shall thereafter make payments on the basis of such revised estimates. With reasonable promptness after the expiration of each calendar year, Landlord will furnish Tenant with a statement ("LANDLORD'S EXPENSE STATEMENT") setting forth in reasonable detail the actual Operating Expenses for such year and Tenant's Share. If Tenant's Share of the actual Operating Expenses for such year exceeds the estimated Operating Expenses paid by Tenant for such year, Tenant shall pay to Landlord (whether or not this Lease has terminated) the difference between the amount of estimated Operating Expenses paid by Tenant and Tenant's Share of the actual Operating Expenses within fifteen (15) days after the receipt of Landlord's Expense Statement. If the total amount paid by Tenant for any year exceeds Tenant's Share of the actual Operating Expenses for that year, the excess shall be credited against the next installments of Base Rent due from Tenant to Landlord, or, if after the Termination Date, the excess shall first be credited against any unpaid Base Rent or Additional Rent due and remaining

any excess shall be refunded to Tenant concurrently with the furnishing of Landlord's Expense Statement.

5.4 PRORATION. If either the Commencement Date or the Termination Date occurs on a date other than the first or last day, respectively, of a calendar year, Tenant's Share of Operating Expenses for the year in which the Commencement Date or Termination Date occurs shall be prorated based on a 365-day year.

5.5 NORMALIZATION. For the purpose of determining Operating Expenses for any partial year, Operating Expenses shall be deemed to accrue uniformly during the entire calendar year. If any part of the Building is not fully occupied and used during a calendar year, Operating Expenses shall be adjusted to add amounts and items of Operating Expenses which would normally have been incurred if the Building had been fully occupied during such calendar year and Tenant's Share of Operating Expenses (both for the purposes of the initial estimate and year-end reconciliation) shall be based on an assumed full occupancy of the Building.

5.6 UTILITY COSTS. Tenant shall be solely responsible for and shall make all arrangements for all utilities and services which are exclusively furnished to or used at the Premises, including, without limitation, all water, gas, telephone and other electronic communications service, sewer service, waste pick-up and any other utilities, materials or services.

5.7 TAXES ON TENANT'S PROPERTY AND BUSINESS. At least ten (10) days prior to delinquency, Tenant shall pay all taxes levied or assessed by any local, state or federal authority upon the conduct of Tenant's business in the Premises or upon Tenant's Property (as defined in Section 9.4) and shall deliver satisfactory evidence of such payment to Landlord. If the assessed value of the Property is increased by the inclusion of a value placed upon Tenant's Property, Tenant shall pay to Landlord, upon written demand, the taxes so levied against Landlord, or the portion of Landlord's taxes resulting from said increase in assessment, as determined from time to time by Landlord.

6. USE OF PREMISES AND CONDUCT OF BUSINESS

6.1 PERMITTED USE. Tenant may use and occupy the Premises during the Term solely for the uses specified and permitted in Article 1 and for no other purpose without the prior written consent of Landlord, such consent to be granted or withheld in Landlord's sole discretion. Tenant's use of the Premises shall in all respects comply with all Applicable Laws (as defined in Section 11.1).

6.2 PROHIBITED USES. Tenant shall not use the Premises or allow the Premises to be used for any illegal or immoral purpose, or so as to create waste, constitute a private or public nuisance, or disturb other occupants of the Property. Tenant shall not place any loads upon the floors, walls, or ceiling which endanger the structure, or place any harmful fluids or other materials in the drainage system of the Building, or overload existing electrical or other mechanical systems. No waste materials or refuse shall be dumped upon or permitted to remain upon any part of the Premises or outside of the Premises except in trash containers placed inside exterior enclosures designated by Landlord for that purpose or inside of the Premises where approved by Landlord. No materials, supplies, equipment, finished products or semi-finished products, raw materials or articles of any nature shall be stored upon or permitted to remain

outside the Premises or on any portion of the Common Area unless otherwise approved by Landlord in its sole discretion. No loudspeaker or other device, system or apparatus which can be heard outside the Premises, other than burglar and fire alarms, shall be used in or at the Premises without the prior written consent of Landlord. No explosives or firearms shall be brought into the Premises.

7. REPAIRS AND MAINTENANCE

7.1 LANDLORD'S OBLIGATIONS. Except as specifically provided in this Lease, Landlord shall not be required to furnish any services, facilities or utilities to the Premises or to Tenant, and Tenant assumes full responsibility for obtaining and paying for all services, facilities and utilities to the Premises. Landlord will repair and maintain the Building Systems, the Common Area, and the structural portions of the Building, including the foundation, floor/ceiling slabs, roof, curtain wall, exterior glass and mullions, columns, beams, shafts (including elevator shafts), stairs, stairwells, escalators, elevators (collectively, the "BUILDING STRUCTURE"). Landlord shall take good care of the Common Area, Building Structure and Building Systems which are the responsibility of Landlord and keep them in good working order and in a clean, safe and sanitary condition. Landlord shall use commercially reasonable efforts to minimize any interference to Tenant's businesses caused by such maintenance and repairs, and shall diligently and expeditiously pursue completion of same. Tenant shall notify Landlord in writing of the need for any repair or maintenance which is Landlord's responsibility under this Section. The costs of such repair and maintenance shall be included in Operating Expenses to the extent provided in Article 5; provided that Tenant shall reimburse Landlord upon written demand for the cost of any repair to the Building, Building Structure, Building Systems or Common Area which is attributable to the conduct or misuse of Tenant or Tenant's Agents. The reimbursement and the administrative fee shall be Additional Rent. Tenant hereby waives and releases any right it may have under any law, statute or ordinance now or hereafter in effect to make any repairs which are Landlord's obligation under this Section.

7.2 TENANT'S OBLIGATIONS. Except as provided in Section 7.1, Tenant assumes full responsibility for the repair and maintenance of the Premises. Tenant shall take good care of the Premises and keep the Premises (other than the Common Area, Building Structure and Building Systems which are the responsibility of Landlord) in good working order and in a clean, safe and

sanitary condition. All repairs and replacements by Tenant shall be made and performed: (a) at Tenant's cost and expense, (b) by contractors or mechanics reasonably approved by Landlord where the work will exceed Fifty Thousand Dollars ($50,000) in cost, (c) so that same shall be at least equal in quality, value and utility to the original work or installation, (d) in a manner and using equipment and materials that will not interfere with or impair the operations, use or occupation of the Building, the Building Systems or the activities of other tenants in the Building, and (e) in accordance with Article 9 (if applicable), the Rules and Regulations, and all Applicable Laws.

7.3 SECURITY. Tenant shall be solely responsible for the security of the Premises and Tenant's Agents while in or about the Premises. Any security services provided to the Property by Landlord shall be at Landlord's sole discretion and Landlord shall not be liable to Tenant or Tenant's Agents for any failure to provide security services or any loss, injury or damage suffered as a result of a failure to provide security services.

7.4 SPECIAL SERVICES. If Tenant requests any services from Landlord other than those for which Landlord is obligated under this Lease, Tenant shall make its request in writing and Landlord may elect in its sole discretion whether to provide the requested services. If Landlord provides any special services to Tenant, Landlord shall charge Tenant for such services at the prevailing rate being charged for such services by other property owners and property managers of comparable buildings in the area of the Property, and Tenant shall pay the cost of such services as Additional Rent within fifteen (15) business days after receipt of Landlord's invoice.

8. ACCEPTANCE

The Premises as furnished by Landlord consist of the improvements as they exist as of the Commencement Date and Landlord shall have no obligation for construction work or improvements on or to the Premises. Prior to entering into this Lease, Tenant has made a thorough and independent examination of the Premises and all matters related to Tenant's decision to enter into this Lease. Tenant is thoroughly familiar with all aspects of the Premises and is satisfied that they are in an acceptable condition and meet Tenant's needs. Tenant does not rely on, and Landlord does not make, any express or implied representations or warranties as to any matters including, without limitation, (a) the physical condition of the Premises, the Building, the Building Structure, Building Systems, or the Common Area, (b) the existence, quality, adequacy or availability of utilities serving the Premises, (c) the use, habitability, merchantability, fitness or suitability of the Premises for Tenant's intended use, (d) the likelihood of deriving business from Tenant's location or the economic feasibility of Tenant's business, (e) Hazardous Materials in the Premises, the Building, or on, in under or around the Property, (f) zoning, entitlements or any laws, ordinances or regulations which may apply to Tenant's use of the Premises or business operations, or (g) any other matter. Tenant has satisfied itself as to such suitability and other pertinent matters by Tenant's own inquiries and tests into all matters relevant in determining whether to enter into this Lease. Tenant accepts the Premises in their existing "as-is" condition. Tenant shall, by entering into and occupying the Premises, be deemed to have accepted the Premises and to have acknowledged that the same are in good order, condition and repair.

9. ALTERATIONS

9.1 ALTERATIONS BY TENANT. Tenant shall not make or permit any alterations to the Building Systems, and shall not make or permit any alterations, installations, additions or improvements, structural or otherwise (collectively, "ALTERATIONS") in or to the Premises or the Building without Landlord's prior written consent, which Landlord shall not unreasonably withhold

or delay. Landlord shall respond to any request by Tenant to make any Alteration within ten (10) business days after receipt of such request for consent from Tenant. Notwithstanding the foregoing, Landlord's consent shall not be required (a) in the case of interior, cosmetic non-structural Alterations that do not require a permit, or affect the Building Systems, or affect the entryways or elevators or any other premises in the Building, or (b) in the case of other Alterations that do not exceed a cost of Fifty Thousand Dollars ($50,000). All Alterations shall be done at Tenant's expense, and subject to all other conditions which Landlord may in its reasonable discretion impose which are not inconsistent with this Lease. Tenant shall be solely responsible for obtaining at its sole cost and expense all permits and approvals required for any Alterations.

9.2 APPROVED PROJECT REQUIREMENTS. The following provisions of this Section 9.2 shall apply to all Alterations, unless otherwise noted below:

(a) Prior to entering into a contract for Alterations requiring Landlords' consent, Tenant shall obtain Landlord's written approval, which approval shall not be unreasonably withheld, of the identity of each of the design architect and the general contractor.

(b) Before commencing the construction of any Alterations, Tenant shall procure or cause to be procured the insurance coverage described below and provide Landlord with certificates of such insurance in form reasonably satisfactory to Landlord. All such insurance shall comply with the following requirements of this Section and of Section 13.2.

(i) During the course of construction, to the extent not covered by property insurance maintained by Tenant pursuant to Section 13.2, comprehensive "all risk" builder's risk insurance, including vandalism and malicious mischief, excluding earthquake and flood, covering all improvements in place on the Premises, all materials and equipment stored at the site and furnished under contract, and all materials and equipment that are in the process of fabrication at the premises of any third party or that have been placed in transit to the Premises when such fabrication or transit is at the risk of, or when title to or an insurable interest in such materials or equipment has passed to, Tenant or its construction manager, contractors or subcontractors (excluding any contractors', subcontractors' and construction managers' tools and equipment, and property owned by the employees of the construction manager, any contractor or any subcontractor), such insurance to be written on a completed value basis in an amount not less than the full estimated replacement value of Alterations.

(ii) Commercial general liability insurance covering Tenant, Landlord and each construction manager, contractor and subcontractor engaged in any work on the Premises, which insurance may be effected by endorsement, if obtainable, on the policy required to be carried pursuant to Section 13.2, including insurance for completed operations, elevators, owner's, construction manager's and contractor's protective liability, products completed operations for one (1) year after the date of acceptance of the work by Tenant, broad form blanket contractual liability, broad form property damage and full form personal injury (including but not limited to bodily injury), covering the performance of all work at or from the Premises by Tenant, its construction manager, contractors and subcontractors, and in a liability amount not less than the amount at the time carried by prudent owners of comparable construction projects, but in any event not less than Three Million Dollars ($3,000,000) combined single limit, which policy shall include thereunder for the mutual benefit of Landlord and Tenant, bodily injury liability and property damage liability, and automobile insurance on any non-owned, hired or leased automotive equipment used in the construction of any work.

(iii) Workers' Compensation Insurance approved by the State of California, in the amounts and coverages required under workers' compensation, disability and similar employee benefit laws applicable to the Premises, and Employer's Liability Insurance with limits not less than One Million Dollars ($1,000,000) or such higher amounts as may be required by law.

(c) All construction and other work in connection with any Alterations shall be done at Tenant's sole cost and expense and in a prudent and first class manner. Tenant shall construct the Alterations in accordance with all Applicable Laws, and with plans and

specifications that are in accordance with the provisions of this Article 9 and all other provisions of this Lease.

(d) Prior to the commencement of any construction, alteration, addition, improvements, repair or landscaping in excess of Ten Thousand Dollars ($10,000), Landlord shall have the right to post in a conspicuous location on the Premises and to record in the public records a notice of Landlord's nonresponsibility. Tenant covenants and agrees to give Landlord at least ten (10) days prior written notice of the commencement of any such construction, alteration, addition, improvement, repair or landscaping in order that Landlord shall have sufficient time to post such notice.

(e) Tenant shall take all necessary safety precautions during any construction.

(f) Tenant shall prepare and maintain (i) on a current basis during construction, annotated plans and specifications showing clearly all changes, revisions and substitutions during construction, and (ii) upon completion of construction, as-built drawings showing clearly all changes, revisions and substitutions during construction, including, without limitation, field changes and the final location of all mechanical equipment, utility lines, ducts, outlets, structural members, walls, partitions and other significant features. These as-built drawings and annotated plans and specifications shall be kept at the Premises and Tenant shall update them as often as necessary to keep them current. The as-built drawings and annotated plans and specifications shall be made available for copying and inspection by Landlord at all reasonable times.

(g) Upon completion of the construction of any Alterations in excess of Ten Thousand Dollars ($10,000) during the Term, Tenant shall file for recordation, or cause to be filed for recordation, a notice of completion and shall deliver to Landlord evidence satisfactory to Landlord of payment of all costs, expenses, liabilities and liens arising out of or in any way connected with such construction (except for liens that are contested in the manner provided herein).

9.3 OWNERSHIP OF IMPROVEMENTS. Except as provided in Section 9.4, all Alterations, and any other appurtenances, fixtures, improvements, equipment, additions and property permanently attached to or installed in the Premises at the commencement of or during the Term, shall at the end of the Term become Landlord's property without compensation to Tenant, or be removed in accordance with this Section. Landlord shall notify Tenant in writing at the time of Landlord's approval of any Alterations whether or not the proposed Alterations will be required to be removed by Tenant at the end of the Term. Tenant shall have no obligation to remove any Alterations that Landlord has not designated in writing for removal. Tenant shall repair or pay the cost of repairing any damage to the Premises or to the Building caused by the removal of Alterations. If Tenant fails to perform its repair obligations, without limiting any other right or remedy, Landlord may on five (5) business days prior written notice to Tenant perform such obligations at Tenant's expense and Tenant shall promptly reimburse Landlord upon demand for all out-of-pocket costs and expenses incurred by

Landlord in connection with such repair. The reimbursement shall be Additional Rent. Tenant's obligations under this Section shall survive the termination of this Lease.

