Neuralstem, Inc.
Form 10-Q
August 14, 2009

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

x Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 2009

Or

¨ Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number 000-1357459

NEURALSTEM, INC.
(Exact name of registrant as specified in its charter)

Delaware	52-2007292
State or other jurisdiction of incorporation or organization	(I.R.S. Employer Identification No.)
9700 Great Seneca Highway Rockville, MD 20850	
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (301)-366-4841

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨

Non-accelerated filer ¨	(Do not check if a small reporting company)	Smaller reporting company x

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

As of July 27 2009 there were 34,551,300 shares of common stock, $.01 par value, issued and outstanding.

SUBSEQUENT EVENTS

On June 4, 2009, we received notification from the NYSE AMEX that we were not in compliance with the continued listing requirements contained in Section 1003(i) of the NYSE AMEX company guide and that our common stock may be delisted. In order to maintain our listing, we were required to submit a plan detailing how we intend to regain compliance. On July 6, 2009, we submitted our plan. If the NYSE AMEX does not accept our plan, our common stock will be delisted. In the event of delisting from the NYSE AMEX, our common stock may commence trading on the over-the-counter bulletin board or on the "pink sheets." As of August 14, 2009, we have not received any additional correspondence from the NYSE AMEX. Please refer to the Part II section 1A of this report entitled "Risk Factors" for a further discussion of the implication of delisting.

Neuralstem, Inc.

Table of Contents

ADVISEMENT

We urge you to read this entire Quarterly Report on Form 10-Q, including the" Risk Factors" section, the financial statements, and related notes included herein. As used in this Quarterly Report, unless the context otherwise requires, the words "we," "us,""our," "the Company," "Neuralstem" and "Registrant" refer to Neuralstem, Inc. Also, any reference to "common shares," "Common Stock," "common stock" or "Common Shares" refers to our $.01 par value common stock. The information contained herein is current as of the date of this Quarterly Report (June 30, 2009), unless another date is specified.

We prepare our interim financial statements in accordance with United States generally accepted accounting principles ("GAAP"). Our financials and results of operation for the three and six month period ended June 30, 2009 are not necessarily indicative of our prospective financial condition and results of operations for the pending full fiscal year ending December 31, 2009. The interim financial statements presented in this Quarterly Report as well as other information relating to our company contained in this Quarterly Report should be read in conjunction and together with the reports, statements and information filed by us with the United States Securities and Exchange Commission ("SEC").

FORWARD LOOKING STATEMENTS

In this Quarterly Report we make a number of statements, referred to as "forward-looking statements," within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"), which are intended to convey our expectations or predictions regarding the occurrence of possible future events or the existence of trends and factors that may impact our future plans and operating results. These forward-looking statements are derived, in part, from various assumptions and analyses we have made in the context of our current business plan and information currently available to use and in light of our experience and perceptions of historical trends, current conditions and expected future developments and other factors we believe are appropriate in the circumstances. You can generally identify forward looking statements through words and phrases such as "believe," "expect," "seek," "estimate," "anticipate," "intend," "plan," "budget," "project," "may likely result," "may be," "ma other similar expressions.

When reading any forward-looking statement you should remain mindful that actual results or developments may vary substantially from those expected as expressed in or implied by such statement for a number of reasons or factors, including but not limited to:

- the success of our research and development activities, the development of a viable commercial production, and the speed with which regulatory authorizations and product launches may be achieved;
- whether or not a market for our proposed product develops and, if a market develops, the rate at which it develops;
- our ability to successfully sell our products once developed;
- our ability to attract and retain qualified personnel to implement our business plan and corporate strategies;
- our ability to develop sales, marketing, and distribution capabilities;
- our ability to obtain reimbursement from third party payers for the products that we intend to sell;
- our ability to fund our short-term and long-term financing needs;

- changes in our business plan and corporate strategies; and

- other risks and uncertainties discussed in greater detail in the section of this report captioned “Risk Factors”

Each forward-looking statement should be read in context with, and in understanding of, the various other disclosures concerning our company and our business made elsewhere in this report as well as our public filings with the SEC. You should not place undue reliance on any forward-looking statement as a prediction of actual results or developments. We are not obligated to update or revise any forward-looking statements contained in this report or any other filing to reflect new events or circumstances unless and to the extent required by applicable law.

PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Neuralstem, Inc.

Balance Sheets

	June 30, 2009 (Unaudited)	December 31, 2008
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 3,218,321	$ 4,903,279
Prepaid expenses	60,812	136,287
Total current assets	3,279,133	5,039,566
Property and equipment, net	144,917	163,930
Intangible assets, net	249,132	212,265
Other assets	58,472	52,972
Total assets	$ 3,731,654	$ 5,468,733
LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY		
CURRENT LIABILITIES		
Accounts payable, accrued expenses and salaries	$ 1,901,789	$ 1,265,488
LONG-TERM LIABILITIES		
Fair value of warrant obligations	3,236,634	-
Total liabilities	5,138,423	1,265,488
STOCKHOLDERS' (DEFICIT) EQUITY		
Preferred stock, 7,000,000 shares authorized, zero shares issued and outstanding	-	-
Common stock, $0.01 par value; 150 million shares authorized, 34,551,300 and 33,751,300 shares outstanding in 2009 and 2008, respectively.	345,513	337,513
Additional paid-in capital	57,733,955	61,352,527
Accumulated deficit	(59,486,237)	(57,486,795)
Total stockholders' (deficit) equity	(1,406,769)	4,203,245

Total liabilities and stockholders' equity	$ 3,731,654	$ 5,468,733

Neuralstem, Inc.

Statements of Operations
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues	$ -	$ -	$ -	$ -
Operating expenses:				
Research and development costs	1,452,793	1,633,729	2,886,802	2,832,572
General, selling and administrative expenses	1,249,947	1,318,708	2,707,186	2,401,877
Depreciation and amortization	21,424	15,780	42,220	29,537
	2,724,164	2,968,217	5,636,208	5,263,986
Operating loss	(2,724,164)	(2,968,217)	(5,636,208)	(5,263,986)
Nonoperating(expense) income:				
Interest income	8,516	10,545	10,780	31,862
(Loss)gain from change in fair value of warrant obligations	(473,799)	-	3,341,659	-
	(465,283)	10,545	3,352,439	31,862
Net loss attributable to common shareholders	$ (3,189,447)	$ (2,957,672)	$ (2,283,769)	$ (5,232,124)
Net loss per share, basic and diluted	$ (0.09)	$ (0.09)	$ (0.07)	$ (0.16)
Weighted average common shares outstanding	33,760,091	32,109,858	33,755,720	31,936,365

Neuralstem, Inc.

Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30, 2009	2008
Cash Flows From Operating Activities:		
Net loss	$ (2,283,769)	$ (5,232,124)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	42,220	29,537
Share based compensation expenses	2,348,656	2,160,900
Gain from change in fair value of warrant obligations	(3,341,659)	0
Changes in operating assets and liabilities:		
Prepaid expenses	75,475	50,017
Other assets	(5,500)	(6,001)
Accounts payable, accrued expenses and salaries	636,300	(80,589)
Net cash used in operating activities	(2,528,277)	(3,078,260)
Cash Flows From Investing Activities:		
Acquisition of intangible assets	(51,692)	(22,456)
Purchase of property and equipment	(8,380)	(61,221)
Net cash used in investing activities	(60,072)	(83,677)
Cash Flows From Financing Activities:		
Issuance of common stock	903,391	2,724,787
Net cash provided by financing activities	903,391	2,724,787
Net decrease in cash and cash equivalents	(1,684,958)	(437,150)
Cash and cash equivalents, beginning of period	4,903,279	7,403,737
Cash and cash equivalents, end of period	$ 3,218,321	$ 6,966,587

Neuralstem, Inc.
STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)
For the period from January 1, 2009 through June 30, 2009
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
Balance at January 1, 2009	33,751,300	$ 337,513	$ 61,352,527	$ (57,486,795)	$ 4,203,245
Cumulative effect of reclassification of warrants under EITF 07-5			(6,862,620)	284,327	(6,578,293)
Balance, January 1, 2009, as adjusted	33,751,300	$ 337,513	54,489,907	(57,202,468)	(2,375,048)
Share based payment - employee compensation			2,348,656		2,348,656
Issuance of common stock through Private Placement ($1.25 per share), net of financing costs of $96,608.	800,000	8,000	895,392		903,392
Net loss				(2,283,769)	(2,283,769)
Balance at June 30, 2009	34,551,300	$ 345,513	$ 57,733,955	$ (59,486,237)	$ (1,406,769)

NEURALSTEM, INC.
NOTES TO (UNAUDITED) FINANCIAL STATEMENTS

Note 1. Basis of Presentation

The accompanying unaudited financial statements of Neuralstem, Inc. (the “Company”) have been prepared in accordance with generally accepted accounting principles in the United States and the rules and regulations of the Securities and Exchange Commission (the “SEC”), for interim financial information. Therefore, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2008. Further, in connection with preparation of the financial statements and in accordance with the recently issued Statement of Financial Accounting Standards No. 165 “Subsequent Events” (SFAS 165), the Company evaluated subsequent events after the balance sheet date through August 14, 2009. See note 6 for a discussion of subsequent events.