9.4 TENANT'S PERSONAL PROPERTY. All furniture, trade fixtures, furnishings, equipment and articles of movable personal property installed in the Premises by or for the account of Tenant (except for ceiling and related fixtures, HVAC equipment and floor coverings), and which can be removed without structural or other material damage to the Building (collectively, "TENANT'S PROPERTY") shall be and remain the property of Tenant and may be removed by it at any time during the Term. Tenant shall remove from the Premises all Tenant's Property on or before the Termination Date, except such items as the parties have agreed pursuant to the provisions of this Lease or by separate agreement are to remain and to become the property of Landlord. Tenant shall repair or pay the cost of repairing any damage to the Premises or to the Building resulting from such removal, and the provisions of Section 9.4 above shall apply in the event Tenant fails to do so. Any items of Tenant's Property which remain in the Premises after the Termination Date may, on five (5) business days prior written notice to Tenant, at the option of Landlord, be deemed abandoned and in such case may either be retained by Landlord as its property (if permitted by Applicable Laws) or be disposed of, without accountability, at Tenant's expense in such manner as is required by Applicable Laws.

10. LIENS

Tenant shall keep the Premises free from any liens arising out of any work performed, material furnished or obligations incurred by or for Tenant. If Tenant shall not, within twenty (20) days following notice of the imposition of any such lien, cause the lien to be released of record by payment or posting of a proper bond, Landlord shall have, in addition to all other remedies provided in this Lease and by law, the right but not the obligation to cause any such lien to be released by such means as it shall deem proper, including payment of the claim giving rise to such lien. All such sums paid by Landlord and all expenses incurred by it in connection therewith (including, without limitation, reasonable counsel fees) shall be payable to Landlord by Tenant upon demand with interest from the date incurred at the Interest Rate. Landlord shall have the right at all times to post and keep posted on the Premises any notices permitted or required by law or that Landlord shall deem proper for the protection of Landlord, the Premises, and the Building from mechanics' and materialmen's liens, as more specifically provided in Section 9.3(b).

11. COMPLIANCE WITH LAWS AND INSURANCE REQUIREMENTS

11.1 APPLICABLE LAWS. Tenant, at Tenant's cost and expense, shall comply with all applicable laws, statutes, codes, ordinances, orders, rules, regulations, conditions of approval, and requirements, of all federal, state, county, municipal and other governmental authorities and the departments, commissions, boards, bureaus, instrumentalities, and officers thereof, and all administrative or judicial orders or decrees and all permits, licenses, approvals and other entitlements issued by governmental entities, and rules of common law, relating to or affecting the Building or the use, operation or occupancy of the Premises, whether now existing or hereafter enacted (collectively, "APPLICABLE LAWS") relating to its use or occupancy of the Premises, its repair and maintenance obligations, or any Alterations. Without limiting the foregoing, Tenant shall be solely responsible for compliance with and shall make or cause to be made all improvements and alterations to the Premises (including, without limitation, removing barriers and providing alternative services) as shall be required to comply with all applicable building codes, laws and ordinances relating to public accommodations, including the Americans with Disabilities Act of 1990, 42 U.S.C. Sections 12111 et seq. (the "ADA"), and the ADA Accessibility Guidelines promulgated by the

Compliance Board, the public accommodations title of the Civil Rights Act of 1964, 42 U.S.C. Sections 2000a et. seq., the Architectural Barriers Act of 1968, 42 U.S.C. Sections 4151 et. seq., as amended, Title V of the Rehabilitation Act of 1973, 29 U.S.C. Sections 790 et. seq., the Minimum Guidelines and Requirements for Accessible Design, 36 C.F.R. Part 1190, the Uniform Federal Accessibility Standards, and Title 24 of the California Code of Regulations, as the same may be amended from time to time, or any similar or successor laws, ordinances and regulations, now or hereafter adopted. Tenant's liability shall be primary and Tenant shall indemnify Landlord in accordance with Section 13.1 in the event of any failure or alleged failure of Tenant to comply with Applicable Laws. Any work or installations made or performed by or on behalf of Tenant or any person or entity claiming through or under Tenant pursuant to the provisions of this Section shall be made in conformity with and subject to the provisions of Article 9. Landlord shall comply with all Applicable Laws relating to its obligations set forth in Section 7.1.

11.2 INSURANCE REQUIREMENTS. Tenant shall not do anything, or permit anything to be done, in or about the Premises that would: (a) invalidate or be in conflict with the provisions of or cause any increase in the applicable rates for any fire or other insurance policies covering the Building or any property located therein (unless Tenant pays for such increased costs), or (b) result in a refusal by fire insurance companies of good standing to insure the Building or any such property in amounts reasonably satisfactory to Landlord (which amounts shall be comparable to the amounts required by comparable landlords of comparable buildings, or (c) subject Landlord to any liability or responsibility for injury to any person or property by reason of any business operation being conducted in the Premises. Tenant, at Tenant's expense, shall comply with all rules, orders, regulations or requirements of the American Insurance Association (formerly the National Board of Fire Underwriters) and with any similar body that shall hereafter perform the function of such Association.

12. HAZARDOUS MATERIALS

12.1 DEFINITIONS. As used in this Lease, the following terms shall have the following meanings:

(a) "ENVIRONMENTAL ACTIVITY" means any use, storage, holding, release, emission, discharge, manufacturing, generation, processing, abatement, removal, disposition, handling, transportation, discharge or release of any Hazardous Materials from, into, on or under the Building, the Common Area or the Property.

(b) "ENVIRONMENTAL LAWS" mean all Applicable Laws, now or hereafter in effect, relating to environmental conditions, industrial hygiene or Hazardous Materials on, under or about the Property, including without limitation the comprehensive environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C. Section 9601, et seq., the Hazardous Materials Transportation Act, 49 U.S.C. Section 1801, et seq., the Solid Waste Disposal Act, 42 U.S.C. Section 6901, et seq., the Clean Water Act, 33 U.S.C. Section 1251, et seq., the Clean Air Act, 42 U.S.C. Section 7401, et seq., the Toxic Substances Control Act, 15 U.S.C. Section 2601 through 2629, the Safe Drinking Water Act, 42 U.S.C. Sections 300f through 300j, and any similar state and local laws and ordinances and the regulations now or hereafter adopted and published and/or promulgated pursuant thereto.

(c) "HAZARDOUS MATERIAL" means any chemical, substance, medical or other waste, living organism or combination thereof which is or may be hazardous to the

environment or human or animal health or safety due to its radioactivity, ignitability, corrosivity, reactivity, explosivity, toxicity, carcinogenicity, mutagenicity, phytotoxicity, infectiousness or other harmful or potentially harmful properties or effects as they relate to human health or the environment. Hazardous Materials shall include, without limitation, petroleum hydrocarbons, including crude oil or any fraction thereof, asbestos, radon, polychlorinated biphenyls (PCBs), methane and all substances which now or in the future may be defined or regulated as "hazardous substances," "hazardous wastes," "extremely hazardous wastes," "hazardous materials," "toxic substances," "infectious wastes," "biohazardous wastes," "medical wastes," "radioactive wastes" or which are otherwise listed, defined or regulated in any manner pursuant to any Environmental Laws.

(d) "TENANT'S HAZARDOUS MATERIALS" means any Hazardous Materials resulting from the Environmental Activity by Tenant or any of Tenant's Agents.

12.2 ENVIRONMENTAL RELEASE. Tenant represents to Landlord that Tenant is aware that detectable amounts of Hazardous Materials have come to be located on, beneath and/or in the vicinity of the Premises. (See, for example, Department of Toxic Substances Control Order No. HSA 90/91-007 (dated 10-25-90), Regional Water Quality Control Board Order No. 94/99 (dated 8-17-94), and Department of Toxic Substances Control Order No HSA 90/91-004 (dated 8-6-90)). Tenant has made such investigations and inquiries as it deems appropriate to ascertain the effects, if any, of such substances and contaminants on its operations and persons using the Building and the Common Area. Landlord makes no representation or warranty with regard to the environmental condition of the Building, the Common Area or the Property. Tenant hereby releases Landlord and Landlord's officers, directors, trustees, agents and employees from any and all claims, demands, debts, liabilities, and causes of action of whatever kind or nature, whether known or unknown or suspected or unsuspected which Tenant or any of Tenant's Agents may have, claim to have, or which may hereafter accrue against the released parties or any of them, arising out of or relating to or in any way connected with Hazardous Materials presently in, on or under, or now or hereafter emanating from or migrating onto the Building or the Property. In connection with such release, Tenant hereby waives any and all rights conferred upon it by the provisions of Section 1542 of the California Civil Code, which reads 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.

12.3 USE OF HAZARDOUS MATERIALS. Tenant shall not be responsible, and it is not the intent of this Article 12 to make Tenant responsible for any preexisting Hazardous Materials which may be located on, under, in or about the Property. Tenant shall not cause or permit any Hazardous Materials to be used, stored, discharged, released or disposed of in the Premises or cause any Hazardous Materials to be used, stored, discharged, released or disposed of in, from, under or about, the Property, or any other land or improvements in the vicinity of the Property excepting only the types and quantities of Hazardous Materials which are normally used in Tenant's research and development activities and then only in strict accordance with all Applicable Laws, including all Environmental Laws. Tenant shall, at its own expense, procure, maintain in effect and comply with all conditions of any and all permits, licenses, and other

governmental and regulatory approvals required for Tenant's use of Hazardous Materials at the Premises, including, without limitation, discharge of appropriately treated materials or wastes into or through any sanitary sewer serving the Building. Tenant shall in all respects handle, treat, deal with and manage any and all Tenant's Hazardous Materials in total conformity with all Environmental Laws and prudent industry practices regarding management of such Hazardous Materials. Without limiting the foregoing, if any Tenant's Hazardous Materials result in contamination of the Building, or any soil or groundwater in, under or about the Property, Tenant, at its expense, shall promptly take all actions necessary to return the Building and/or the Property, to the condition existing prior to the appearance of the Tenant's Hazardous Material, subject to Landlord's right to reasonably approve Tenant's proposed remediation method. On or prior to the Termination Date, Tenant shall cause all Tenant's Hazardous Materials in, on, under or about the Building to be removed in accordance with and in compliance with all Applicable Laws. Tenant shall promptly notify Landlord and, except in the case of an emergency, obtain Landlord's written approval before taking any remedial action in response to the presence of any Tenant's Hazardous Materials or entering into any settlement agreement, consent decree or other compromise with respect to any claims relating to Tenant's Hazardous Materials, which consent shall not be unreasonably withheld, delayed or denied.

12.4 HAZARDOUS MATERIALS INVENTORY. Upon or prior to the Commencement Date, Tenant shall provide to Landlord a complete list of any and all Hazardous Materials (excluding normal office and janitorial supplies) expected to be employed by Tenant at the Premises. Throughout the Term, Tenant shall regularly and periodically update the list to reflect its current inventory of Hazardous Materials at the Premises to the extent such current inventory changes.

12.5 TENANT INDEMNITY. Tenant shall indemnify, defend (by counsel reasonably acceptable to Landlord), protect and hold Landlord and Landlord's trustees, directors, officers, agents and employees and their respective successors and assigns (collectively, "LANDLORD'S AGENTS"), free and harmless from and against any and all claims, liabilities, penalties, forfeitures, losses or expenses (including reasonable attorneys' and consultants' fees and oversight and response costs) to the extent arising from events occurring during the Term and arising from (a) Environmental Activity by Tenant or Tenant's Agents; or (b) failure of Tenant or Tenant's Agents to comply with any Environmental Law with respect to Tenant's Environmental Activity; or (c) Tenant's failure to remove Tenant's Hazardous Materials as required in Section 12.3.

12.6 LANDLORD INDEMNITY. Landlord shall indemnify, defend (by counsel reasonably acceptable to Tenant), protect and hold Tenant harmless from and against any remediation costs incurred by Tenant (and Tenant's Agents, permitted Transferees under Article 14, and affiliates who acquire rights to the Premises under Section 14.6), and all penalties and other actual expenses (including reasonable attorneys' and consultants' fees) associated with such remediation costs, to the extent resulting from or arising out of the release, treatment, storage, use or disposal of Hazardous Materials in, on, under or from the Property prior to the Commencement Date of this Lease, including, without limitation, groundwater contamination migrating onto or under the Property from other properties. Landlord's indemnification obligations hereunder shall extend only to Tenant's actual "out of pocket" costs but shall not include consequential damages or incidental damages such as lost profits or any loss of rental value of the Premises suffered or allegedly suffered by Tenant or any of Tenant's Agents.

12.7 NO LIEN. Tenant shall not suffer any lien to be recorded against the Building or the Property as a consequence of any Tenant's Hazardous

Materials, including any so called state, federal or local "super fund" lien related to the remediation of any Tenant's Hazardous Materials in, on or about the Building or the Property.

12.8 INVESTIGATION. In the event Hazardous Materials are discovered in or about the Building or the Property, and Landlord reasonably believes that such Hazardous Materials are Tenant's Hazardous Materials, then Landlord shall have the right to appoint a consultant to conduct an investigation to determine the nature and extent of such Hazardous Materials, whether such Hazardous Materials are Tenant's Hazardous Materials, and the corrective measures, if any, required by Environmental Law to remove such Hazardous Materials. If such Hazardous Materials are determined to be Tenant's Hazardous Materials, Tenant, at its expense, shall comply with all investigation, remediation or other actions required by any applicable governmental authority and reasonably approved by Landlord. If Tenant fails to promptly commence and diligently prosecute the investigation, remediation or other required action, then upon thirty (30) days prior written notice from Landlord to Tenant, Landlord shall undertake such investigation, remediation or other required action for Tenant's account, and Tenant shall promptly reimburse Landlord as Additional Rent for all costs incurred by Landlord in connection therewith.

12.9 NOTICES. Tenant shall promptly notify Landlord of any inquiry, test, claim, investigation or enforcement proceeding by or against Tenant (except to the extent unrelated to this Lease) or the Premises or the Property known to Tenant concerning any Hazardous Materials. Tenant shall promptly notify Landlord of any release or discharge of Hazardous Materials on, in under or about the Property which was caused or permitted by Tenant or anyone within Tenant's reasonable control. Tenant acknowledges that Landlord, as the owner of the Property, shall have the sole right at its election and at Tenant's expense, to negotiate, defend, approve and appeal any action taken or order issued with regard to Tenant's Hazardous Materials by any applicable governmental authority; provided, however, that Landlord agrees to cooperate and consult with Tenant in the course of any dealings with such governmental authorities.