The interim financial statements are unaudited, but in the opinion of management all adjustments, consisting only of normal recurring accruals, considered necessary to present fairly the results of these interim periods have been included. The results of the Company’s operations for any interim period are not necessarily indicative of results that may be expected for any other interim period or for the full year.

Note 2. Significant Accounting Policies and Recent Accounting Pronouncements

Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Because of the use of estimates inherent in the financial reporting process, actual results could differ significantly from those estimates.

The Company's business currently generates limited amounts of cash which will not be sufficient to meet all its future capital requirements and research and development efforts. The Company's management does not know when this will change. The Company has expended and will continue to expend substantial funds in the research, development and clinical and pre-clinical testing of the Company's stem cell technologies and products with the goal of ultimately obtaining approval from the United States Food and Drug Administration ("FDA") to market and sell our products. We believe our long-term cash position is inadequate to fund all of the costs associated with the full range of testing and clinical trials required by the FDA for our core products. Based on our current operating levels, we believe that we have sufficient levels of cash and cash equivalents and access to funds that we will not require additional debt or equity financing during 2009.

No assurance can be given that (i) we will be able to expand our operations prior to FDA approval of our products, or (ii) that FDA approval will ever be granted for our products.

Revenue Recognition

Our revenue recognition policies are in accordance with the SEC’s Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements as amended by SAB 104. Our revenue is derived primarily from providing treated samples for gene expression data from stem cell experiments, from providing services under various grant programs and through the licensing of the use of our intellectual property. Revenue is recognized when there is

persuasive evidence that an arrangement exists, delivery of goods and services has occurred, the price is fixed and determinable, and collection is reasonably assured.

Research and Development

Research and development expenses consist primarily of costs associated with basic and pre-clinical research, exclusively in the field of human neural stem cell therapies and regenerative medicine, related to our clinical cell therapy candidates. These expenses represent both pre-clinical development costs and costs associated with non-clinical support activities such as quality control and regulatory processes. Research and development costs are expensed as they are incurred.

Loss per Common Share

Basic loss per common share is calculated by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted loss per common share adjusts basic loss per share for the potentially dilutive effects of shares issuable under our stock option plan, using the treasury stock method. All of the Company's options and warrants, which are common stock equivalents, have been excluded from the calculation of diluted loss per share, as their effect would have been anti-dilutive.

Share Based Payments

We have granted stock-based compensation awards to employees and board members. Awards may consist of common stock, warrants, or stock options. Our stock options and warrants have up to a ten year life. The stock options or warrants vest either upon the grant date or over varying periods of time. The stock options we grant provide for option exercise prices equal to or greater than the fair market value of the common stock at the date of the grant.

During the six months ended June 30, 2009, we granted 246,000 options, and in the similar period ended June 30, 2008, we granted 5,370,000 options. We recorded related compensation expenses as our options vest in accordance with the Statement of Financial Accounting Standards (SFAS) 123(R), Share-Based Payment. We recognized $1,149,952 and $1,066,362 in share-based compensation expense during the three months ended June 30, 2009 and 2008, respectively, from the vesting of stock options or warrants. We recognized $2,348,656 and $2,160,900 in share-based compensation expense during the six months ended June 30, 2009 and 2008, respectively, from the vesting of stock options or warrants.

A summary of stock option activity during the six months ended June 30, 2009 and related information is included in the table below:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Outstanding at January 1, 2009	8,750,659	$ 2.55	8.2	$ -
Granted	246,000	1.71	5.4	-
Exercised	-			
Forfeited	-			
Outstanding at June 30, 2009	8,996,659	$ 2.53	7.6	$ 1,296,000
Exercisable at June 30, 2009	4,349,659	$ 2.08	7.2	$ 972,000

Share-based compensation expense included in the statements of operations for the three months and six months ended June 30, 2009 and 2008 was as follows:

	Three Months Ended June 30, 2009	2008
Research and development costs	$ 740,201	$ 696,661
General, selling and administrative expenses	409,751	369,701
Total	$ 1,149,952	$ 1,066,362

	Six Months Ended June 30, 2009	2008
Research and development costs	$ 1,480,402	$ 1,448,675
General, selling and administrative expenses	868,254	712,225
Total	$ 2,348,656	$ 2,160,900

Warrants to purchase common stock were issued to certain officers, directors, stockholders and consultants.

	Number of Warrants	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Outstanding at January 1, 2009	13,079,762	$ 2.27	4.2	-
Granted	2,440,000	1.26	2.0	-
Exercised	-			
Forfeited	-			
Outstanding at June 30, 2009	15,519,762	$ 2.11	3.6	-
Exercisable at June 30, 2009	12,519,762	$ 1.89	2.8	-

Effective January 1, 2009 we adopted the provisions of EITF 07-05, described below. As a result of adopting EITF 07-05, 8,547,762 of our issued and outstanding common stock purchase warrants previously treated as equity pursuant to the derivative treatment exemption were no longer afforded equity treatment. These warrants have the following characteristics:

	Strike Price	Date of Issue	Date of Expiration	Warrants Outstanding
Series A & B Warrants	$ 1.25	February-06	February-11	4,359,605
Series A & B Warrants, Placement Agent	$ 1.10	February-06	February-11	782,005
Series C Warrants	$ 1.25	October-07	October-12	1,227,000
Series C Warrants, Placement Agent	$ 1.25	March-07	March-12	294,480
Series C Warrants, anti-dilution awards	$ 1.25	December-08	October-12	1,472,400
Series C Warrants, Placement Agent, anti-dilution awards	$ 1.25	December-08	March-12	412,272
Total warrants no longer accounted for as equity				8,547,762

As such, effective January 1, 2009 we reclassified the fair value of these common stock purchase warrants, which were outstanding at January 1, 2009, and which have exercise price reset and anti-liquidation features, from equity to liability status as if these warrants were treated as a derivative liability since their date of issue. On January 1, 2009, we reduced additional paid-in capital by $6.9 million and decreased the beginning retained deficit by $.3 million as a cumulative effect to establish a long-term warrant liability of $6.6 million to recognize the fair value of such warrants. The fair value of these common stock purchase warrants declined to $3.3 million as of June 30, 2009. We recognized a $3.3 million gain from the change in fair value of these warrants for the six months ended June 30, 2009.

These common stock purchase warrants were initially issued in connection with placement of the Company's common stock. The common stock purchase warrants were not issued with the intent of effectively hedging any future cash flow, fair value of any asset, liability or any net investment in a foreign operation. The warrants do not qualify for hedge accounting, and as such, all future changes in the fair value of these warrants will be recognized currently in earnings until such time as the warrants are exercised or expire. These common stock purchase warrants do not trade in an active securities market, and as such, we estimate the fair value of these warrants using the Black-Scholes option pricing model using the following assumptions:

	June 30, 2009	January 1, 2009
Annual dividend yield	—	—
Expected life (years)	.75-2.25	1 to 2.5
Risk-free interest rate	0.56-1.11%	0.4%
Expected volatility	82-115%	86%

Expected volatility is based primarily on historical volatility. Historical volatility was computed using daily pricing observations for a group of similar companies for recent periods that correspond to the expected life of the warrants. We believe this method produces an estimate that is representative of our expectations of future volatility over the expected term of these warrants. We currently have no reason to believe future volatility over the expected remaining life of these warrants is likely to differ materially from historical volatility. The expected life is estimated by management based on the remaining term of the warrants. The risk-free interest rate is based on the rate for U.S. Treasury securities over the expected life.