12.10 SURRENDER. Tenant shall surrender the Premises to Landlord, upon the expiration or earlier termination of the Lease, free of Tenant's Hazardous Materials. If Tenant fails to so surrender the Premises, Tenant shall indemnify and hold Landlord harmless from all losses, costs, claims, damages and liabilities resulting from Tenant's failure to surrender the Premises as required by this Section 12.10, including, without limitation, (a) any claims or damages arising in connection with the condition of the Premises, and (b) damages occasioned by Landlord's inability to relet the Premises or a reduction in the fair market and/or rental value of the Building or any portion thereof, by reason of the existence of any Tenant's Hazardous Materials. 12.11 SURVIVAL. The provisions of this Article 12 shall survive the expiration or earlier termination of this Lease.

13. INDEMNITY; INSURANCE

13.1 INDEMNITY. Tenant shall indemnify, protect, defend and save and hold Landlord and Landlord's Agents harmless from and against any and all losses, costs, liabilities,

claims, judgments, liens, damages (including consequential damages) and expenses, including, without limitation, reasonable attorneys' fees and costs (including Landlord's in-house counsel), and reasonable investigation costs, incurred in connection with or arising from: (a) any default by Tenant in the observance or performance of any of the terms, covenants or conditions of this Lease on Tenant's part to be observed or performed, or (b) the use or occupancy or manner of use or occupancy of the Premises, the Building and the Property by Tenant and Tenant's Agents, (c) the condition of the Premises, and any

occurrence on the Premises, the Building or the Property from any cause whatsoever, except to the extent caused by the gross negligence, willful misconduct or breach of this Lease by Landlord, and (d) any acts or omissions or negligence of Tenant or of Tenant's Agents, in, on or about the Premises, the Building or the Common Area. In case any action or proceeding be brought, made or initiated against Landlord relating to any matter covered by Tenant's indemnification obligations under this Section or under Section 12.5, Tenant, upon notice from Landlord, shall at its sole cost and expense, resist or defend such claim, action or proceeding by counsel approved by Landlord. Notwithstanding the foregoing, Landlord may retain its own counsel to defend or assist in defending any claim, action or proceeding involving potential liability of Five Million Dollars ($5,000,000) or more, and Tenant shall pay the reasonable fees and disbursements of such counsel. Tenant's obligations under this Section shall survive the expiration or earlier termination of this Lease.

13.2 INSURANCE. Tenant shall procure at its sole cost and expense and keep in effect during the Term:

(a) commercial general liability insurance covering Tenant's operations in the Premises and the use and occupancy of the Premises and the Building and any part thereof by Tenant. Such insurance shall include broad form contractual liability insurance coverage insuring Tenant's obligations under this Lease. Such coverage shall be written on an "occurrence" form and shall have a minimum combined single limit of liability of not less than three million dollars ($3,000,000.00). Tenant's policy shall be written to apply to all bodily injury, property damage, personal injury and other covered loss (however occasioned) occurring during the policy term, with at least the following endorsements to the extent such endorsements are generally available: (i) deleting any employee exclusion on personal injury coverage, (ii) including employees as additional insureds, (iii) providing broad form property damage coverage and products completed operations coverage (where applicable), (iv) deleting any liquor liability exclusions, and (v) providing for coverage of owned and non-owned automobile liability, if applicable. Such insurance shall name Landlord and any other party reasonably designated by Landlord as an additional insured, shall specifically include the liability assumed hereunder by Tenant, shall provide that it is primary insurance, shall provide for severability of interests, shall further provide that an act or omission of one of the named insureds which would void or otherwise reduce coverage shall not reduce or void the coverage as to any insured, shall afford coverage for claims based on acts, omissions, injury or damage which occurred or arose (or the onset of which occurred or arose in whole or in part during the policy period);

(b) commercial property insurance, including sprinkler leakages, vandalism and malicious mischief and plate glass damage covering all the items specified as Tenant's Property and all other property of every description including stock-in-trade, furniture, fittings, installations, alterations, additions, partitions and fixtures or anything in the nature of a leasehold improvement made or installed by or on behalf of the Tenant in an amount of not less than one hundred percent (100%) of the full replacement cost thereof as shall from time to time be determined by Tenant in form reasonably satisfactory to Landlord; and

(c) Worker's Compensation Insurance in the amounts and coverages required under worker's compensation, disability and similar employee benefit laws applicable to Tenant and/or the Premises from time to time, and Employer's Liability Insurance, with limits of not less than one million dollars ($1,000,000) such higher amounts as may be required by law.

13.3 POLICIES. All policies of insurance provided for herein shall be issued by insurance companies with general policyholders' rating of not less than A, as rated in the most current available "Best's Insurance Reports," and

not prohibited from doing business in the State of California, and shall, with the exception of Workers Compensation Insurance, include as additional insureds Landlord, and such other persons or entities as Landlord reasonably specifies from time to time. Such policies shall be for the mutual and joint benefit and protection of Landlord, Tenant and others reasonably specified by Landlord. Executed copies of Tenant's policies of insurance or certificates thereof shall be delivered to Landlord prior to the delivery of possession of the Premises to Tenant and thereafter within thirty (30) days prior to the expiration of the term of each such policy. All commercial general liability and property damage policies shall contain a provision that Landlord and any other additional insured, although named as additional insureds, shall nevertheless be entitled to recover under said policies for a covered loss occasioned by it, its servants, agents and employees, by reason of Tenant's negligence. As often as any policy shall expire or terminate, renewal or additional policies shall be procured and maintained by Tenant in like manner and to like extent. All such policies of insurance shall provide that the company writing said policy will give to Landlord fifteen (15) days notice in writing in advance of any cancellation or lapse or of the effective date of any reduction in the amounts of insurance. All commercial general liability, property damage and other casualty policies shall be written on an occurrence basis. Landlord's coverage shall not be contributory. No policy shall have a deductible in excess of $5,000 for any one occurrence.

13.4 LANDLORD'S RIGHTS. Should Tenant fail to take out and keep in force each insurance policy required under this Article 13, or should such insurance not be approved by Landlord and should the Tenant not rectify the situation within five (5) business days after written notice from Landlord to Tenant, Landlord shall have the right, without assuming any obligation in connection therewith, to purchase such insurance at the sole cost of Tenant, and all costs incurred by Landlord shall be immediately payable to Landlord by Tenant as Additional Rent and without prejudice to any other rights and remedies of Landlord under this Lease.

13.5 WAIVER OF SUBROGATION. Notwithstanding anything to the contrary contained herein, Landlord and Tenant each hereby waive any right of recovery against the other party and against any other party maintaining a policy of insurance or required to maintain a policy of insurance under this Lease with respect to the Property or any portion thereof or the contents of the Premises or the Building, for any loss or damage sustained by such other party with respect to the Premises, the Building or the Property, or any portion thereof, or the contents of the same or any operation therein, whether or not such loss is caused by the fault or negligence of such other party. Either party shall notify the other party if the policy of insurance carried by it does not permit the foregoing waiver.

13.6 NO LIABILITY. No approval by Landlord of any insurer, or the terms or conditions of any policy, or any coverage or amount of insurance, or any deductible amount shall be construed as a representation by Landlord of the solvency of the insurer or the sufficiency of any policy or any coverage or amount of insurance or deductible and Tenant assumes full risk and responsibility for any inadequacy of insurance coverage or any failure of insurers.

13.7 LANDLORD'S INSURANCE. During the Term, Landlord shall keep the Building (excluding Tenant's improvements, alterations, trade fixtures, equipment, furniture and other personal property) insured through a funded program of self-insurance or through reputable insurance underwriters against perils covered by a standard "all risk" insurance policy or policies, with deductible limits that do not materially exceed those carried by prudent operators of comparable buildings in the Palo Alto area, and in an amount equal to not less than one hundred percent (100%) of the full replacement value of the

Building. Further, Landlord shall carry commercial general liability insurance or self-insurance with amounts of coverage that Landlord deems appropriate in its good faith business judgment.

14. ASSIGNMENT AND SUBLETTING

14.1 CONSENT REQUIRED. Except as provided in Section 14.6 below, Tenant shall not directly or indirectly, voluntarily or by operation of law, sell, assign, encumber, pledge or otherwise transfer or hypothecate all or any part of its interest in or rights with respect to the Premises or its leasehold estate (collectively, "ASSIGNMENT"), or permit all or any portion of the Premises to be occupied by anyone other than itself or sublet all or any portion of the Premises (collectively, "SUBLEASE") without Landlord's prior written consent, such consent not to be unreasonably withheld.

14.2 NOTICE. If Tenant desires to enter into a Sublease of the Premises or Assignment of this Lease, it shall give written notice (the "TRANSFER NOTICE") to Landlord of its intention to do so, which notice shall contain (a) the name and address of the proposed assignee, subtenant or occupant (the "TRANSFEREE"), (b) the nature of the proposed Transferee's business to be carried on in the Premises, (c) the terms and provisions of the proposed Assignment or Sublease, and (d) such financial information as Landlord may reasonably request concerning the proposed Transferee. Without limitation of any other provision hereof, it shall not be unreasonable for Landlord to withhold its consent if (i) an Event of Default has occurred and is continuing (as defined in Section 15.1), (ii) the use of the Premises would not comply with the provisions of this Lease, (iii) the base rent to be paid by the Transferee is not at substantially the prevailing market rent then being charged by landlords of comparable buildings in the Palo Alto Area (taking into consideration all of the terms of the transaction and the creditworthiness of the Transferee), or (iv) in Landlord's reasonable judgment, the proposed Transferee does not have the financial capability to perform its obligations under this Lease with respect to the Premises which are the subject of the Assignment or Sublease.

14.3 TERMS OF APPROVAL. Landlord shall respond to Tenant's request for approval within fifteen (15) business days after receipt of the Transfer Notice. If Landlord approves the proposed Assignment or Sublease, Tenant may, not later than thirty (30) days thereafter, enter into the Assignment or Sublease with the proposed Transferee upon the terms and conditions set forth in the Transfer Notice, and fifty percent (50%) of the Excess Rent received by Tenant shall be paid to Landlord as and when received by Tenant. "EXCESS RENT" means the gross revenue received from the Transferee during the Sublease term or with respect to the Assignment, less (a) the gross revenue paid to Landlord by Tenant during the period of the Sublease term or during the Assignment; (b) any reasonably documented tenant improvement allowance or other economic concession (free rent, planning allowance, moving expenses, etc.), paid by Tenant to the Transferee or spent on the Premises by Tenant in connection with the Sublease or Assignment; (c) customary and reasonable external brokers' commissions to the extent paid and documented; (d) reasonable attorneys' fees; and (e) reasonable costs of

advertising the space for Sublease or Assignment (collectively, "TRANSFER COSTS"). Tenant shall not have to pay to Landlord any Excess Rent until Tenant has recovered its Transfer Costs.

14.4 RIGHT OF FIRST REFUSAL. Except as provided in Section 14.6, if Tenant desires to assign Tenant's interest in the Premises or to sublease twenty-five percent (25%) or more of the Premises for more than three (3) years or for the balance of the Term (collectively, a "TRANSFER"), the Transfer Notice shall also include a written offer (the "OFFER") that describes all of the substantial business terms that Tenant has offered to a Transferee which Tenant would execute if Landlord does not accept Tenant's offer, and shall offer to

Transfer Tenant's interest in the Premises to Landlord on such terms and conditions. Landlord shall have fifteen (15) business days from Landlord's receipt of the Offer to accept the Offer by written notice to Tenant, or to respond as provided in Section 14.3. If Landlord does not give Tenant written notice accepting the Offer within said fifteen (15) business day period, Tenant may at any time within the six (6) month period after the expiration of the fifteen (15) business day period, subject to all of the conditions, restrictions and terms of this Article 14, Transfer its interest to a Transferee without reoffering the interest to Landlord, provided that the terms and conditions of such Transfer shall not be more favorable to the Transferee than those set forth in the Offer. If Tenant proposes to Transfer its interest in the Premises under this Lease at any time after the expiration of the aforesaid six (6) month period to the Transferee or any other third party, or at any time within the aforesaid six (6) month period on terms more favorable to the Transferee than those contained in the Offer, Tenant shall again deliver to Landlord an Offer in accordance with this Section and offering the interest to Landlord on such more favorable terms. Landlord shall have another period of fifteen (15) business days after receipt of such Offer to accept such Offer. If Landlord accepts the Offer, Landlord and Tenant shall consummate the Transfer within fifteen (15) days after Landlord's written notice of acceptance. The Transfer shall be consummated by Tenant's delivery to Landlord of a good and sufficient assignment of lease or sublease.

14.5 NO RELEASE. No Sublease or Assignment by Tenant nor any consent by Landlord thereto shall relieve Tenant of any obligation to be performed by Tenant under this Lease, unless this Lease is terminated pursuant to Section 14.4. Any Sublease or Assignment that is not in compliance with this Article shall be null and void and, at the option of Landlord, shall constitute an Event of Default by Tenant under this Lease, and Landlord shall be entitled to pursue any right or remedy available to Landlord under the terms of this Lease or under the laws of the State of California. The acceptance of any Rent or other payments by Landlord from a proposed Transferee shall not constitute consent to such Sublease or Assignment by Landlord or a recognition of any Transferee, or a waiver by Landlord of any failure of Tenant or other Transferor to comply with this Article.