Significant New Accounting Pronouncements

In May 2008, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") 162, "The Hierarchy of Generally Accepted Accounting Principles" (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. SFAS 162 was effective November 15, 2008. The adoption of SFAS 162 did not have a material impact on our financial position, results of operations or cash flows.

In June 2008, the FASB ratified the consensus reached on EITF Issue No. 07-05, "Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity's Own Stock" (Issue 07-05). This Issue provides guidance for determining whether an equity-linked financial instrument (or embedded feature) is indexed to an entity's own stock. Issue 07-05 applies to any freestanding financial instrument or embedded feature that has all the characteristics of a derivative under paragraphs 6-9 of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," (SFAS 133) for purposes of determining whether that instrument or embedded feature qualifies for the first part of the scope exception under paragraph 11(a) of SFAS 133. Issue 07-05 also applies to any freestanding financial instrument that is potentially settled in an entity's own stock, regardless of whether the instrument has all the characteristics of a derivative under paragraphs 6-9 of SFAS 133, for purposes of determining whether the instrument is within the scope of EITF Issue 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," (Issue 00-19) which provides accounting guidance for instruments that are indexed to, and potentially settled in, the issuer's own stock. Issue 07-05 is effective for fiscal years beginning after December 15, 2008. See Note 5 for a discussion of the effect of this standard, that was adopted on January 1, 2009.

In May 2009, the FASB issued SFAS 165, “Subsequent Events.” SFAS 165 requires the disclosure of the date through which a company has evaluated subsequent events occurring after the balance sheet date of the financial statements and whether this date is the date the financial statements were issued or the date the financial statements were available to be issued. SFAS 165 is effective for financial statements issued for interim or annual periods ending after June 15, 2009. The implementation of SFAS 165 did not have a material impact on our financial statements. See note 6 for a discussion of subsequent events.

In June 2009, the FASB issued SFAS 166, “Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140” (“SFAS 166”). The Board’s objective in issuing SFAS 166 is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor’s continuing involvement, if any, in transferred financial assets. SFAS 166 must be applied as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company does not believe the adoption of SFAS 166 will have a material impact on the Company’s financial statements.

In June 2009, the FASB issued SFAS 167, “Amendments to FASB Interpretation No. 46(R)” (“SFAS 167”). The Board’s objective in issuing SFAS 167 is to improve financial reporting by enterprises involved with variable interest entities. SFAS 167 shall be effective as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company does not believe the adoption of SFAS 167 will have a material impact on the Company’s financial statements.

In June 2009, the FASB issued SFAS 168 the FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles “a replacement of FASB Statement No. 162” (“SFAS 168”). SFAS 168 will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of SFAS 168, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. Once the Codification is in effect, all of its content will carry the same level of authority, effectively superseding SFAS 162.

3. Fair Value

In September 2006, the FASB issued SFAS 157, "Fair Value Measurements," (“SFAS 157”). SFAS 157 establishes a standard framework for measuring fair value in generally accepted accounting principles, clarifies the definition of "fair value" within that framework, and expands disclosures about the use of fair value measurements. We adopted SFAS 157 in the first quarter of 2008 with regard to all financial assets and liabilities in our financial statements going forward, and, consistent with FASB Staff Position 157-2, "Effective Date of FASB Statement No. 157," we have elected to adoption of SFAS 157 for non-financial assets and liabilities not recognized or disclosed at fair value on a recurring basis until the first quarter of 2009. The adoption of SFAS 157 had no material impact on our financial statements. The book value of our nonfinancial assets approximated their fair values at June 30, 2009.

Fair value is defined as the price at which an asset could be exchanged or a liability transferred (an exit price) in an orderly transaction between knowledgeable, willing parties in the principal or most advantageous market for the asset or liability. Where available, fair value is based on observable market prices or parameters or derived from such prices

or parameters. Where observable prices or inputs are not available, valuation models are applied.

Financial assets recorded at fair value in the accompanying financial statements are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by SFAS No. 157 and directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities, are as follows:

Level 1 — Inputs are unadjusted, quoted prices in active markets for identical assets at the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

The fair valued assets we hold that are generally included in this category are money market securities where fair value is based on publicly quoted prices and included in cash equivalents.

Level 2 — Inputs are other than quoted prices included in Level 1, which are either directly or indirectly observable for the asset or liability through correlation with market data at the reporting date and for the duration of the instrument's anticipated life.

We carry no investments classified as Level 2.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities and which reflect management's best estimate of what market participants would use in pricing the asset or liability at the reporting date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model. Our warranty obligations are considered Level 3.

Financial assets and liabilities measured at fair value on a recurring basis are summarized below:

	Fair value measurements at June 30, 2009 using			
	Fair Value on Balance Sheet	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Cash and cash equivalents	$ 3,218,321	$ 3,218,321	$ -	$ -
Liabilities:				
Fair value of warrant obligations	$ 3,236,634	$ -	$ -	$ 3,236,634

The following table is a reconciliation of the changes in the fair value of the Company's warrant obligations, which have been classified in Level 3 in the fair value hierarchy.

	Three months ended June 30, 2009	Six months ended June 30, 2009
Fair value of warrant obligations at beginning of period	$ 2,762,835	$ -
Cumulative effect of reclassification of warrants under EITF 07-5 at beginning of period	-	6,578,293
Unrealized loss (gain) included in the statement of operations for period	473,799	(3,341,659)
Issuances, extinguishments and reclassifications	-	-
Fair value of warrant obligations at end of period	$ 3,236,634	$ 3,236,634

The fair value of the warrant obligations was determined using the Black-Scholes option pricing model with inputs which are described in Note 2.

Note 4. Stockholders' Equity

During the first six months of 2009, the Company granted 246,000 options on shares of common stock to consultants as an incentive for these consultants' continued employment. The options vest in periods between issue date and one year. The Company valued these options using the Black-Scholes option pricing model using the following assumptions: exercise price of between $1.25 and $1.64, term of two to three years, volatility rate of 73% to 74% and interest rates of 0.74% to 0.84%. The total value of these options will be expensed over the vesting period. The Company began to record the expense related to these options in the first quarter of 2009.

The Company also completed a private placement of 800,000 common shares at $1.25 per share increasing equity by approximately $1,000,000 in June 2009, less approximately $97,000 in related placement and closing costs.

Note 5. Change in Accounting Principle: Recharacterization of Warrants

In June 2008, the FASB ratified the consensus reached on Emerging Issues Task Force (EITF) Issue No. 07-05, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock." (Issue 07-5). Issue 07-05 clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which would qualify as a scope exception under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities."

We adopted Issue 07-05 as of January 1, 2009. As is discussed in Note 1 above, as of that date we had 8,547,762 warrants which were reassessed under Issue 07-05. Because of certain price adjustment provisions contained in the warrants, they were no longer deemed to be indexed to our stock and therefore, no longer meet the scope exception of FAS 133. Hence, these warrants were determined to be derivatives and were reclassified from equity to liabilities. As a result of this change in accounting principle, on January 1, 2009 we recorded these liabilities at their value of $6,578,293. At that date we also recorded a cumulative catch up adjustment of $284,327 to reduce the accumulated deficit and a $6,862,620 decrease to additional paid-in capital. The adjustment to the accumulated deficit (the cumulative income effect of the accounting change) was calculated for the decrease in the fair value of the warrants from the date of their issuance through January 1, 2009.

These warrant liabilities will be marked to market from January 1, 2009 going forward resulting in the recognition of income or expense in our statement of operations for changes in their fair value. In the six months ended June 30, 2009 we recognized a gain from the change in the fair value of these warrant obligations of $3,341,659.

Note 6. Subsequent Events

On June 4, 2009, NYSE Amex advised the Company that it does not comply with Section 1003(a)(i) of the Amex Company Guide. On July 6, 2009, the Company submitted a plan to resolve listing deficiencies and to regain compliance with the NYSE Amex continued listing requirements within eighteen months. The Plan will be reviewed by the exchange staff. The Company would be subject to periodic review to determine whether it is making progress consistent with the plan. If the Company has made a reasonable demonstration of an ability to regain compliance with the continued listing standards within the specified timeframe, the plan will be accepted.

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is provided in addition to the accompanying financial statements and notes to assist readers in understanding our results of operations, financial condition, and cash flows. The MD&A section is organized as follows:

- Overview - Discussion of our business and overall analysis of financial and other highlights affecting the company in order to provide context for the remainder of MD&A.

- Trends & Outlook - Discussion of what we view as the overall trends affecting our business and the strategy for 2009.

- Critical Accounting Policies - Accounting policies that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results and forecasts.

- Results of Operations - Analysis of our financial results comparing: (i) the first quarter of 2009 to 2008; (ii) the six month period ended June 30, 2009 and 2008.

- Liquidity and Capital Resources - An analysis of changes in our balance sheets and cash flows, and discussion of our financial condition and potential sources of liquidity.

The various sections of the MD&A contain a number of forward looking statements. Words such as "expects," "goals," "plans," "believes," "continues," "may," and variations of such words and similar expressions are intended to identify such forward looking statements. In addition any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are

forward looking statements. Such statements are based on our current expectations and could be affected by the uncertainties and risk factors described throughout this filing, and particularly in the "Overview" and Trends & Outlook" section (see also "Risk Factors" in Part II, Item 1A of this Quarterly Report). Our actual results may differ materially.

OVERVIEW

Neuralstem is focused on the development and commercialization of treatments based on transplanting human neural stem cells.

We have developed and we maintain a portfolio of patents and patent applications that form the proprietary base for our research and development efforts in the area of neural stem cell research. We own or exclusively license four (4) issued patents and thirteen (13) patent pending applications in the field of regenerative medicine and related technologies. We believe our technology base, in combination with our know-how, and collaborative projects with major research institutions provides a competitive advantage and will facilitate the successful development and commercialization of products for use in the treatment of a wide array of neurodegenerative conditions and in regenerative repair of acute disease.

This is a young and emerging field. There can be no assurances that our intellectual property portfolio will ultimately produce viable commercial products and processes. Even if we are able to produce a commercially viable product, there are strong competitors in this field and our product may not be able to successfully compete against them.

All of our research efforts to date have been at the level of basic research or in the pre-clinical stage of development. On December 18, 2008 we filed our first Investigational New Drug Application ("IND") with the U.S. Food and Drug Administration ("FDA") to begin a clinical trial to treat amyotrophic lateral sclerosis ("ALS" or "Lou Gehrig's Disease"). On February 20, 2009, the FDA provided us with specific comments, questions and recommendations for modification to the protocol submitted in our IND. The trial is currently on clinical hold. We are in the process of analyzing the notice and the FDA's comments and recommendations and in formulating a response thereto.

In addition to our core stem cell tissue based technology we have begun developing a small-molecule compound. The Company has performed preliminary in vitro and in vivo tests on the compound with regard to neurogenesis. In June the company received a notice of allowance from the U.S. Patent and Trademark Office (USPTO) for a patent on four new chemical entities that boost the generation of new neurons. Patent application 12/049,922, entitled "Use of Fused Nicotinamides to Promote Neurogenesis," claims four chemical entities and any pharmaceutical composition including them.

Technology

Our technology is the ability to isolate human neural stem cells from most areas of the developing human brain and spinal cord and our technology includes the ability to grow them into physiologically relevant human neurons of all types. Our two issued core patents entitled: (i) Isolation, Propagation, and Directed Differentiation of Stem Cell from Embryonic and Adult Central Nervous System of Mammals ; and (ii) In Vitro Generation of Differentiated Neurons from Cultures of Mammalian Multi-potential CNS Stem Cell contain claims which cover the process of deriving the cells and the cells created from such process.

What differentiates our stem cell technology from others is that our patented processes do not require us to "push" the cells towards a certain fate by adding specific growth factors. Our cells actually "become" the type of cell they are fated to be. We believe this process and the resulting cells create a technology platform that will allow for the efficient isolation and production, in commercially reasonable quantities of neural stem cells from the human brain and spinal cord.

Our technology also allows for cells to grow in cultured dishes, also known as in vitro growth, without mutations or other adverse events that would compromise their usefulness.

16

Research

We have devoted substantial resources to our research programs in order to isolate and develop a series of neural stem cell banks that we believe can serve as a basis for therapeutic products. Our efforts to date have been directed at methods to identify, isolate and culture large varieties of stem cells of the human nervous system, and to develop therapies utilizing these stem cells. This research is conducted both internally and through the use of third party laboratory consulting companies under our direct supervision.

TRENDS & OUTLOOOK

Revenue: Historically, our revenue was primarily derived from grant reimbursements, licensing fees and consulting fees. As our focus is now on pre-clinical work in anticipation of entering clinical trials in 2009, we are not concentrated on generating revenue. Accordingly, we do not anticipate realizing any revenue in the immediate future.

Long-term, we anticipate our revenue will be derived primarily from licensing fees and the sale of our cell therapy products. At present, we are in our pre-clinical stage of development and as a result, we cannot accurately predict when or if we will be able to produce a product for commercialization. Accordingly, we cannot accurately estimate if or when we will begin generating revenue from such sources.

Research & Development Expense: Our research and development expenses consist primarily of costs and expenses associated with pre-clinical research, exclusively in the field of human neural stem cell therapies and regenerative medicine, related to our clinical cell therapy candidates. These expenses represent both pre-clinical development costs and costs associated with non-clinical support activities such as quality control and regulatory processes. The cost of our research and development personnel is the most significant category of expense. However, we also incur expenses with third parties, including license agreements, third-party contract services, sponsored research programs and consulting expenses.

We do not segregate research and development costs on a per project basis. Although we have different areas of focus for our research, these areas are completely intertwined and have not yet matured to the point where they are separate and distinct projects. The intellectual property, scientists and other resources dedicated to these efforts are not separately allocated to individual projects, since our research is conducted on an integrated basis.

We expect that research and development expenses will continue to increase, as funding allows, in the foreseeable future as we add personnel, expand our pre-clinical research (animal surgeries, manufacturing of cells, and in vitro characterization of cells which includes testing and cell quality control), begin clinical trial activities, increase our regulatory compliance capabilities, and ultimately begin manufacturing.

The amount of monetary increases stemming from increased personnel and expenses as we move from pre-clinical to clinical stage is difficult to predict due to the uncertainty inherent in the timing and extent of progress with regard to our research programs and clinical trials. In addition, the results from our basic research and pre-clinical trials, as well as the results of trials of similar therapeutics underdevelopment by others, will influence the number, size and duration of planned and unplanned trials. As our research efforts mature, we will continue to review the direction of our research based on an assessment of the value of possible commercial applications emerging from these efforts. Based on this continuing review, we expect to establish discrete research programs and evaluate the cost and potential for cash inflows from commercializing products, partnering with others in the biotechnology industry, or licensing the technologies associated with these programs to third parties.

On December 18, 2008 we filed our first IND with the FDA to begin a clinical trial to treat ALS or Lou Gehrig's Disease. On February 20, 2009, the FDA provided us with specific comments, questions and recommendations for modifying our protocol submitted in our IND. As a result, the trial is on clinical hold. We are in the process of analyzing the FDA's comments and in formatting a response. We believe that it is not possible at this stage to provide a meaningful estimate of the total cost to complete our ongoing projects, including clinical trials, and bring any proposed products to market. The use of human stem cells as a therapy is an emerging area of medicine, and it is not known what clinical trials will be required by the FDA in order to gain marketing approval. The costs to complete such clinical trials could vary substantially depending upon the projects selected for development, the number of clinical trials required and the number of patients needed for each study. At a minimum, we estimate that a trial for an individual indication such as ALS will require at least 10 to 12 patients at an estimated cost of $100,000 per patient. It is possible that the completion of these studies could be delayed for a variety of reasons, including difficulties in enrolling patients, delays in manufacturing, incomplete or inconsistent data from the pre-clinical or clinical trials, and difficulties evaluating the trial results. Any delay would increase the cost of the trial, which would harm our operating results. Due to these uncertainties, we cannot reasonably estimate the size, nature, nor timing of the costs to complete, or the amount or timing of the net cash inflows, if any, from our current activities. Until we obtain further relevant pre-clinical and clinical data, we will not be able to estimate our future expenses related to these programs or when, if ever, and to what extent, we will receive cash inflows from resulting products.

General and Administrative Expenses: Our general and administrative ("G&A") expenses consist of the general costs, expenses and salaries for the operation and maintenance of our business. We anticipate that general and administrative expenses will increase as we progress from pre-clinical to a clinical phase.

We anticipate G&A expenses related to our core business will increase at a slower rate than that of similar companies making such transition, due in large part to our outsourcing model.