14.6 CORPORATE TRANSFERS. Except as provided in this Section, the term "Assignment" shall include one or more sales or transfers by operation of law or otherwise by which (a) an aggregate of more than fifty percent (50%) of (i) the total capital stock of a corporate Tenant, (ii) the total partnership interests of a general partnership Tenant, (iii) the total membership interests of a limited liability company Tenant, or (iv) the total beneficial interests of a trust Tenant, or (b) if the Tenant is a limited partnership, fifty percent (50%) of the interest in the general partner of such limited partnership or, if there is more than one general partner, fifty percent (50%) of the interests in all such general partners in the aggregate, or (c) if the Tenant is a limited liability company that is manager-managed, fifty percent (50%) of the interest in the manager of such limited liability company or, if there is more than one manager, fifty

percent (50%) of the interest in all such managers in the aggregate, shall become vested in one or more individuals, firms or corporations who or which are not stockholders, partners, members, or beneficiaries thereof, either legally or equitably, as of the Commencement Date or of Tenant's subsequent acquisition of this Lease by assignment, it being understood that ownership of such capital stock, partnership interests and beneficial interest shall be determined in accordance with the principles enunciated in Section 544 of the IRS Code. Notwithstanding the foregoing, the following shall not be deemed an Assignment or Sublease for the purposes of this Lease, and the provisions of Sections 14.1, 14.2 and 14.3 shall not apply to:

(a) The transfer of stock of Tenant, or of Celtrans LLC, a Delaware limited liability company ("CELTRANS"), or of a limited liability company whose members consist of Celtrans and Tenant ("NEW LLC") (or any permitted Transferee, including Celtrans and New LLC), if such party is a corporation whose capital stock is listed on the New York or American Stock exchanges or the NASDAQ, or any public offering of capital stock on any such exchange;

(b) Any financing which affects the ownership of Tenant, Celtrans or New LLC (or any permitted Transferee, including Celtrans and New LLC) due to its effect on capital stock;

(c) A sale of substantially all of the assets of Tenant, Celtrans or New LLC (or any permitted Transferee, including Celtrans and New LLC) where the surviving company has a net worth which is equal to or greater than that of Tenant (or the Transferee, or Celtrans or New LLC) as of the Commencement Date;

(d) The Sublease or any license or other agreement granting use of any portion of the Premises to any department or school of Stanford University;

(e) A Sublease or Assignment to Celtrans, it being the understanding of the parties that either Tenant and/or Celtrans may occupy the Premises, but only so long as the party exercising such rights is an occupant of the Premises pursuant to this Lease or a written Sublease or Assignment. In addition, Landlord agrees that Celtrans may, so long as it is a subtenant of Tenant occupying space in the Premises, cure any default by Tenant within any applicable cure period provided in this Lease, and Landlord agrees to provide written notice to Celtrans of any default by Tenant;

(f) A Sublease or Assignment to New LLC, so long as Tenant either increases the Security Deposit to the equivalent of six (6) months worth of Base Rent or provides a guaranty of Tenant's obligations under this Lease in form reasonably satisfactory to Landlord;

(g) A sublease of any portion of the Premises back to Tenant if this Lease is assigned to New LLC and

(h) A transfer of the member interests in New LLC between Celtrans and Tenant.

14.7 ASSUMPTION OF OBLIGATIONS. Any Transferee shall, from and after the effective date of the Assignment or Sublease, assume all obligations of Tenant under this Lease with respect to the Premises or the portion subleased to such Transferee, and shall be and remain liable jointly and severally with Tenant for the payment of Rent and Additional Rent (to the extent of the space which is transferred in the case of a Sublease), and for the performance of all

of the terms, covenants, conditions and agreements herein contained on Tenant's part to be performed for the Term. No Assignment shall be binding on Landlord unless Tenant delivers to Landlord a counterpart of the Assignment and an instrument that contains a covenant of assumption satisfactory in substance and form to Landlord, and consistent with the requirements of this Section.

15. DEFAULT

15.1 EVENT OF DEFAULT. The occurrence of any of the following after the expiration of any applicable grace period shall be an "EVENT OF DEFAULT" on the part of Tenant:

(a) Failure to pay any part of the Base Rent or Additional Rent, or any other sums of money that Tenant is required to pay under this Lease where

such failure continues for a period of five (5) days after written notice of default from Landlord to Tenant. Landlord's notice to Tenant pursuant to this subsection shall be deemed to be the notice required under California Code of Civil Procedure Section 1161.

(b) Failure to perform any other covenant, condition or requirement of this Lease when such failure shall continue for a period of thirty (30) days after written notice thereof from Landlord to Tenant; provided that if the nature of the default is such that more than thirty (30) days are reasonably required for its cure, then an Event of Default shall not be deemed to have occurred if Tenant shall commence such cure within said thirty (30) day period and thereafter diligently and continuously prosecute such cure to completion. Landlord's notice to Tenant pursuant to this subsection shall be deemed to be the notice required under California Code of Civil Procedure Section 1161.

(c) The abandonment of the Premises by Tenant.

(d) Tenant shall admit in writing its inability to pay its debts generally as they become due, file a petition in bankruptcy, insolvency, reorganization, dissolution or liquidation under any law or statute of any government or any subdivision thereof either now or hereafter in effect, make an assignment for the benefit of its creditors, consent to or acquiesce in the appointment of a receiver of itself or of the whole or any substantial part of the Premises.

(e) A court of competent jurisdiction shall enter an order, judgment or decree appointing a receiver of Tenant or of the whole or any substantial part of the Premises and such order, judgment or decree shall not be vacated, set aside or stayed within thirty (30) days after the date of entry of such order, judgment, or decree, or a stay thereof shall be thereafter set aside.

(f) A court of competent jurisdiction shall enter an order, judgment or decree approving a petition filed against Tenant under any bankruptcy, insolvency, reorganization, dissolution or liquidation law or statute of the federal or state government or any subdivision of either now or hereafter in effect, and such order, judgment or decree shall not be vacated, set aside or stayed within thirty (30) days from the date of entry of such order, judgment or decree, or a stay thereof shall be thereafter set aside.

15.2 REMEDIES. Upon the occurrence and during the continuance of an Event of Default, Landlord shall have the following rights and remedies:

(a) The right to terminate this Lease upon written notice to Tenant, in which event Tenant shall immediately surrender possession of the Premises in accordance with Article 20.

(b) The right to bring a summary action for possession of the Premises.

(c) The rights and remedies described in California Civil Code Section 1951.2, including without limitation the right to recover from Tenant all Rent due through the date this Lease terminates (with interest at the Interest Rate until paid), plus the present worth of the Rent payable hereunder for the balance of the Term, plus any amount necessary to compensate Landlord for the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom which includes, without limitation, (i) the unamortized portion of any brokerage or real estate agent's commissions paid in connection with the execution of this Lease, (ii) any direct costs or expenses

incurred by Landlord in recovering possession of the Premises, maintaining or preserving the Premises after such default, (iii) preparing the Premises for reletting to a new tenant, (iv) any repairs or alterations to the Premises for such reletting, (v) leasing commissions, architect's fees and any other costs necessary or appropriate either to relet the Premises or, if reasonably necessary in order to relet the Premises, to adapt them to another beneficial use by Landlord and (vi) such amounts in addition to or in lieu of the foregoing as may be permitted from time to time by Applicable Law to the extent that such payment would not result in a duplicative recovery.

(d) The rights and remedies described in California Civil Code Section 1951.4 which allow Landlord to continue this Lease in effect and to enforce all of Landlord's rights and remedies under this Lease, including the right to recover Base Rent, Additional Rent and other charges payable hereunder as they become due. Acts of maintenance or preservation, efforts to relet the Premises or the appointment of a receiver upon Landlord's initiative to protect its interest under this Lease shall not constitute a termination of Tenant's right to possession.

(e) The right to collect rents from all subtenants and to provide or arrange for the provision of all services and fulfill all obligations of Tenant under any permitted subleases. Landlord is hereby authorized on behalf of Tenant, but shall have absolutely no obligation, to provide such services and fulfill such obligations and to incur all such expenses and costs as Landlord deems reasonably necessary. Landlord is hereby authorized, but not obligated, to relet the Premises or any part thereof on behalf of Tenant, to incur such expenses as may be necessary to effect a relet and make said relet for such term or terms, upon such conditions and at such rental as Landlord in its reasonable discretion may deem proper. Tenant shall be liable immediately to Landlord for all reasonable costs and expenses Landlord incurs in reletting the Premises including, without limitation, brokers' commissions, expenses of remodeling the Premises required by the reletting, and the cost of collecting rents and fulfilling the obligations of Tenant to any subtenant. If Landlord relets the Premises or any portion thereof, such reletting shall not relieve Tenant of any obligation hereunder, except that Landlord shall apply the rent or other proceeds actually collected by it as a result of such reletting against any amounts due from Tenant hereunder to the extent that such rent or other proceeds compensate Landlord for the nonperformance of any obligation of Tenant hereunder. Such payments by Tenant shall be due at such times as are provided elsewhere in this Lease, and Landlord need not wait until the termination of this Lease, by expiration of the Term or

otherwise, to recover them by legal action or in any other manner. Landlord shall not by any reentry or other act be deemed to have accepted any surrender by Tenant of the Premises or Tenant's interest therein, or be deemed to have otherwise terminated this Lease, or to have relieved Tenant of any obligation hereunder, unless Landlord shall have given Tenant express written notice of Landlord's election to do so as set forth herein.

(f) The right to enjoin, and any other remedy or right now or hereafter available to a Landlord against a defaulting tenant under the laws of the State of California or the equitable powers of its courts, and not otherwise specifically reserved herein.

15.3 CUMULATIVE REMEDIES. The various rights and remedies reserved to Landlord, including those not specifically described herein, shall, to the extent that the exercise of such right and/or remedy does not result in a duplicative recovery, be cumulative and shall be in addition to every other right or remedy provided for in this Lease or now or hereafter existing at law or in equity and the exercise of the rights or remedies provided for in this Lease or now or hereafter existing at law or in equity shall not preclude the

simultaneous or later exercise by Landlord of any or all other rights and remedies.

15.4 LANDLORD'S RIGHT TO CURE. If Tenant shall fail or neglect to do or perform any covenant or condition required under this Lease and such failure shall not be cured within any applicable grace period, Landlord may, on five (5) days notice to Tenant, but shall not be required to, make any payment payable by Tenant hereunder, discharge any lien, take out, pay for and maintain any insurance required hereunder, or do or perform or cause to be done or performed any such other act or thing (entering upon the Premises for such purposes, if Landlord shall so elect), and Landlord shall not be or be held liable or in any way responsible for any loss, disturbance, inconvenience, annoyance or damage resulting to Tenant on account thereof. Tenant shall repay to Landlord upon demand the entire out-of-pocket cost and expense incurred by Landlord in connection with the cure, including, without limitation, compensation to the agents, consultants and contractors of Landlord and reasonable attorneys' fees and expenses. Landlord may act upon shorter notice or no notice at all if necessary in Landlord's reasonable judgment to meet an emergency situation or governmental or municipal time limitation or to protect Landlord's interest in the Premises. Landlord shall not be required to inquire into the correctness of the amount of validity or any tax or lien that may be paid by Landlord and Landlord shall be duly protected in paying the amount of any such tax or lien claimed and in such event Landlord also shall have the full authority, in Landlord's sole judgment and discretion and without prior notice to or approval by Tenant, to settle or compromise any such lien or tax. Any act or thing done by Landlord pursuant to the provisions of this Section shall not be or be construed as a waiver of any such failure by Tenant, or as a waiver of any term, covenant, agreement or condition herein contained or of the performance thereof.

15.5 LANDLORD'S DEFAULT. Landlord shall be in default under this Lease if Landlord fails to perform obligations required of Landlord within thirty (30) days after written notice by Tenant to Landlord and to the holder of any first mortgage or deed of trust covering the Premises whose name and address shall have heretofore been furnished to Tenant in writing, specifying wherein Landlord has failed to perform such obligations; provided, however, that if the nature of Landlord's obligations is such that more than thirty (30) days are required for performance, then Landlord shall not be in default if Landlord commences performance within such thirty (30) day period and thereafter diligently prosecutes the same to completion. Tenant

shall be entitled to actual (but not consequential) damages in the event of an uncured default by Landlord, but the provisions of Article 17 shall apply to any Landlord default.

16. LANDLORD'S RESERVED RIGHTS

16.1 CONTROL OF COMMON AREA. Landlord reserves the right, at any time and from time to time, to make alterations, additions, repairs or improvements to all or any part of the Building (including the Building Structure and Building Systems), the Common Area and the Property. As long as there is no material reduction in the amenities offered in the Common Area, Landlord may make changes at any time and from time to time in the size, shape, location, use and extent of the Common Area, and no such change shall entitle Tenant to any abatement of rent or damages. Landlord shall at all times during the Term have the sole and exclusive control of the Building Structure and the Common Area, and may at any time and from time to time during the Term restrain any use or occupancy of the Common Area except as authorized by the Rules and Regulations. Landlord may temporarily close any portion of the Common Area for repairs or alterations, to prevent a dedication or the accrual of prescriptive rights, or for any other reason deemed sufficient by Landlord; provided, however, that Landlord shall use reasonable efforts not to materially adversely affect

Tenant's use of the Premises. Tenant's rights in and to the Common Area shall at all times be subject to the rights of Landlord and Tenant shall keep the Common Area free and clear of any obstructions created or permitted by Tenant or resulting from Tenant's operations.

16.2 ACCESS. Landlord reserves (for itself and its agents, consultants, contractors and employees) the right to enter the Premises at all reasonable times and, except in cases of emergency, after giving Tenant at least twenty-four (24) hours prior telephonic notice, to inspect the Premises, to supply any service to be provided by Landlord hereunder, to show the Premises to prospective purchasers, mortgagees or tenants (during the last six (6) months of the Term), to post notices of nonresponsibility, and to alter, improve or repair the Premises and any portion of the Building, without abatement of Rent, and may for that purpose erect, use and maintain necessary structures in and through the Premises and the Building where reasonably required by the character of the work to be performed. Tenant hereby waives any claim for damages for any injury or inconvenience to or interference with Tenant's business, any loss of occupancy or quiet enjoyment of the Premises or any other loss occasioned thereby which results from Landlord's actions done in accordance with this Section. All locks for all of the doors in, upon and about the Premises, excluding Tenant's vaults and safes or special security areas (designated in advance in writing by Tenant) shall at all times be keyed to the Building master system and Landlord shall at all times have and retain a key with which to unlock all of said doors. Landlord shall have the right to use any and all means that Landlord may deem necessary or proper to open said doors in an emergency in order to obtain entry to any portion of the Premises, and any entry to the Premises or portions thereof obtained by Landlord by any of said means, or otherwise, shall not under any circumstances be construed or deemed to be a forcible or unlawful entry into, or a detainer of, the Premises, or an eviction, actual or constructive, of Tenant from the Premises or any portion thereof.

16.3 EASEMENTS. Landlord reserves the right to grant or relocate all easements and rights of way which Landlord in its sole discretion may deem necessary or appropriate.

16.4 USE OF ADDITIONAL AREAS. Landlord reserves the exclusive right to use any air space above the Building and the Property, the roof and exterior walls of the Building

and the land beneath the Building; provided that such use shall not materially impede Tenant's use of and access to the Premises.

16.5 SUBORDINATION. Landlord represents to Tenant that there are currently no loans, mortgages, deeds of trust or ground leases affecting the Property. Without the necessity of any additional documentation, except as set forth below, this Lease shall be subject and subordinate at all times to: (a) all reciprocal easement agreements, and any ground leases or underlying leases which may hereafter be executed affecting any or all of the Building, and (b) the lien of any mortgage or deed of trust which may hereafter be executed in any amount for which the Building, or any ground leases or underlying leases, or Landlord's interest or estate in any of said items, is specified as security. Notwithstanding the foregoing, Landlord shall have the right to subordinate or cause to be subordinated to this Lease any of the items referred to in clause (a) or (b) above, subject to compliance with the condition precedent set forth below. In the event that any ground lease or underlying lease terminates for any reason or any mortgage or deed of trust is foreclosed or a conveyance in lieu of foreclosure is made for any reason, (i) no person or entity which as a result of the foregoing succeeds to the interest of Landlord under this Lease, (a "SUCCESSOR") shall be liable for any default by Landlord or any other matter that occurred prior to the date the Successor succeeded to Landlord's interest in this Lease, and (ii) Tenant shall, notwithstanding any subordination, attorn

to and become the tenant of the Successor. Tenant covenants and agrees, however, to execute and deliver, upon demand by Landlord and in the form reasonably requested by Landlord, any additional documents evidencing the priority or subordination of this Lease with respect to any such ground leases, underlying leases, reciprocal easement agreements or similar documents or instruments, or with respect to the lien of any such mortgage or deed of trust and Tenant's failure to execute and deliver any such document within ten (10) business days after such demand by Landlord shall constitute an Event of Default without further notice. Landlord shall obtain the written agreement of the mortgagee or trustee named in any mortgage, deed of trust or other encumbrance that so long as an Event of Default by Tenant is not in existence, neither this Lease nor any of Tenant's rights hereunder shall be terminated or modified, nor shall Tenant's possession of the Premises be disturbed or interfered with, by any trustee's sale or by an action or proceeding to foreclose said mortgage, deed of trust or other encumbrance.

17. LIMITATION OF LANDLORD'S LIABILITY

17.1 LIMITATION. Landlord shall not be responsible for or liable to Tenant and Tenant hereby releases Landlord, waives all claims against Landlord and assumes the risk for any injury, loss or damage to any person or property in or about the Premises, the Building or the Property by or from any cause whatsoever (other than Landlord's gross negligence or willful misconduct) including, without limitation, (a) acts or omissions of persons occupying adjoining premises, (b) theft or vandalism, (c) burst, stopped or leaking water, gas, sewer or steam pipes, (d) loss of utility service, (e) accident, fire or casualty, (f) nuisance, and (g) work done by Landlord in the Building or the Common Area. There shall be no abatement of Rent and no liability of Landlord by reason of any injury to or interference with Tenant's business arising from the making of any repairs, alterations or improvements to any portion of the Building or to fixtures, appurtenances and equipment therein; provided, however, that in the event Landlord's repair, alterations or improvements are performed in a negligent manner which results in Tenant being unable to operate its business at the Premises for a period of more than five (5) days, then Tenant shall be entitled to an abatement of Rent commencing on the sixth business day Tenant is unable to operate and continuing until the Premises are again available for operation of Tenant's

business. Such Rent abatement shall be Tenant's only remedy in the event of a negligent interference with Tenant's business and Tenant shall not be entitled to damages or to termination of this Lease arising from Landlord's repairs, alterations or improvements. No interference with Tenant's operations in the Premises shall constitute a constructive or other eviction if Tenant. Tenant hereby waives and releases any right it may have to make repairs at Landlord's expense under Sections 1941 and 1942 of the California Civil Code, or under any similar law, statute or ordinance now or hereafter in effect.

17.2 SALE OF PROPERTY. It is agreed that Landlord may at any time sell, assign or transfer its interest as landlord in and to this Lease, and may at any time sell, assign or transfer its interest in and to the Property. In the event of any transfer of Landlord's interest in the Property, the transferor shall be automatically relieved of any and all of Landlord's obligations and liabilities accruing from and after the date of such transfer; provided that the transferee assumes all of Landlord's obligations under this Lease. Tenant hereby agrees to attorn to Landlord's assignee, transferee, or purchaser from and after the date of notice to Tenant of such assignment, transfer or sale, in the same manner and with the same force and effect as though this Lease were made in the first instance by and between Tenant and the assignee, transferee or purchaser.

17.3 NO PERSONAL LIABILITY. In the event of any default by Landlord hereunder, Tenant shall look only to Landlord's interest in the Property and

rents therefrom and any available insurance proceeds for the satisfaction of Tenant's remedies, and no other property or assets of Landlord or any trustee, partner, member, officer or director thereof, disclosed or undisclosed, shall be subject to levy, execution or other enforcement procedure for the satisfaction of Tenant's remedies under or with respect to this Lease.

18. DESTRUCTION

18.1 LANDLORD'S REPAIR OBLIGATION. If the Premises or the Building or any portion thereof (whether or not the Premises are affected) are damaged by fire or other casualty, Landlord shall repair the same (not including any Tenant Alterations); provided that (a) such repairs can be made under the laws and regulations of the federal, state and local governmental authorities having jurisdiction within twelve (12) months after the date of such damage (or in the case of damage occurring during the last twenty-four (24) months of the Term, provided that such repairs can be made within ninety (90) days after the date of such damage), (b) such repairs are fully covered (except for any deductible) by the proceeds of insurance maintained or required to be maintained by Landlord, and (c) the damage does not affect more than fifty percent (50%) of the assessed value of the Building.

18.2 NOTICE. Landlord shall notify Tenant within sixty (60) days after the date of damage whether or not the requirements for reconstruction and repair described in Section 18.1 are met. If such requirements are not met, Landlord shall have the option, exercisable within sixty (60) days after the date of such damage either to: (a) notify Tenant of Landlord's intention to repair such damage, in which event this Lease shall continue in full force and effect (unless terminated by Tenant pursuant to Section 18.3 below), or (b) notify Tenant of Landlord's election to terminate this Lease as of the date of the damage. If such notice to terminate is given by Landlord, this Lease shall terminate as of the date of such damage. If within fifteen (15) days after receipt of a notice from Landlord electing to terminate this Lease because of the unavailability of insurance proceeds, Tenant sends Landlord a notice electing to reimburse

Landlord for the cost of such repairs in excess of five percent (5%) of the replacement cost of the Building, this Lease shall not terminate, and Landlord shall complete such repairs.

18.3 TERMINATION BY TENANT. If Landlord elects to repair or is required to repair the damage and any such repair is not commenced by Landlord within one hundred twenty (120) days after the occurrence of such damage or destruction or is not or cannot practicably be substantially completed by Landlord within twelve (12) months after the occurrence of such damage or destruction (or in the case of damage occurring in the last twelve (12) months of the Term, within ninety (90) days), then in either such event Tenant may, at its option, upon written notice to Landlord to be delivered after the expiration of the 120-day commencement period (so long as repairs have not actually commenced), elect to terminate this Lease as of the date of the occurrence of such damage or destruction.

18.4 RENT ADJUSTMENT. In case of termination pursuant to Sections 18.2 or 18.3 above, the Base Rent and Operating Expenses shall be reduced by a proportionate amount based upon the extent to which such damage interfered with the business carried on by Tenant in the Premises, and Tenant shall pay such reduced Base Rent and Operating Expenses up to the date of termination. If Landlord is required or elects to make repairs, this Lease shall remain in full force and effect except that Tenant shall be entitled to a proportionate reduction of Base Rent and Operating Expenses from the date of such casualty and during the period such repairs are being made by a proportionate amount based upon the extent of interference with Tenant's operations in the Premises. The

full amount of Base Rent and Operating Expenses shall again become payable immediately upon the completion of such work of repair, reconstruction or restoration. Landlord shall restore the improvements which were in the Premises as of the Commencement Date, but shall not be required to repair any casualty damage to Tenant's Property or any Alterations.

18.5 TENANT OBLIGATIONS. If Landlord elects or is required to repair, reconstruct or restore the Premises after any damage or destruction, Tenant shall be responsible at its own expense for the repair and replacement of Tenant's Property and any Alterations which Tenant elects to replace. Tenant hereby waives the provisions of any statute or law that may be in effect at the time of the occurrence of any such damage or destruction, under which a lease is automatically terminated or a tenant is given the right to terminate a lease upon such an occurrence.

18.6 NO CLAIM. Tenant shall have no interest in or claim to any portion of the proceeds of any insurance or self-insurance maintained by Landlord. If Landlord is entitled and elects not to rebuild the Premises, Landlord shall relinquish to Tenant such claim as Landlord may have for any part of the proceeds of any insurance maintained by Tenant under Section 13.2 of this Lease.

18.7 NO DAMAGES. If Landlord is required or elects to make any repairs, reconstruction or restoration of any damage or destruction to the Premises under any of the provisions of this Article 18, Tenant shall not be entitled to any damages by reason of any inconvenience or loss sustained by Tenant as a result thereof. Except as expressly provided in Section 18.4, there shall be no reduction, change or abatement of any rental or other charge payable by Tenant to Landlord hereunder, or in the method of computing, accounting for or paying the same. Tenant hereby waives the provisions of Section 1932(2) and Section 1933(4) of the California Civil Code, or any other statute or law that may be in effect at the time of a

casualty under which a lease is automatically terminated or a tenant is given the right to terminate a lease due to a casualty.

19. EMINENT DOMAIN

19.1 TAKING. If all or any part of the Premises shall be taken as a result of the exercise of the power of eminent domain or any transfer in lieu thereof, this Lease shall terminate as to the part so taken as of the date of taking or as of the date of final judgment, whichever is earlier, and, in the case of a partial taking of the Premises, either Landlord or Tenant shall have the right to terminate this Lease as to the balance of the Premises by written notice to the other within thirty (30) days after such date, provided, however, that a condition to the exercise by Tenant of such right to terminate shall be that the portion of the Premises taken shall be of such extent and nature as substantially to handicap, impede or impair Tenant's use of the balance of the Premises. If any material part of the Common Area shall be taken as a result of the exercise of the power of eminent domain or any transfer in lieu thereof, whether or not the Premises are affected, Landlord shall have the right to terminate this Lease by written notice to Tenant within thirty (30) days of the date of taking. If any material part of the Common Area shall be taken as a result of the exercise of the power of eminent domain or any transfer in lieu thereof, such that Tenant's access to or use of the Premises is materially adversely affected, Tenant shall have the right to terminate this Lease by written notice to Landlord within thirty (30) days of the date of taking.

19.2 AWARD. In the event of any taking, Landlord shall be entitled to any and all compensation, damages, income, rent, awards, or any interest therein whatsoever which may be paid or made in connection therewith, and Tenant shall assign to Landlord any right to compensation or damages for the condemnation of

its leasehold interest; provided that Tenant may file a claim for (a) Tenant's relocation expenses, and (b) the taking of Tenant's Property.

19.3 PARTIAL TAKING. In the event of a partial taking of the Premises which does not result in a termination of this Lease, the Base Rent and Operating Expenses shall be adjusted as follows:

(a) During the period between the date of the partial taking and the completion of any necessary repairs, reconstruction or restoration, Tenant shall be entitled to a reduction of Base Rent and Operating Expenses by a proportionate amount based upon the extent of interference with Tenant's operations in the Premises; and

(b) Upon completion of said repairs, reconstruction or restoration, and thereafter throughout the remainder of the Term, the Base Rent and Operating Expenses shall be recalculated based on the remaining total number of square feet of Rentable Area of the Premises.

19.4 TEMPORARY TAKING. Notwithstanding any other provision of this Article, if a taking occurs with respect to all or any portion of the Premises for a period of twelve (12) months or less, this Lease shall remain unaffected thereby and Tenant shall continue to pay Base Rent and Additional Rent and to perform all of the terms, conditions and covenants of this Lease, provided that Tenant shall have the right to terminate this Lease if the taking continues beyond twelve (12) months. In the event of any such temporary taking, and if this Lease is not terminated, Tenant shall be entitled to receive that portion of any award which represents

compensation for the use or occupancy of the Premises during the Term up to the total Base Rent and Additional Rent owing by Tenant for the period of the taking, and Landlord shall be entitled to receive the balance of any award.

19.5 SALE IN LIEU OF CONDEMNATION. A voluntary sale by Landlord of all or any part of the Building or the Common Area to any public or quasi-public body, agency or person, corporate or otherwise, having the power of eminent domain, either under threat of condemnation or while condemnation proceedings are pending, shall be deemed to be a taking under the power of eminent domain for the purposes of this Article.

19.6 WAIVER. Except as provided in this Article, Tenant hereby waives and releases any right it may have under any Applicable Law to terminate this Lease as a result of a taking, including without limitation Sections 1265.120 and 1265.130 of the California Code of Civil Procedure, or any similar law, statute or ordinance now or hereafter in effect.

20. SURRENDER

20.1 SURRENDER. Upon the Termination Date, Tenant shall surrender the Premises to Landlord in good order and repair, reasonable wear and tear and damage by casualty excepted, free and clear of all letting and occupancies and free of Hazardous Materials as required pursuant to Section 12.9. Subject to Article 9, upon any termination of this Lease, all improvements, except for Tenant's Property, shall automatically and without further act by Landlord or Tenant, become the property of Landlord, free and clear of any claim or interest therein by Tenant, and without payment therefore by Landlord.

20.2 HOLDING OVER. Any holding over after the expiration of the Term with the consent of Landlord shall be construed to automatically extend the Term on a month-to-month basis at a Base Rent equal to the greater of (a) one hundred fifty percent (150%) of the then-current Base Rent, and (b) prevailing rate at which Landlord is then offering space in buildings reasonably determined by

Landlord to be comparable to the Building, in either case together with an amount estimated by Landlord as Tenant's Share of Operating Expenses payable under this Lease, and shall otherwise be on the terms and conditions of this Lease to the extent applicable. Any holding over without Landlord's consent shall entitle Landlord to exercise any or all of its remedies provided in Article 15, notwithstanding that Landlord may elect to accept one or more payments of Base Rent and Operating Expenses from Tenant.

20.3 QUITCLAIM. At the expiration or earlier termination of this Lease, Tenant shall execute, acknowledge and deliver to Landlord, within ten (10) days after written demand from Landlord to Tenant, any quitclaim deed or other document required by any reputable title company, licensed to operate in the State of California, to remove the cloud or encumbrance created by this Lease from the Property.