CRITICAL ACCOUNTING POLICIES

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Note 2 of the Notes to Financial Statements describes the significant accounting policies used in the preparation of the financial statements. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

A critical accounting policy is defined as one that is both material to the presentation of our financial statements and requires management to make difficult, subjective or complex judgments that could have a material effect on our financial condition and results of operations. Specifically, critical accounting estimates have the following attributes: (1) we are required to make assumptions about matters that are highly uncertain at the time of the estimate; and (2) different estimates we could reasonably have used, or changes in the estimate that are reasonably likely to occur, would have a material effect on our financial condition or results of operations.

Estimates and assumptions about future events and their effects cannot be determined with certainty. We base our estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as our operating environment changes. These changes have historically been minor and have been included in the financial statements as soon as they became known. Based on a critical assessment of our accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes that our financial statements are fairly stated in accordance with accounting principles generally accepted in the United States, and present a meaningful presentation of our financial condition and results of operations. We believe the following

critical accounting policies reflect our more significant estimates and assumptions used in the preparation of our financial statements:

Use of Estimates—our financial statements have been prepared in accordance with accounting principles generally accepted in the United States and, accordingly, require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Specifically, our management has estimated the expected economic life and value of our licensed technology, our net operating loss for tax purposes and our stock option and warrant expenses related to compensation to employees and directors, consultants and investment banks. Actual results could differ from those estimates.

Revenue Recognition—our revenues, to date, has been derived primarily from providing services as a subcontractor under federal grant programs and licensing fees. Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery of goods and services has occurred, the price is fixed and determinable, and collection is reasonably assured.

Intangible and Long-Lived Assets—we follow SFAS 144, "Accounting for Impairment of Disposal of Long-Lived Assets," which established a "primary asset" approach to determine the cash flow estimation period for a group of assets and liabilities that represents the unit of accounting for a long lived asset to be held and used. Long-lived assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell. During the period ended June 30, 2008 no impairment losses were recognized.

Accounting for Warrants – The Company has adopted the provisions of EITF 07-05, "Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock" ("EITF 07-05"). EITF 07-05 applies to any freestanding financial instruments or embedded features that have the characteristics of a derivative, as defined by SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," and to any freestanding financial instruments that are potentially settled in an entity's own common stock. As a result, certain of our warrants are considered to be derivatives and must be valued using various assumptions as they are recorded as liabilities.

Research and Development Costs—Research and development costs consist of expenditures for the research and development of patents and technology, which are not capitalizable and charged to operations when incurred. Our research and development costs consist mainly of payroll and payroll related expenses, research supplies and costs incurred in connection with specific research grants.

Stock Based Compensation—The Company accounts for equity instruments issued to non-employees in accordance with EITF 96-18, "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services." Accordingly, the estimated fair value of the equity instrument is recorded on the earlier of the performance commitment date or the date the services required are completed.

Beginning in 2006, we adopted SFAS 123R "Share Based Payment" which superseded APB Opinion No. 25. SFAS 123R requires compensation costs related to share-based payment transactions to be recognized in the financial statements.

RESULTS OF OPERATIONS

Summary Income Statement for the Three and Six Months Ended June 30, 2009 & 2008

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues	-	-	-	-
Operating expenses	$ 2,724,164	$ 2,968,217	$ 5,636,208	$ 5,263,986
Operating loss	(2,724,164)	(2,968,217)	(5,636,208)	(5,263,986)
Non-operating income (expense)	(465,283)	10,545	3,352,439	31,862

Net income (loss)	$ (3,189,447)	$ (2,957,672)	$ (2,283,769)	$ (5,232,124)

For the second quarter of 2009, the Company reported a net loss of $3,189,447, or $0.09 per share, compared to a net loss of $2,957,672 or $0.09 per share, for the comparable 2008 period. The increase was caused by a non cash charge related to a change in the way we account for certain warrants offset in part by reductions in most other expense categories. Net loss attributable to common stockholders for the first six months of 2009 was $2,283,769 or $0.07 per share, compared to $5,232,124, or $0.16 per share, for the comparable period in 2008. The decrease in net loss from year to year was due to a year to date gain in our warrant accounting, partially offset by increases in non cash stock-based compensation expense, R&D and legal fees.

Results of Operations for the Three Months ending June 30, 2009 and 2008

Our results of operations have varied significantly from year to year and quarter to quarter, and may vary significantly in the future.

We did not have revenues for the three months ended June 30, 2009 and 2008, respectively.
We do not anticipate any revenues for 2009.

Operating expenses totaled $2,724,164 and $2,968,217 for the three months ended June 30, 2009 and 2008. The decrease in operating expense of $244,053 was due to a decrease in R&D spending, and legal fees offset in part by an increase in non-cash stock based compensation expense.

Research and development expenses totaled $1,452,793 for the three months ended June 30, 2009 compared to $1,633,729 for the same period of 2008. The decrease of $180,936 or 11% for the three months ended June 30, 2009 compared to the comparable period in 2008 was primarily attributable to the completion of the application to the FDA to move our tissue based products into clinical trials in the first quarter of the year which significantly reduced spending for contracted research.

General and administrative expenses totaled $1,249,947 for the three months ended June 30, 2009 compared to $1,318,708 for the same period of 2008. The decrease of $68,761 or 5% for the three months ended June 30, 2009 compared to the comparable period in 2008 was primarily attributable to a reduction in legal expenses.

Depreciation and amortization expenses totaled $21,424 for the three months ended June 30, 2009 compared to $15,780 for the same period of 2008. The increase of $5,644 or 36% for the three months ended June 30, 2009 compared to the comparable period in 2008 was primarily attributable to fixed asset and patent filing fee additions over the past year.

Nonoperating income (expense) totaled ($465,283) and $10,545 for the three months ended June 30, 2009 and 2008, respectively.

Interest income totaled $8,516 for the three months ended June 30, 2009 compared to $10,545 for the same period of 2008. The decrease of $2,029 for the three months ended June 30, 2009 compared to the comparable period in 2008 was attributable to lower cash balances.

On January 1, 2009 we reclassified the fair value of common stock purchase warrants, which have exercise price reset and anti-liquidation features, from equity to liability status as if these warrants were treated as a derivative liability since their date of issue. We established a long-term warrant liability of $6.6 million to recognize the fair value of such warrants. In the three months ended March 30, 2009, the fair value of these common stock purchase warrants decreased because of a decrease in the stock price, resulting in a gain for the quarter. In the three months ended June 30, 2009, the fair value of these common stock purchase warrants increased to $3.2 million because of an increase in the stock price. We recognized a $0.5 million non-cash expense from the change in fair value of these warrants for the three months ended June 30, 2009.

Results of Operations for the Six Months ending June 30, 2009 and 2008

The company did not have revenues for the six months ended June 30, 2009 and 2008, respectively.
We do not anticipate any revenues for 2009.

Operating expenses totaled $5,636,208 and $5,263,986 for the six months ended June 30, 2009 and 2008. About half of the increase of $372,222 for the six months ended June 30, 2009 compared to the comparable period in 2008 was attributable to an increase in non-cash stock compensation expense. Most of the remainder was due to increased legal costs.

Research and development expenses totaled $2,886,802 for the six months ended June 30, 2009 compared to $2,832,572 for the same period of 2008. The increase of $54,230 for the six months ended June 30, 2009 compared to the comparable period in 2008 was primarily attributable to the costs of completing the application to the FDA to move our tissue based products into clinical trials and other operating expenses in the first quarter of this year.

General and administrative expenses totaled $2,707,186 for the six months ended June 30, 2009 compared to $2,401,877 for the same period of 2008. The increase of $305,309 or 13% for the six months ended June 30, 2009 compared to the same period in 2008 was primarily attributable to increased litigation expenses and an increase in non-cash stock-based compensation expense.

Depreciation and amortization expenses totaled $42,220 for the six months ended June 30, 2009 compared to $29,537for the same period of 2008. The increase of $12,683 or 43% for the six months ended June 30, 2009 compared to the same period in 2008 was primarily attributable to fixed asset and patent filing fee additions over the past year.

Nonoperating (expense) income totaled $3,341,439 and $31,862 for the six months ended June 30, 2009 and 2008, respectively. The nonoperating income or expense are discussed below.

Interest income totaled $10,780 for the six months ended June 30, 2009 compared to $31,862 for the same period of 2008. The decrease of $21,082 for the six months ended June 30, 2009 compared to the comparable period in 2008 was attributable to lower cash balances and much reduced interest rates on short term savings.