21. FINANCIAL STATEMENTS

Tenant shall tender to Landlord within ten (10) business days after receipt of a written request any information reasonably requested by Landlord regarding the financial stability, credit worthiness or ability of Tenant to pay the Rent due under this Lease. Landlord shall be entitled to rely upon the information provided in determining whether or not to enter into this Lease or for the purpose of any financing or other transaction subsequently undertaken by Landlord. Tenant hereby represents and warrants to Landlord the following: (a) that all documents

provided by Tenant to Landlord in connection with the negotiation of this Lease are true and correct copies of the originals, (b) Tenant has not withheld any information from Landlord that is material to Tenant's credit worthiness, financial condition or ability to perform its obligations hereunder, (c) all information supplied by Tenant to Landlord is true, correct and accurate, and (d) no part of the information supplied by Tenant to Landlord contains any misleading or fraudulent statements. A default under this Article shall be a non-curable default by Tenant and Landlord shall be entitled to pursue any right or remedy available to Landlord under the terms of this Lease or available to Landlord under the laws of the State of California.

22. TENANT CERTIFICATES

Tenant, at any time and from time to time within ten (10) business days after receipt of written notice from Landlord, shall execute, acknowledge and deliver to Landlord or to any party reasonably designated by Landlord, a certificate of Tenant stating, to the best of Tenant's knowledge: (a) that Tenant has accepted the Premises, (b) the Commencement Date and Expiration Date of this Lease, (c) that this Lease is unmodified and in full force and effect (or, if there have been modifications, that same is in full force and effect as modified and stating the modifications), (d) whether or not there are then existing any defenses against the enforcement of any of the obligations of Tenant under this Lease (and, if so, specifying same), (e) whether or not there are then existing any defaults by Landlord in the performance of its obligations under this Lease (and, if so, specifying same), (f) the dates, if any, to which the Base Rent and Operating Expenses have been paid, and (g) any other factual information relating to the rights and obligations under this Lease that may reasonably be required by any of such persons. Failure to deliver such certificate shall constitute an Event of Default. At the request of Tenant, Landlord shall execute, acknowledge and deliver to Tenant a certificate with similar types of information and in the time period set forth above. Failure by either Landlord or Tenant to execute, acknowledge and deliver such certificate shall be conclusive evidence that this Lease is in full force and effect and has not been modified except as may be represented by the requesting party.

23. RULES AND REGULATIONS

23.1 RULES AND REGULATIONS. Tenant shall faithfully observe and comply with any rules and regulations, if any, from time to time put into effect by Landlord (the "RULES AND REGULATIONS"), and with all reasonable modifications thereof and additions thereto . Landlord shall not enforce any Rules and Regulations in an unreasonable or discriminatory manner. In the event of any conflict between the terms of this Lease and the terms, covenants, agreements and conditions of any Rules and Regulations, this Lease shall control.

23.2 SIGNS. Without Landlord's written consent, which may be given or withheld in Landlord's sole discretion, Tenant shall not place or permit to be placed on the front of the Premises any sign, picture, advertisement, name, notice, marquee or awning; provided that upon Landlord's reasonable approval, Tenant shall have the right to place a sign on or adjacent to the entrance doors to Tenant's Premises identifying Tenant. Landlord hereby reserves the exclusive right to the exterior side walls, rear walls and roof of the Premises.

24. INABILITY TO PERFORM

If Landlord is unable to fulfill, or is delayed in fulfilling, any of Landlord's obligations under this Lease, by reason of acts of God, accidents, breakage, repairs, strikes, lockouts, other

labor disputes, inability to obtain utilities or materials or by any other reason beyond Landlord's reasonable control, then no such inability or delay by Landlord shall constitute an actual or constructive eviction, in whole or in part, or entitle Tenant to any abatement or diminution of Base Rent or Additional Rent, or relieve Tenant from any of its obligations under this Lease, or impose any liability upon Landlord, or Landlord's Agents by reason of inconvenience, annoyance, interruption, injury or loss to or interference with Tenant's business or use and occupancy or quiet enjoyment of the Premises or any loss or damage occasioned thereby. If Tenant is unable to fulfill, or is delayed in fulfilling, any of Tenant's obligations under this Lease (other than the payment of Rent), by reason of acts of God, accidents, breakage, repairs, strikes, lockouts, other labor disputes, inability to obtain utilities or materials or by any other reason beyond Tenant's reasonable control, then such inability or delay by Tenant shall excuse the performance of Tenant for a period equal to the duration of such prevention, delay or stoppage. Tenant hereby waives and releases any right to terminate this Lease under Section 1932(1) of the California Civil Code, or any similar law, statute or ordinance now or hereafter in effect.

25. NOTICES

Notices or other communications given or required to be given under this Lease shall be effective only if rendered or given in writing, sent by certified mail with a return receipt requested, or delivered in person or by reputable overnight courier (e.g., Federal Express, DHL, etc.): (a) to Tenant (i) at Tenant's address set forth in Article 1, if sent prior to the Commencement Date, or (ii) at the Premises and at the address specified in Article 1 if sent subsequent to the Commencement Date, or (iii) at the place where Tenant designates subsequent to Tenant's vacating, deserting, abandoning or surrendering the Premises; or (b) to Landlord at Landlord's address set forth in Article 1; or (c) to such other address as either Landlord or Tenant may designate as its new address for such purpose by notice given to the other in accordance with the provisions of this Article. Any such notice or other communication shall be deemed to have been rendered or given five (5) days after the date mailed, if sent by certified mail, or upon the date of delivery in person or by courier, or when delivery is attempted but refused. Celtrans shall receive any notices of default delivered by Landlord by separate mailing to

Celtrans at the Premises, or to such other or additional addresses which Celtrans designates to Landlord in writing.

26. QUIET ENJOYMENT

Landlord covenants that so long as an Event of Default by Tenant is not in existence, upon paying the Base Rent and Additional Rent and performing all of its obligations under this Lease, Tenant shall peaceably and quietly enjoy the Premises, subject to the terms and provisions of this Lease.

27. AUTHORITY

If Tenant is a corporation or a partnership, Tenant represents and warrants as follows: Tenant is an entity as identified in Article 1, duly formed and validly existing and in good standing under the laws of the state of organization specified in Article 1 and qualified to do business in the State of California. Tenant has the power, legal capacity and authority to enter into and perform its obligations under this Lease and no approval or consent of any person is required in connection with the execution and performance hereof. The execution and performance of Tenant's obligations under this Lease will not result in or constitute any default

or event that would be, or with notice or the lapse of time would be, a default, breach or violation of the organizational instruments governing Tenant or any agreement or any order or decree of any court or other governmental authority to which Tenant is a party or to which it is subject. Tenant has taken all necessary action to authorize the execution, delivery and performance of this Lease and this Lease constitutes the legal, valid and binding obligation of Tenant. Upon Landlord's request, Tenant shall provide Landlord with evidence reasonably satisfactory to Landlord confirming the foregoing representations and warranties.

28. BROKERS

Tenant and Landlord warrant that they have had dealings with only the real estate brokers or agents listed in Article 1 in connection with the negotiation of this Lease and that they know of no other real estate broker or agent who is entitled to a commission in connection with this Lease. Tenant and Landlord shall indemnify, defend and hold the other harmless from and against all liabilities arising from any other claims of brokerage commissions or finder's fees based on Tenant's or Landlord's dealings or contacts with brokers or agents other than those listed in Article 1.

29. MISCELLANEOUS

29.1 ENTIRE AGREEMENT. This Lease, including the exhibits which are incorporated herein and made a part of this Lease, contains the entire agreement between the parties and all prior negotiations and agreements are merged herein. Tenant hereby acknowledges that neither Landlord nor Landlord's Agents have made any representations or warranties with respect to the Premises, the Building, the Property, or this Lease except as expressly set forth herein, and no rights, easements or licenses are or shall be acquired by Tenant by implication or otherwise unless expressly set forth herein.

29.2 NO WAIVER. No failure by Landlord or Tenant to insist upon the strict performance of any obligation of Tenant or Landlord under this Lease or to exercise any right, power or remedy consequent upon a breach thereof, no acceptance of full or partial Base Rent or Additional Rent during the continuance of any such breach by Landlord, or payment of Base Rent or Additional Rent by Tenant to Landlord, and no acceptance of the keys to or possession of the Premises prior to the expiration of the Term by any employee

or agent of Landlord shall constitute a waiver of any such breach or of such term, covenant or condition or operate as a surrender of this Lease. No waiver of any breach shall affect or alter this Lease, but each and every term, covenant and condition of this Lease shall continue in full force and effect with respect to any other then-existing or subsequent breach thereof. The consent of Landlord or Tenant given in any instance under the terms of this Lease shall not relieve Tenant or Landlord, as applicable, of any obligation to secure the consent of the other in any other or future instance under the terms of this Lease.

29.3 MODIFICATION. Neither this Lease nor any term or provisions hereof may be changed, waived, discharged or terminated orally, and no breach thereof shall be waived, altered or modified, except by a written instrument signed by the party against which the enforcement of the change, waiver, discharge or termination is sought.

29.4 SUCCESSORS AND ASSIGNS. The terms, covenants and conditions contained in this Lease shall bind and inure to the benefit of Landlord and Tenant and, except as otherwise provided or limited herein, their respective personal representatives and successors and assigns.

29.5 VALIDITY. If any provision of this Lease or the application thereof to any person, entity or circumstance shall, to any extent, be invalid or unenforceable, the remainder of this Lease, or the application of such provision to persons, entities or circumstances other than those as to which it is invalid or unenforceable, shall not be affected thereby, and each provision of this Lease shall be valid and be enforced to the full extent permitted by law.

29.6 JURISDICTION. This Lease shall be construed and enforced in accordance with the laws of the State of California. Any action that in any way involves the rights, duties and obligations of the parties under this Lease may (and if against Landlord, shall) be brought in the courts of the State of California, and the parties hereto hereby submit to the personal jurisdiction of such court.

29.7 ATTORNEYS' FEES. In the event that either Landlord or Tenant fails to perform any of its obligations under this Lease or in the event a dispute arises concerning the meaning or interpretation of any provision of this Lease, the defaulting party or the party not prevailing in such dispute, as the case may be, shall pay any and all costs and expenses incurred by the other party in enforcing or establishing its rights hereunder, including, without limitation, court costs, costs of arbitration and reasonable attorneys' fees. Should Landlord be named as a defendant in any suit brought against Tenant in connection with or arising out of Tenant's occupancy hereunder Tenant shall pay to Landlord its costs and expenses incurred in such suit, including reasonable attorneys' fees.

29.8 WAIVER OF JURY TRIAL. Landlord and Tenant each hereby voluntarily and knowingly waive and relinquish their right to a trial by jury in any action, proceeding or counterclaim brought by either against the other on any matter whatsoever arising out of or in any way connected with this Lease, the relationship of Landlord with Tenant, or Tenant's use or occupancy of the Premises, including any claim of injury or damage, and any emergency and other statutory remedy with respect thereto.

29.9 LIGHT AND AIR. Tenant covenants and agrees that no diminution of light, air or view by any structure that may hereafter be erected (whether or not by Landlord) shall entitle Tenant to any reduction of the Base Rent or Additional Rent under this Lease, result in any liability of Landlord to Tenant, or in any other way affect this Lease or Tenant's obligations hereunder.

29.10 LEASE MEMORANDUM. Neither Landlord or Tenant shall record this Lease or a short form memorandum hereof without the consent of the other.

29.11 CONFIDENTIALITY. Except as required by Applicable Law, the parties agree that neither of them shall make public the terms and conditions of this Lease or the fact that they have entered into this Lease without first obtaining the written permission from the other party.

29.12 TERMS. The term "Premises" includes the space leased hereby and any improvements now or hereafter installed therein or attached thereto. The words "Landlord" and "Tenant" as used herein shall include the plural as well as the singular. If there is more than one Tenant or Landlord, the obligations under this Lease imposed on Tenant or Landlord shall be

joint and several. The captions preceding the articles of this Lease have been inserted solely as a matter of convenience and such captions in no way define or limit the scope or intent of any provision of this Lease.

29.13 REVIEW AND APPROVAL. The review, approval, inspection or examination by Landlord of any item to be reviewed, approved, inspected or examined by Landlord under the terms of this Lease or the exhibits attached hereto shall not constitute the assumption of any responsibility by Landlord for either the accuracy or sufficiency of any such item or the quality of suitability of such item for its intended use. Any such review, approval, inspection or examination by Landlord is for the sole purpose of protecting Landlord's interests in the and under this Lease, and no third parties, including, without limitation, Tenant or any person or entity claiming through or under Tenant, or the contractors, agents, servants, employees, visitors or licensees of Tenant or any such person or entity, shall have any rights hereunder with respect to such review, approval, inspection or examination by Landlord.

29.14 NO BENEFICIARIES. This Lease shall not confer or be deemed to confer upon any person or entity other than the parties hereto, any right or interest, including without limitation, any third party status or any right to enforce any provision of this Lease.

29.15 TIME OF THE ESSENCE. Time is of the essence in respect of all provisions of this Lease in which a definite time for performance is specified.

29.16 MODIFICATION OF LEASE. In the event of any ruling or threat by the Internal Revenue Service, or opinion of counsel, that all or part of the Rent paid or to be paid to Landlord under this Lease will be subject to the income tax or unrelated business taxable income, Tenant agrees to reasonably modify this Lease to avoid such tax; provided that such modifications will not result in any increase in Rent, cost or expense to Tenant. Landlord will pay all Tenant's reasonable costs incurred in reviewing and negotiating any such lease modification, including reasonable attorneys' and accountants' fees.

29.17 CONSTRUCTION. This Lease has been negotiated extensively by Landlord and Tenant with and upon the advice of their respective legal counsel, all of whom have participated in the drafting hereof. Consequently, Landlord and Tenant agree that no party shall be deemed to be the drafter of this Lease and in the event this Lease is ever construed by a court of law, such court shall not construe this Lease or any provision of this Lease against any party as the drafter of the Lease.

29.18 SURVIVAL. The obligations of this Lease shall survive the expiration of the Term to the extent necessary to implement any requirement for the performance of obligations or forbearance of an act by either party hereto

which has not been completed prior to the termination of this Lease. Such survival shall be to the extent reasonably necessary to fulfill the intent thereof, or if specified, to the extent of such specification, as same is reasonably necessary to perform the obligations and/or forbearance of an act set forth in such term, covenant or condition. Notwithstanding the foregoing, in the event a specific term, covenant or condition is expressly provided for in such a clear fashion as to indicate that such performance of an obligation or forbearance of an act is no longer required, then the specific shall govern over this general provisions of this Lease.

29.19 REASONABLE STANDARD. Unless otherwise provided in this Lease, (a) each party shall act in a reasonable manner in exercising or undertaking its rights, duties and obligations under this Lease, and (b) whenever approval, consent or satisfaction (collectively, an "APPROVAL") is required of a party pursuant to this Lease or an Exhibit hereto, such approval shall not be unreasonably withheld or delayed. Unless provision is made for a specific time period, approval (or disapproval) shall be given within thirty (30) days after receipt of the request for approval.