Gain (loss) from change in fair value of warrant obligations

On January 1, 2009 we reclassified the fair value of common stock purchase warrants, which have exercise price reset and anti-liquidation features, from equity to liability classification as if these warrants were treated as a derivative liability since their date of issue. We established a long-term warrant liability of $6.6 million to recognize the fair value of such warrants. In the first quarter ended March 30, 2009, the fair value of these common stock purchase warrants decreased because of a decrease in the stock price, resulting in a gain for the quarter. In the three months ended June 30, 2009, the fair value of these common stock purchase warrants increased to $3.2 million because of an

increase in the stock price. We recognized a $473,799 non-cash expense from the change in fair value of these warrants for the three months ended June 30, 2009. The net gain for the six month period ended June 30, 2009 is $3,341,659.

LIQUIDITY AND CAPITAL RESOURCES

Since our inception, we have financed our operations through the private placement of our securities, the exercise of investor warrants, and to a lesser degree from research grants. Our currently monthly cash burn rate is approximately $500,000. We anticipate that our available cash will be sufficient to finance most of our current activities for at least the next 6 months from June 30, 2009, although certain activities and related personnel may need to be reduced.

On December 18, 2008, we filed our first IND with the FDA. In the event the FDA approves our IND, we expect additional costs related to the trial this year of about $350,000. Assuming approval of the IND, we estimate that we will have sufficient cash and cash equivalents to finance our current operations, pre-clinical and clinical work for at least 6 months from June 30, 2009. We cannot assure you that public or private financing or grants will be available on acceptable terms, if at all. Several factors will affect our ability to raise additional funding, including, but not limited to, the volatility of our common shares and general market conditions.

	Six Months Ended June 30,	
	2009	2008
Cash and cash equivalents	$ 3,218,321	$ 6,966,587
Net cash used in operating activities	$ (2,528,277)	$ (3,078,260)
Net cash used in investing activities	$ (60,072)	$ (83,677)
Net cash provided by financing activities	$ 903,391	$ 2,724,787

Total cash and cash equivalents was $3,218,321 and $6,966,587 for the six months ended June 30, 2009 and 2008, respectively. The decrease in our cash and cash equivalents of $3,748,266 or 54% for the six months ended June 30, 2009 compared to the same period in 2008 was primarily attributed to placement of our common equity of $2,573,937 in the first quarter of 2008 vs. $1,000,000 in the second quarter of 2009, an increase of $300,000 in short term financing by vendors, employees and other service providers in the first quarter of 2009. The Company also accelerated research and development spending in the first quarter of 2009 to prepare for clinical trials and experienced higher legal fees due to litigation.

Net Cash Used in Operating Activities

In our operating activities we used $2,528,277 for the six months ended June 30, 2009 compared to $3,078,260 for the same period in 2008. The decrease in our cash of $549,983 or 18% for the six months ended June 30, 2009 compared to the same period in 2008 was primarily attributable to an increase of $300,000 in short term financing by vendors, employees and other service providers in the first quarter of 2009 and a reduction in spending particularly in research.

Net Cash Used in Investing Activities

In our investment activities we used $60,072 for the six months ended June 30, 2009 compared to $86,677 for the same period of 2008. The decrease in our cash of $23,605 or 31% for the six months ended June 30, 2009 compared to the same period in 2008 was primarily attributable to the fact that we had a decrease in our investment in property and equipment.

Net Cash Provided by Financing Activities

Cash provided by financing activities was $903,391for the six months ended June 30, 2009, compared to $2,724,787 for the same period of 2008.

Listed below are key financing transactions entered into by us. Also, please refer to the section of this Quarterly Report entitled “Recent Sale of Unregistered Securities” for a further description of the following transactions:

- In February of 2008, we sold a strategic purchaser $2,500,000 of our common stock.
- On December 18, 2008, we sold $2,000,000 of common stock pursuant to our shelf registration statement on Form S-3.
- On June 30, 2009, we sold $1,000,000 of common stock and warrants to purchase an additional 2,440,000 common shares pursuant to our shelf registration statement on Form S-3.

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

We intend to pursue opportunities to obtain additional financing in the future through the sale of our securities and additional research grants. We have a shelf registration statement which was declared effective on September 29, 2008 and covers up to approximately $25,000,000 of our securities that could be available for financings. On December 18, 2008 and June 30, 2009, we filed Prospectus Supplements under which we sold securities with an aggregate market value pursuant to General Instruction I.B.6. of Form S-3, of $6,167,520. Accordingly, depending on our market capitalization and other restrictions and conditions contained in General Instruction I.B.6. of Form S-3, we may be able to sell up to an additional $18,832,420 pursuant to our shelf registration statement.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are not required to provide the information required by this items as we are considered a smaller reporting company, as defined by Rule 229.10(f)(1).

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed in the Quarterly Reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time period specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Based on management's evaluation (with the participation of our CEO and Chief Financial Officer (CFO)), as of the end of the period covered by this report, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

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

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As of the date of this Quarterly Report, there are no material pending legal or governmental proceedings relating to our company or properties to which we are a party, and to our knowledge there are no material proceedings to which any of our directors, executive officers or affiliates are a party adverse to us or which have a material interest adverse to us, other than the following:

On May 7, 2008, Neuralstem filed suit against StemCells, Inc., StemCells California, Inc. (collectively "StemCells") and Neurospheres Holding Ltd., (collectively StemCells and Neurospheres Holding Ltd. are referred to as "Defendants") in U.S. District Court for the District of Maryland, alleging that U.S. Patent No. 7,361,505 (the "'505 patent"), alleging that the 505 patent was exclusively licensed to the Plaintiffs, is invalid, not infringed, and unenforceable. See Civil Action No. 08-1173. StemCells filed a near "mirror image" lawsuit in California the same day which was subsequently transferred to Maryland. See Civil Action No. 08-2664. On May 13, Neuralstem filed an Amended Complaint seeking declaratory judgment that U.S. Patent No. 7,155,418 (the "'418 patent") is invalid and not infringed and that certain statements made by our CEO are not trade libel or do not constitute unfair competition as alleged by the

Plaintiffs. On July 15, 2008, the Defendants filed a Motion to Dismiss for Lack of Subject Matter Jurisdiction, Lack of Personal Jurisdiction, and Improper Venue or in the Alternative to Transfer to the Northern District of California. On August 27, 2008, Judge Alexander Williams, Jr. of the District of Maryland denied StemCells' Motion to Dismiss, but granted Neurospheres' motion to dismiss. On September 11, 2008, StemCells filed its answer asserting counterclaims of infringement for the '505 patent, the '418 patent, and state law claims for trade libel and unfair competition. Discovery has started in this case, but not trial date has been set. This matter has also been consolidated with Civil Action Nos. 06-1877 and 08-2664. It is not known when nor on what basis these matters will be concluded

On July 28, 2006, StemCells, Inc. and StemCells California, Inc. ("StemCells") filed suit against Neuralstem, Inc. in the U.S. District Court in Maryland, alleging that Neuralstem has been infringing, contributing to the infringement of, and or inducing the infringement of four patents owned by or exclusively licensed to StemCells relating to stem cell culture compositions, genetically modified stem cell cultures, and methods of using such cultures (Civil Action No. 06-1877). The case was stayed for approximately two years pending reexamination proceedings in the United States Patent & Trademark Office. The stay in this case was recently lifted and this matter was consolidated with Civil Action Nos. 08-1173 and 08-2664. Discovery has started, but no trial date has been set. It is not known when nor on what basis this matter will be concluded

ITEM 1A. RISK FACTORS

Investing in our common stock involves a high degree of risk. We have described below a number of uncertainties and risks which, in addition to uncertainties and risks presented elsewhere in this Quarterly Report, may adversely affect our business, operating results and financial condition. The uncertainties and risks enumerated below as well as those presented elsewhere in this Quarterly Report should be considered carefully in evaluating our company and our business and the value of our securities.

The occurrence of any event detailed in the following risk factors could result in a substantial decrease in the value of our securities

Risks Relating to Our Stage of Development

We have a limited operating history and have significantly shifted our operations and strategies since inception.

Since inception in 1996 and through June 30, 2009, we have raised $58,079,468 of capital and recorded accumulated losses totaling $59,486,237. On June 30, 2009, we had a working capital surplus of $1,377,344 and stockholders' (deficit) equity of $(1,406,769). Our net losses for the two most recent fiscal years have been $11,830,798 and $7,063,272 for 2008 and 2007 respectively. Our net loss for the six month period ended June 30, 2009 was $2,283,769. We had no revenues for the six months ended June 30, 2009.

Our ability to generate revenues and achieve profitability will depend upon our ability to complete the development of our proposed stem cell products, obtain the required regulatory approvals, manufacture, and market and sell our proposed products. In part because of our past operating results, no assurances can be given that we will be able to accomplish any of these goals.

Although we have generated some revenue in prior years, we have not generated any revenue from the commercial sale of our proposed stem cell products. Since inception, we have engaged in several related lines of business and have discontinued operations in certain areas. For example, in 2002, we lost a material contract with the Department of Defense and were forced to close our principal facility and lay off almost all of our employees in an attempt to focus our development strategy on stem cell technologies. This limited and changing history may not be adequate to enable you to fully assess our current ability to develop and commercialize our technologies and proposed products, obtain approval from the FDA, achieve market acceptance of our proposed products, and respond to competition. No assurances can be given as to exactly when, if at all, we will be able to fully develop, commercialize, market, sell and/or derive material revenues from our proposed products.

We will need to raise additional capital to continue operations.

Since inception, we have relied almost entirely on external financing to fund operations. Such financing has primarily come primarily from the sale of common stock and the exercise of investor warrants. As of June 30, 2009, we had cash and cash equivalents on hand of $3,218,321. Presently, we have a monthly cash burn rate of approximately $500,000. We will need to raise additional capital to fund anticipated operating expenses and future expansion. Among other things, external financing will be required to cover the further development of our technologies and products, as well as general operating costs. On December 18, 2008, we filed our first IND to commence clinical trials on one of our proposed products. On February 20, 2009, we received notification from the FDA that our IND was on clinical hold pending our submission of additional information and modifications to our IND protocols. In the event the IND is approved, we expect additional cost related to the trials to be phased in slowly over the following 12 months.

We have expended and expect to continue to expend substantial cash in the research, development, clinical and pre-clinical testing of our stem cell technologies with the goal of ultimately obtaining FDA approval to market our proposed products. We will require additional capital to conduct research and development, establish and conduct clinical and pre-clinical trials, enter into commercial-scale manufacturing arrangements and to provide for marketing and distribution of our products.

Our long term capital requirements are expected to depend on many factors, including:

- the continued progress and costs of our research and development programs;
- the progress of pre-clinical studies and clinical trials;
- the time and costs involved in obtaining regulatory clearance;
- the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims;
- the costs of developing sales, marketing and distribution channels and our ability to sell our products if developed;
- the costs involved in establishing manufacturing capabilities for commercial quantities of our proposed products;
- competing technological and market developments;
- market acceptance of our proposed products;
- the costs of recruiting and retaining employees and consultants; and
- the costs associated with educating and training physicians about our proposed products.

We cannot assure you that financing whether from external sources or related parties will be available if needed. If additional financing is not available when required or is not available on acceptable terms, we may not be unable to fund operations and planned growth, develop or enhance our technologies, take advantage of business opportunities or respond to competitive market pressures. Also, we may have to delay, reduce the scope of, or eliminate one or more of our research, development or commercialization programs, which may materially harm our business, financial condition and results of operations.

26

Additional financing requirements could result in dilution to existing stockholders.

We are not able to finance our operations through the sale of our products. Accordingly, we will be required to secure additional financing which may be dilutive to current shareholders. We are authorized to issue 150,000,000 shares of common stock and 7,000,000 shares of preferred stock. Such securities may generally be issued without the approval or consent of our stockholders.

Risks Relating to Intellectual Property and Government Regulation

We may not be able to withstand challenges to our intellectual property rights.

We rely on our intellectual property, including issued and applied-for patents, as the foundation of our business. Our intellectual property rights may come under challenge. No assurances can be given that, even though issued, our current and potential future patents will survive such challenges. For example, in 2005 our neural stem cell technology was challenged in the U.S. Patent and Trademark Office. Although we prevailed in this particular matter upon re-examination by the patent office, these cases are complex, lengthy, expensive, and could potentially be adjudicated adversely to our interests, removing the protection afforded by an issued patent. The viability of our business would suffer if such patent protection were limited or eliminated. Moreover, the costs associated with defending or settling intellectual property claims would likely have a material adverse effect on our business and future prospects. At present, there is litigation with StemCells, Inc. which is in its initial stages and any likely outcome is difficult to predict. For a further description of pending litigation, see Item 1. of Part II to the Quarterly Report entitled “Legal Proceedings.”

We may not be able to adequately protect against the piracy of the intellectual property in foreign jurisdictions.

We anticipate conducting research in countries outside of the United States. A number of our competitors are located in these countries and may be able to access our technology or test results. The laws protecting intellectual property in some of these countries may not adequately protect our trade secrets and intellectual property. The misappropriation of our intellectual property may materially impact our position in the market and any competitive advantages, if any, that we may have.

Our products may not receive regulatory approval.

The FDA and comparable government agencies in foreign countries impose substantial regulations on the manufacturing and marketing of pharmaceutical products through lengthy and detailed laboratory, pre-clinical and clinical testing procedures, sampling activities and other costly and time-consuming procedures. Satisfaction of these regulations typically takes several years or more and vary substantially based upon the type, complexity and novelty of the proposed product. On December 18, 2008, we submitted our first IND application to the FDA. On February 20, 2009 we received notification from the FDA that our IND was on clinical hold pending our submission of additional information and modifications to our IND protocols. We cannot assure you when or if such IND application will be granted, nor can we assure you that if the IND is granted, that we will successfully complete any clinical trials in connection with such IND. Further, we cannot yet accurately predict when we might first submit any product license application for FDA approval or whether any such product license application will be granted on a timely basis, if at all. Moreover, we cannot assure you that FDA approvals for any products developed by us will be granted on a timely basis, if at all. Any delay in obtaining, or failure to obtain, such approvals could have a material adverse effect on the marketing of our products and our ability to generate product revenue.

Development of our technologies is 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, and restricted by, extensive regulation by governmental authorities in the United States and other countries. The process of obtaining FDA and other necessary regulatory approvals is lengthy, expensive and uncertain. FDA and other legal and regulatory requirements applicable to the development and manufacture of the cells and cell lines required for our preclinical and clinical products could substantially delay or prevent us from producing the cells needed to initiate additional clinical trials. We may fail to obtain the necessary approvals to commence clinical testing or to manufacture or market our potential products in reasonable time frames, if at all. In addition, the U.S. 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 cells obtained from human tissue. The U.S. federal and state governments and other jurisdictions impose restrictions on the acquisition and use of human tissue, including those incorporated in federal Good Tissue Practice, or cGTP, regulations. These regulatory and other constraints could prevent us from obtaining cells and other components of our products in the quantity or of the quality needed for their development or commercialization. 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 laws and guidelines for cell procurement. Certain components used to manufacture our stem and progenitor cell product candidates will need to be manufactured in compliance with the FDA's Good Manufacturing Practices, or cGMP. Accordingly, we will need to enter into supply agreements with companies that manufacture these components to cGMP standards. There is no assurance that we will be able to enter into any such agreements.

Noncompliance with applicable requirements both before and after approval, if any, can subject us, our third party suppliers and manufacturers and our other collaborators to administrative and judicial sanctions, such as, among other things, warning letters, fines and other monetary payments, recall or seizure of products, criminal proceedings, suspension or withdrawal of regulatory approvals, interruption or cessation of clinical trials, total or partial suspension of production or distribution, injunctions, limitations on or the elimination of claims we can make for our products, refusal of the government to enter into supply contracts or fund research, or government delay in approving or refusal to approve new drug applications.

We cannot predict if or when we will be permitted to commercialize our products due to regulatory constraints.

Federal, state and local governments and agencies in the United States (including the FDA) and governments in other countries have significant regulations in place that govern many of our activities. We are or may become subject to various federal, state and local laws, regulations and recommendations relating to safe working conditions, laboratory and manufacturing practices, the experimental use of animals and the use and disposal of hazardous or potentially hazardous substances used in connection with its research and development work. The preclinical testing and clinical trials of our proposed products are subject to extensive government regulation that may prevent us from creating commercially viable products. In addition, our sale of any commercially viable product will be subject to government regulation from several standpoints, including manufacturing, advertising, marketing, promoting, selling, labeling and distributing. If, and to the extent that, we are unable to comply with these regulations, our ability to earn revenues will be materially and negatively impacted.