29.20 BUSINESS DAYS. The time in which any act is to be done hereunder is computed by excluding the first day and including the last. If the last day is not a business day, then the date for performance will be extended to the next succeeding day that is a business day.

29.21 LANDLORD'S REPRESENTATIONS AND WARRANTIES. Landlord hereby represents and warrants that (a) it owns fee simple title in and to the Building, and (b) no party other than Landlord has any right as of the Commencement Date to possession of all or part of the Premises.

29.22 ACCESS. Tenant shall have access to the Premises twenty-four (24) hours per day, seven (7) days per week throughout the Term.

29.23 USE OF NAME. Tenant acknowledges and agrees that the names "The Leland Stanford Junior University," "Stanford" and "Stanford University," and all variations thereof, are proprietary to Landlord. Tenant shall not use any such name or any variation thereof or identify Landlord in any promotional advertising or other promotional materials to be disseminated to the public or any portion thereof or use any trademark, service mark, trade name or symbol of Landlord or that is associated with it, without Landlord's prior written consent, which may be given or withheld in Landlord's sole discretion.

IN WITNESS WHEREOF, Landlord and Tenant have executed this Lease as of the date first above written.

LANDLORD:	TENANT:
THE BOARD OF TRUSTEES OF THE LELAND STANFORD JUNIOR UNIVERSITY	STEMCELLS, INC. a Delaware corporation
By: Stanford Management Company	By: _____
	Its: _____
By: _____	By: _____
Its: _____	Its: _____

GLOSSARY

DEFINITIONS

As used in this Lease, the following terms shall have the following meanings, applicable, as appropriate, to both the singular and plural form of the terms defined below:

"ABATED RENT" is defined in Section 15.2(g).

"ADA" is defined in Section 11.1.

"ADDITIONAL RENT" is defined in Section 4.4.

"ADJUSTMENT DATE" is defined in Section 4.2.

"ALTERATIONS" is as defined in Section 9.1.

"APPLICABLE LAWS" are defined in Section 11.1.

"ASSIGNMENT" is defined in Section 14.1.

"BASE RENT" means the amount stated in Article 1, to be adjusted and payable in accordance with Article 4.

"BUILDING" is defined in Section 2.1.

"BUILDING STRUCTURE" is defined in Section 7.1.

"BUILDING SYSTEMS" are defined in Section 5.2(b)(ii).

"CELTRANS" is defined in Section 14.6(e).

"COMMON AREA" is defined in Section 2.2.

"BUSINESS DAYS" means Monday through Friday, excluding Saturdays, Sundays and federal or state legal holidays.

"COMMENCEMENT DATE" means the date specified in Article 1.

"ENVIRONMENTAL ACTIVITY" is defined in Section 12.1(a).

"ENVIRONMENTAL LAWS" are defined in Section 12.1(b).

"EVENT OF DEFAULT" is defined in Section 15.1.

"EXCESS RENT" is defined in Section 14.3.

"EXPIRATION DATE" means the date specified in Article 1.

"HAZARDOUS MATERIAL" is defined in Section 12.1(c).

"INTEREST RATE" is defined in Section 4.5.

"LANDLORD'S AGENTS" is defined in Section 12.5.

"LANDLORD'S EXPENSE STATEMENT" is defined in Section 5.3.

"LETTER OF CREDIT" is defined in Section 4.5.

"OFFER" is defined in Section 14.4.

"OPERATING EXPENSES" are defined in Section 5.2(b).

"PREMISES" is defined in Section 2.1.

"PREPAYMENT" is defined in Section 4.3.

"PREPAYMENT PERIOD" is defined in Section 4.3.

"PROPERTY" is defined in Section 2.1.

"REAL ESTATE TAXES" are defined in Section 5.2(b)(i).

"RENT" means Base Rent, Additional Rent, and all other sums due from Tenant under this Lease.

"RENTABLE AREA" means the enclosed areas of the Building measured to the outside face of the exterior wall or glass line and second floor vertical shafts, but excluding outside balconies, arcades, covered entrances, elevator shafts and fire-life safety stairwells and any portion of the electrical room on the first floor which exclusively serves areas of the Building other than the Premises. Any portion of the electrical room which provides service exclusively to the Premises shall be included in Rentable Area, and any portion of the electrical room which provides shared service to the Premises and to other areas of the Building shall be included in Rentable Area on a pro rata basis. The Rentable Area shall also include Tenant's pro rata share of the Building lobby, public restrooms, hallways and other areas within the Building which are shared in common by all tenants of the Building.

"RULES AND REGULATIONS" are defined in Section 23.1.

"SCHEDULED DELIVERY DATE" is defined in Article 1.

"SECURITY DEPOSIT" is defined in Article 1.

"SUBLEASE" is defined in Section 14.1.

"SUCCESSOR" is defined in Section 16.5.

"TENANT'S AGENTS" is defined in Section 2.2.

"TENANT'S HAZARDOUS MATERIALS" is defined in Section 12.1(d).

"TENANT'S PROPERTY" is defined in Section 9.4.

"TENANT'S SHARE" is defined in Article 1.

"TERM" is defined in Article 1 and Section 3.1.

"TERMINATION DATE" is defined in Section 3.1.

"TERMINATION NOTICE" is defined in Section 3.2.

"TRANSFER" is defined in Section 14.4.

"TRANSFER COSTS" is defined in Section 14.3.

"TRANSFER NOTICE" is defined in Section 14.2.

"TRANSFEREE" is defined in Section 14.2.

EXHIBIT A

LOCATION OF PREMISES

EXHIBIT 23.1

CONSENT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 33-49524 and 333-29335) pertaining to the 1998 Incentive Stock Plan, 1992 Equity Incentive Plan, 1992 Employee Stock Purchase Plan and 1992 Stock Option Plan for Non-Employee Directors, in the Registration Statement (Form S-8 No. 333-10773) pertaining to the 1992 Equity Incentive Plan, in the Registration Statement (Form S-8 No. 333-37313) pertaining to the 1996 StemCells, Inc. Stock Option Plan and the 1997 CytoTherapeutics, Inc. StemCells Research Stock Option Plan and in the Registration Statements (Form S-3 No. 33-68900 and No. 333-91228) of CytoTherapeutics, Inc. and in the related Prospectuses of our report dated February 23, 2001, with respect to the consolidated financial statements of StemCells, Inc. included in the Annual Report (Form 10-K) for the year ended December 31, 2000.

Palo Alto, California
March 29, 2001

EXHIBIT 99.1

CAUTIONARY FACTORS RELEVANT TO FORWARD-LOOKING INFORMATION

YOU SHOULD CAREFULLY CONSIDER THE RISKS DESCRIBED BELOW BEFORE MAKING AN INVESTMENT DECISION REGARDING STEMCELLS, INC. WE MAY FACE OTHER RISKS NOT DESCRIBED BELOW THAT WE DO NOT PRESENTLY KNOW ABOUT OR THAT WE CURRENTLY DEEM IMMATERIAL.

Our business, financial condition or results of operations could be materially adversely affected by any of these risks. Consequentially, the trading price of our common stock could decline, resulting in the loss of all or part of your investment.

OUR TECHNOLOGY IS AT AN EARLY STAGE OF DISCOVERY AND DEVELOPMENT AND WE MAY FAIL TO DEVELOP ANY PRODUCTS.

Our stem cell technology is at the early pre-lcinical stage for the brain stem cell and at the discovery phase for the liver and pancreas stem cells and has not yet led to the development of any proposed product. We may fail to discover the stem cells we are seeking, to develop any products, to obtain regulatory approvals, to enter clinical trials, or to commercialize any products. Any product using stem cell technology may fail to (i) survive and persist in the desired location, (ii) provide the intended therapeutic benefits, (iii) properly integrate into existing tissue in the desired manner, or (iv) achieve benefits therapeutically equal to or better than the standard of treatment at the time of testing. In addition, any such product may cause undesirable side effects. Results of early pre-clinical research may not be indicative of the results that will be obtained in later stages of preclinical or clinical research. If the appropriate regulatory authorities do not approve our products, or if we fail to maintain regulatory compliance, we would have limited ability to commercialize our products, and our business and results of operations would be harmed. Furthermore, since stem cells are a new form of therapy, the marketplace may not accept any products we may develop.

If we do succeed in developing products, we will face many potential obstacles such as the need to obtain regulatory approvals, and to develop or obtain manufacturing, marketing and distribution capabilities. In addition, we will face substantial additional risks such as product liability.

WE HAVE LIMITED LIQUIDITY AND CAPITAL RESOURCES AND MAY NOT OBTAIN THE SIGNIFICANT CAPITAL RESOURCES WE WILL NEED TO SUSTAIN OUR RESEARCH AND DEVELOPMENT EFFORTS.

We have limited liquidity and capital resources and must obtain substantial additional capital to support our research and development programs, for acquisition of technology and intellectual property rights, and, to the extent we decide to undertake these activities ourselves, for pre-clinical and clinical testing of our anticipated products, pursuit of regulatory approvals, establishment of production capabilities, establishment of marketing and sales capabilities and distribution channels, and general administrative expenses.

Even though we owned 103,577 shares of Modex Therapeutics Ltd., stock with an estimated fair market value on March 27, 2001 of $8,732,797 based on the per share price of approximately $84.31, which we converted from a market price of 145.00 Swiss francs on that date, we are restricted from selling these shares until April 12, 2001. The performance of Modex stock since Modex's initial public offering does not predict its future value and the value of our holdings is subject to change and could decrease significantly. If we decide to sell our Modex shares, due to the relatively small trading volume in Modex shares and the relatively large size of our holding, or other factors, we may not be able to sell our Modex shares at their market value or at all, and we may have to sell these shares at a significant discount to the

market price. In addition, fluctuations in currency exchange rates could decrease the proceeds we might realize on a potential sale of Modex shares.

We intend to pursue our needed capital resources through equity and debt financings, corporate alliances, grants and collaborative research arrangements. Our ability to complete any such

arrangements successfully will depend upon market conditions and, more specifically, on continued progress in our research and development efforts. We may fail to obtain the necessary capital resources from any such sources when needed or on terms acceptable to us. If we do not obtain the necessary capital resources, we may have to delay, reduce or eliminate some or all of our research and development programs or license our technology or any potential products to third parties rather than commercializing them ourselves.

WE HAVE PAYMENT OBLIGATIONS RESULTING FROM REAL PROPERTY OWNED OR LEASED BY US IN RHODE ISLAND, WHICH ADVERSELY AFFECT OUR ABILITY TO FUND OUR STEM CELL RESEARCH AND DEVELOPMENT.

Prior to our reorganization in 1999 and the resulting consolidation of all functions in California, we carried out our former encapsulated cell therapy programs at facilities in Lincoln, Rhode Island, where we also had our administrative offices. Although we have vacated these facilities, we have continuing obligations for lease payments and operating costs of approximately $1,200,000 per year for our former science and administrative facility, which we have leased through June 30, 2013, and debt service payments and operating costs of approximately $1,000,000 per year for our former encapsulated cell therapy pilot manufacturing facility. We are currently seeking to sublease the science and administrative facility and to sell the pilot manufacturing facility, but may not be able to do so. These continuing costs significantly reduce our cash resources and adversely affect our ability to fund further development of our stem cell technology. The lease for the science and administrative facility contains a provision requiring occupancy of the premises and we currently are in violation of this provision. The landlord agreed not to take any action as a result of this violation until November 19, 2000. We cannot give any assurance that the landlord will extend any additional forebearance. If the landlord decides to pursue its rights after any period of forebearance, we may be required to pay the landlord the entire amount due for the rest of the lease period. In March, 2001, the Landlord approved a sublease of part of the premises.

WE MAY NEED BUT FAIL TO OBTAIN PARTNERS TO SUPPORT OUR STEM CELL DEVELOPMENT EFFORTS AND TO COMMERCIALIZE OUR TECHNOLOGY.

Equity and debt financings alone may not be sufficient to fund the cost of developing our stem cell technologies and we may need to rely on our ability to reach partnering arrangements to provide financial support for our stem cell discovery and development efforts. In addition, in order to successfully develop and commercialize our technology, we may need to enter into a wide variety of arrangements with corporate sponsors, pharmaceutical companies, universities, research groups and others. While we have engaged, and expect to continue to engage, in discussions regarding such arrangements, we have not reached any agreement regarding any such arrangement and we may fail to obtain any such agreement on terms acceptable to us, if at all. Even if we enter into these arrangements, we may not be able to satisfy our obligations under them or renew or replace them after their original terms. Furthermore, these arrangements may require us to grant certain rights to third parties, including exclusive marketing rights to one or more products, or may have other terms that are burdensome to us, and may involve the acquisition of our securities. If any of our collaborators terminates its relationship with us or fails to perform its obligations in a timely manner, the development or commercialization of our technology and potential products may be adversely affected.

We entered into a Sponsored Research Agreement with the Scripps Research

Institute under which we funded certain research in return for licenses or options to license the inventions resulting from the research. This agreement expired on November 14, 2000 and we are negotiating with Scripps to extend the term of this agreement or to enter into a new agreement. As of the date of this prospectus, we have not yet completed our negotiations with Scripps and we cannot give any assurance that our negotiations will be successful. If we are unable to extend the term of this agreement or enter into a new agreement, we will have to find a replacement to perform this research or we will have to

perform this research ourselves. In either case, we may experience delay and additional expense in connection with this research effort.

WE HAVE A HISTORY OF OPERATING LOSSES AND WE MAY FAIL TO OBTAIN REVENUES OR BECOME PROFITABLE.

We have an accumulated deficit of $130,498,187 at December 31, 2000, and expect to continue to incur substantial operating losses in the future in order to conduct our research and development activities, and if those activities are successful, to fund clinical trials and other expenses. These expenses include the cost of acquiring technology, product testing, acquiring regulatory approvals, establishing production, marketing, sales and distribution programs, and administrative expenses. We have not earned any revenues from sales of any product. All of our past revenues have been derived from, and any revenues we may obtain for the foreseeable future are expected to be derived from, cooperative agreements, research grants, investments and interest on invested capital. We have no cooperative agreements and we have received only two research grants for our stem cell technology, and we may not obtain any such agreements or additional grants in the future, or receive any revenues from them.

WE DO NOT ANTICIPATE RECEIVING FUTURE REVENUES FROM THE SALE OF OUR ENCAPSULATED CELL TECHNOLOGY.

In December 1999, we sold our encapsulated cell therapy technology to Neurotech S.A. While under the terms of the sale we may receive royalty and other payments from Neurotech under certain circumstances, we do not anticipate receiving any material payments from Neurotech in the near future, if at all.

WE DEPEND ON PATENTS AND PROPRIETARY RIGHTS TO PROTECT OUR INTELLECTUAL PROPERTY FROM INFRINGEMENT. NEVERTHELESS, SUCH PROTECTION IS UNCERTAIN AND, IF GAINED, MAY OFFER ONLY LIMITED PROTECTION. IF WE ARE UNABLE TO PROTECT OUR PATENTS AND PROPRIETARY RIGHTS, OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS WILL BE HARMED.

We own or license a number of patents or pending patent applications covering human nerve stem cell cultures, central nervous system stem cell cultures, neuroblast cultures, peripheral nervous system stem cell cultures, and an animal model for liver failure. Patent protection for products such as those we propose to develop is highly uncertain and involves complex and continually evolving factual and legal questions. The governmental authorities that consider patent applications can deny or significantly reduce the patent coverage requested in an application before or after issuing the patent. Consequently, we do not know whether any of our pending applications will result in the issuance of patents, or if any existing or future patents will provide sufficient protection or significant commercial advantage or if others will circumvent these patents. Since patent applications are secret until patents are issued in the United States or until the applications are published in foreign countries, and since publication of discoveries in the scientific or patent literature often lags behind actual discoveries, we cannot be certain that we were the first to make the inventions covered by each of our pending patent applications or that we were the first to file patent applications for such inventions. Our patents may not issue from our pending or future patent applications or, if

issued, may not be of commercial benefit to us, or may not afford us adequate protection from competing products. In addition, third parties may challenge our patents or governmental authorities may declare them invalid. In the event that a third party has also filed a patent application relating to inventions claimed in our patent applications, we may have to participate in proceedings to determine priority of invention. This could result in substantial uncertainties and cost for us, even if the eventual outcome is favorable to us, and the outcome might not be favorable to us. Even if a patent issues, a court could decide that the patent was issued invalidly.

IF OTHERS ARE FIRST TO DISCOVER AND PATENT ANY STEM CELLS WE ARE SEEKING TO DISCOVER, WE COULD BE BLOCKED FROM FURTHER WORK ON THAT STEM CELL, AND OUR BUSINESS WOULD BE HARMED.

Because the first person or entity to discover and obtain a valid patent to a particular stem or progenitor cell may effectively block all others, it will be important to our development efforts for us or

our collaborators to be the first to discover any stem cell that we are seeking. Failure to be the first could prevent us from commercializing all of our research and development related to such stem cell and have a material adverse effect on us.

WE MAY NEED TO OBTAIN LICENSES TO THIRD PARTY PATENTS, AND MAY NOT BE ABLE TO GET THEM.

A number of pharmaceutical, biotechnology and other companies, universities and research institutions have filed patent applications or have received patents relating to cell therapy, stem cells and other technologies potentially relevant to or necessary for our expected products. We cannot predict which, if any, of the applications will issue as patents. We are also aware of a number of patent applications and patents claiming use of genetically modified cells to treat disease, disorder or injury. We are aware of three patents issued to two competitors claiming certain methods for enriching central nervous system stem cells through gene modification of in vitro cultured cells. These patents were issued or licensed to NeuralStem and Layton Bioscience. It is possible that NeuralStem or Layton Bioscience will be able to produce commercially available stem cell products before we can. These genetically modified cells may be effective in treating defective, diseased or damaged central nervous system tissue.

If third party patents or patent applications contain claims infringed by our technology and these claims are valid, we may be unable to obtain licenses to these patents at a reasonable cost, if at all, and may also be unable to develop or obtain alternative technology. If we are unable to obtain such licenses at a reasonable cost, our business could be significantly harmed. We may have to to defend ourselves in court against allegations of infringement of third party patents. Patent litigation is very expensive and could consume substantial resources and create significant uncertainties. An adverse outcome in such a suit could subject us to significant liabilities to third parties, require disputed rights to be licensed from third parties, or require us to cease using such technology.

Proprietary trade secrets and unpatented know-how are also important to our research and development activities. We cannot be certain that others will not independently develop the same or similar technologies on their own or gain access to our trade secrets or disclose such technology, or that we will be able to meaningfully protect our trade secrets and unpatented know[cad 220]how and keep them secret.

We require our employees, consultants, and significant scientific collaborators and sponsored researchers to execute confidentiality agreements upon the commencement of an employment or consulting relationship with us. These agreements may, however, fail to provide meaningful protection or adequate remedies for us in the event of unauthorized use, transfer or

disclosure of such information or inventions.

We have obtained rights from universities and research institutions to technologies, processes and compounds that we believe may be important to the development of our products. Licensors may cancel our licenses or convert them to non-exclusive licenses if we fail to use the relevant technology or otherwise breach these agreements. Loss of such licenses could expose us to the risks of third party patents and[ib]/or technology. We can give no assurance that any of these licenses will provide effective protection against our competitors.

WE COMPETE WITH COMPANIES THAT HAVE SIGNIFICANT ADVANTAGES OVER US.

The market for therapeutic products that address degenerative diseases is large and competition is intense. We expect competition to increase. We believe that our most significant competitors will be fully integrated pharmaceutical companies and more established biotechnology companies, such as Biogen, Inc. and Genzyme, an Elan Corporation. These companies already produce or are developing treatments for degenerative diseases that are not stem-cell based, and they have significantly greater capital resources and expertise in research and development, manufacturing, testing, obtaining regulatory approvals and marketing than we do. Many of these potential competitors have significant

products approved or in development that could be competitive with our potential products, and also operate large, well[cad 220]funded research and development programs. In addition, we expect to compete with smaller companies such as NeuralStem and Layton Bioscience and with universities and other research institutions who are developing treatments for degenerative diseases that are stem[cad 220]cell based.

Our competitors may succeed in developing technologies and products that are more effective than those being developed by us, or that would render our technology obsolete or non[cad 220]competitive.

The relative speed with which we and our competitors can develop products, complete the clinical testing and approval processes, and supply commercial quantities of a product to market will affect our ability to gather market acceptance and market share. With respect to clinical testing, competition may delay progress by limiting the number of clinical investigators and patients available to test our potential products.

DEVELOPMENT OF OUR TECHNOLOGY WILL BE SUBJECT TO EXTENSIVE GOVERNMENT REGULATION.

Our research and development efforts, as well as any future clinical trials, and the manufacturing and marketing of any products we may develop, will be subject to extensive regulation by governmental authorities in the United States and other countries. The process of obtaining U.S. Food and Drug Administration and other necessary regulatory approvals is lengthy, expensive and uncertain. We or our collaborators may fail to obtain the necessary approvals to commence or continue clinical testing or to manufacture or market our potential products in reasonable time frames, if at all. In addition, the United States Congress and other legislative bodies may enact regulatory reforms or restrictions on the development of new therapies that could adversely affect the regulatory environment in which we operate or the development of any products we may develop.

We base our research and development on the use of human stem and progenitor cells obtained from fetal tissue. The federal and state governments and other jurisdictions impose restrictions on the use of fetal tissue. These restrictions change from time to time and may become more onerous. Additionally, we may not be able to identify or develop reliable sources for the cells necessary for our potential products-that is, sources that follow all state and federal guidelines for cell procurement. Further,

we may not be able to obtain such cells in the quantity or quality sufficient to satisfy the commercial requirements of our potential products. As a result, we may be unable to develop or produce our products in a profitable manner.

We may apply for status under the Orphan Drug Act for certain of our therapies, in order to gain a seven year period of marketing exclusivity for those therapies. The U.S. Congress in the past considered, and in the future again may consider, legislation that would restrict the extent and duration of the market exclusivity of an orphan drug. If enacted, such legislation could prevent us from obtaining some or all of the benefits of the existing statute even if we were to apply for and be granted orphan drug status with respect to a potential product.

WE DEPEND ON A LIMITED NUMBER OF KEY PERSONNEL.

We are highly dependent on the principal members of our management and scientific staff and certain of our outside consultants, including the members of our scientific advisory board, our chief executive officer, each of our vice presidents and the directors of our neural stem cell and liver stem cell programs. Although we have entered into employment agreements with some of these individuals, they may terminate their agreements at any time. We currently have outside consultants and interim personnel in key management and scientific positions who are not permanent employees. Loss of services of any of these individuals could have a material adverse effect on our operations, because these individuals possess management experience or specialized scientific skills which we do not otherwise have and which we may not be able to replace. In addition, our operations are dependent upon our ability to attract and retain additional qualified scientific and management personnel. More generally, we may not be able to attract and retain the personnel we need on acceptable terms given

the competition for experienced personnel among pharmaceutical, biotechnology and health care companies, universities and research institutions. If we lose the services of these key personnel or are unable to attract and retain additional qualified personnel, we may have to delay, reduce or eliminate some or all of our research and development programs.

HEALTHCARE INSURERS AND OTHER ORGANIZATIONS MAY NOT PAY FOR OUR PRODUCTS OR MAY IMPOSE LIMITS ON REIMBURSEMENTS.

In both domestic and foreign markets, sales of potential products are likely to depend in part upon the availability and amounts of reimbursement from third party health care payor organizations, including government agencies, private health care insurers and other health care payors such as health maintenance organizations and self-insured employee plans. There is considerable pressure to reduce the cost of therapeutic products, and government and other third party payors are increasingly attempting to contain health care costs by limiting both coverage and the level of reimbursement for new therapeutic products, and by refusing, in some cases, to provide any coverage for uses of approved products for disease indications for which the Food and Drug Administration has not granted marketing approval. Significant uncertainty exists as to the reimbursement status of newly approved health care products. We can give no assurance that reimbursement will be provided by such payors at all or without substantial delay, or, if such reimbursement is provided, that the approved reimbursement amounts will be sufficient to enable us to sell products we develop on a profitable basis. Changes in reimbursement policy could also adversely affect the willingness of pharmaceutical companies to collaborate with us on the development of our stem cell technology.

In certain foreign markets, pricing or profitability of prescription pharmaceuticals is subject to government control. We expect that there will continue to be a number of Federal and state proposals to implement government control over health care costs. Efforts at healthcare reform are

likely to continue in future legislative sessions. We do not know what legislative proposals Federal or state governments will adopt or what actions Federal, state or private payers for healthcare goods and services may take in response to healthcare reform proposals or legislation. We cannot predict the effect government control and other healthcare reforms may have on our business.

OUR QUARTERLY OPERATING RESULTS MAY FLUCTUATE.

Our operating results have varied, and may in the future continue to vary, significantly from quarter to quarter due to a variety of factors. These factors include the receipt of one-time license or milestone payments under collaborative agreements, costs associated with the wind-down of our encapsulated cell therapy programs, variation in the level of expenses related to our research and development efforts, receipt of grants or other support for our research and development efforts, and other factors. Quarterly comparisons of our financial results are not necessarily meaningful and you should not rely upon them as an indication of future performance.

OUR STOCK PRICE MAY BE VOLATILE AND THIS VOLATILITY COULD RESULT IN LAWSUITS OR MAKE IT DIFFICULT TO RAISE CAPITAL.

Our stock price may be volatile and this volatility could result in lawsuits or make it difficult to raise capital. The market price for our common stock has been volatile and could decline below the offering price for the shares. We believe that the market price for our common stock could fluctuate substantially due to some or all of the risk factors enumerated above.

The stock market has recently experienced extreme price and volume fluctuations. These fluctuations have especially affected the market price of the stock of many high technology and health care-related companies. Such fluctuations have often been unrelated to the operating performance of these companies. Nonetheless, these broad market fluctuations may negatively affect the market price of our common stock. In the past, companies that have experienced volatility in the market price of their stock have been the objects of securities class action litigation. If we were the object of securities

class action litigation, we could incur material costs and suffer a diversion of our management's attention and resources. In addition, volatility in our stock price may make it difficult for us to obtain additional capital resources through financings on terms acceptable to us.

EVENTS WITH RESPECT TO OUR SHARE CAPITAL COULD CAUSE THE PRICE OF OUR COMMON STOCK TO DECLINE.

Sales of substantial amounts of our common stock on the open market, or the availability of such shares for sale, could adversely affect the price of our common stock. In particular, as of December 31, 2000, we had outstanding stock options to purchase approximately 2,716,966 shares of common stock, at an average exercise price of approximately $4.325 per share, subject to adjustment in certain circumstances. Of this total, options covering approximately 731,523 shares are currently exercisable at an average exercise price of approximately $4.015 per share.

EXHIBIT 99.2

[STEMCELLS, INC. LETTERHEAD]

March 17, 2001

NeuroSpheres Ltd.
C/o University Technologies International Inc.
Suite 130, 3553 - 31 St. N.W.
Calgary Technology Centre
Calgary, Alberta T2L 2K7 Canada

Attention: Oleh S. Hnatiuk
Personal and Confidential
Re: Generation of Hematopoietic Cells from Multipotent Neural Stem Cells

Dear Oleh:

As you know, NeuroSpheres Ltd. and StemCells, Inc. have had a dispute regarding whether or not the above named inventions were included in the 1997 License Agreement. By entering the new License Agreement dated October 30, 2000 (2000 License Agreement), the Parties seek to avoid the need to resolve that dispute. It is my belief, and StemCells' intention, that the 2000 License Agreement will not be terminated before its expiration, so we have every hope that there will never be a need to address the dispute. As we have discussed, this letter is to make sure we are in agreement about the effect of the 2000 License Agreement on the issue:

1. We agree so long as the 2000 License Agreement is in effect, StemCells, Inc. will have licensed rights from NeuroSpheres Ltd. for use of the above named inventions without regard to whether those licensed rights arise under the 2000 License Agreement or the 1997 License Agreement.

2. We agree that so long as the 2000 License Agreement is in effect, StemCells, Inc. will make all payments (milestone, royalty, sublicense, other) that may be applicable to the above named inventions under the terms of the 2000 License Agreement.

3. We agree that in the event of a termination of the 2000 License Agreement then their dispute, mentioned above, shall be considered an open issue, that the parties may need to seek to resolve it, and that neither the entering nor the terms of the 2000 License Agreement shall constitute evidence for either party on the merits of the dispute.

I trust this accurately states our understanding, and ask that you confirm below if it does. With best personal regards, I remain

Sincerely,

Iris Brest
General Counsel

Numbered paragraphs 1, 2 and 3 above correctly state the understanding and agreement of NeuroSpheres, Ltd., concerning the effect of the 2000 License Agreement on its dispute with StemCells, Inc. regarding "Generation of

Hematopoietic Cells from Multipotent Neural Stem Cells."

NeuroSpheres Ltd.

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by: Oleh S. Hnatiuk date