Risks Relating to Our Business

Our business relies on stem cell technologies that we may not be able to commercially develop.

We have concentrated our research on stem cell technologies Our ability to generate revenue and operate profitably will depend on being able to develop these technologies for human applications. These are emerging technologies and have limited human applications. We cannot guarantee that we will be able to develop our technologies or that such development will result in products with any commercial utility or value. We anticipate that the commercial sale of such products and royalty/licensing fees related to the technology, will be our primary sources of revenues. If we are unable to develop the technologies, investors will likely lose their entire investment.

Our product development programs are based on novel technologies and are inherently risky.

We are subject to the risks of failure inherent in the development of products based on new technologies. The novel nature of these therapies creates significant challenges in regard to product development and optimization, manufacturing, government regulation, third party reimbursement, and market acceptance. For example, the pathway to regulatory approval for cell-based therapies, including our product candidates, may be more complex and lengthy than the pathway for conventional drugs. These challenges may prevent us from developing and commercializing products on a timely or profitable basis or at all.

Our inability to complete pre-clinical and clinical testing and trials will impair our viability.

On December 18, 2008, we submitted our first IND application to the FDA. On February 20, 2009, the FDA provided us with specific comments, questions and recommendations for modification to the protocol submitted in our IND. The trial is on clinical hold. We are in the process of analyzing the notice and the FDA's comments and recommendations. Even if we eventually receive approval from the FDA to commence clinical trials, the outcome of pre-clinical, clinical and product testing of our products is uncertain. If we are unable to satisfactorily complete testing, or if such testing yields unsatisfactory results, we will be unable to commercially produce its proposed products. Before obtaining regulatory approvals for the commercial sale of any potential human products, our products will be subjected to extensive pre-clinical and clinical testing to demonstrate their safety and efficacy in humans. No assurances can be given that the clinical trials will demonstrate the safety and efficacy of such products at all, or to the extent necessary to obtain appropriate regulatory approvals, or that the testing of such products will be completed in a timely manner, if at all, or without significant increases in costs, program delays or both, all of which could harm our ability to generate revenues. In addition, our proposed products may not prove to be more effective for treating disease or injury than current therapies. Accordingly, we may have to delay or abandon efforts to research, develop or obtain regulatory approval to market its proposed products. Many companies involved in biotechnology research and development have suffered significant setbacks in clinical trials, even after promising results in earlier trials. The failure to adequately demonstrate the safety and efficacy of a therapeutic product under development could delay or prevent regulatory approval of the product and could harm our ability to generate revenues, operate profitably or produce any return on an investment.

Our proposed products may not have favorable results in clinical trials or receive regulatory approval.

Positive results from pre-clinical studies should not be relied upon as evidence that clinical trials will succeed. Even if our product candidates achieve positive results in clinical studies, we will be required to demonstrate through clinical trials that the product candidates are safe and effective for use in a diverse population before we can seek regulatory approvals for their commercial sale. There is typically an extremely high rate of attrition from the failure of product candidates as they proceed through clinical trials. If any product candidate fails to demonstrate sufficient safety and efficacy in any clinical trial, then we would experience potentially significant delays in, or be required to abandon,

development of that product candidate. If we delay or abandon our development efforts of any of our product candidates, then we may not be able to generate sufficient revenues to become profitable, and our reputation in the industry and in the investment community would likely be significantly damaged, each such outcome would cause our stock price to decrease significantly.

The commencement of clinical testing of our potential product candidates may be delayed.

The commencement of clinical trials may be delayed for a variety of reasons, including:

- delays in demonstrating sufficient safety and efficacy in order to obtain regulatory approval to commence clinical trials;
- delays in reaching agreement on acceptable terms with contract research organizations and clinical trial sites;
- delays in manufacturing quantities of a product candidate sufficient for clinical trials;
- delays in obtaining approval of an IND from the FDA or similar foreign approvals;
- delays in obtaining institutional review board approval to conduct a clinical trial at a prospective site; and
- insufficient financial resources.

In addition, the commencement of clinical trials may be delayed due to insufficient patient enrollment, which is a function of many factors, including the size of the patient population, the nature of the protocol, the proximity of patients to clinical sites, the availability of effective treatments for the relevant disease, and the eligibility criteria for the clinical trial. Delays in the commencement of clinical testing of our product candidates could significantly increase our product development costs and delay product commercialization. In addition, many of the factors that may cause, or lead to, a delay in the commencement of clinical trials may also ultimately lead to a denial of regulatory approval of a product candidate.

There are no assurances that we will be able to submit or obtain FDA approval of a biologics license application.

There can be no assurance that if the clinical trials of any potential product candidate are successfully initiated and completed, we will be able to submit a Biologics License Application ("BLA") to the FDA or that any BLA we submit will be approved in a timely manner, if at all. If we are unable to submit a BLA with respect to any future product candidate, or if any BLA we submit is not approved by the FDA, we will be unable to commercialize that product. The FDA can and does reject BLAs and requires additional clinical trials, even when product candidates performed well or achieved favorable results in clinical trials. If we fail to commercialize our product candidate, we may be unable to generate sufficient revenues to attain profitability and our reputation in the industry and in the investment community would likely be damaged, each of which would cause our stock price to decrease.

The manufacturing of cell-based therapeutic products is novel and dependent upon specialized key materials.

The manufacturing of cell-based therapeutic products is a complicated and difficult process, dependent upon substantial know-how and subject to the need for continual process improvements. We depend almost exclusively on third party manufacturers to supply our cells. In addition, our suppliers' ability to scale-up manufacturing to satisfy the various requirements of our planned clinical trials is uncertain. Manufacturing irregularities or lapses in quality control could have a material adverse effect on our reputation and business, which could cause a significant loss of stockholder value. Many of the materials that we use to prepare our cell-based products are highly specialized, complex and available from only a limited number of suppliers. At present, some of our material requirements are single sourced, and the loss of one or more of these sources may adversely affect our business.

Our business is subject to ethical and social concerns.

The use of stem cells for research and therapy has been the subject of debate regarding ethical, legal and social issues. Negative public attitudes toward stem cell therapy could result in greater governmental regulation of stem cell therapies, which could harm our business. For example, concerns regarding such possible regulation could impact our ability to attract collaborators and investors. Existing and potential U.S. government regulation of human tissue may lead researchers to leave the field of stem cell research or the country altogether, in order to assure that their careers will not be impeded by restrictions on their work. Similarly, these factors may induce graduate students to choose other fields less vulnerable to changes in regulatory oversight, thus exacerbating the risk that we may not be able to attract and retain the scientific personnel we need in the face of competition among pharmaceutical, biotechnology and health care companies, universities and research institutions for what may become a shrinking class of qualified individuals.

We may be subject to litigation that will be costly to defend or pursue and uncertain in its outcome.

Our business may bring us into conflict with licensees, licensors, or others with whom we have contractual or other business relationships or with our competitors or others whose interests differs from ours. If we are unable to resolve these conflicts on terms that are satisfactory to all parties, we may become involved in litigation brought by or against it. Any litigation is likely to be expensive and may require a significant amount of management's time and attention, at the expense of other aspects of our business. The outcome of litigation is always uncertain, and in some cases could include judgments against us which could have a materially adverse effect on our business. By way of example, in May of 2008, we filed a complaint against StemCells Inc., alleging that U.S. Patent No. 7,361,505 (the "'505 patent"), allegedly exclusively licensed to StemCells, Inc., is invalid, not infringed and unenforceable. On the same day, StemCells, Inc. filed a complaint alleging that we had infringed, contributed to the infringement of, and or induced the infringement of two patents owned by or exclusively licensed to StemCells relating to stem cell culture compositions. At present, the litigation is in its initial stages and any likely outcome is difficult to predict. For a further description of pending litigation, see Item 1. of Part II to the Quarterly Report entitled "Legal Proceedings."

We may not be able to obtain third-party patient reimbursement or favorable product pricing.

Our ability to successfully commercialize our proposed products in the human therapeutic field depends to a significant degree on patient reimbursement of the costs of such products and related treatments. We cannot assure you that reimbursement in the United States or foreign countries will be available for any products developed, or, if available, will not decrease in the future, or that reimbursement amounts will not reduce the demand for, or the price of, our products. The Company cannot predict what additional regulation or legislation relating to the health care industry or third-party coverage and reimbursement may be enacted in the future or what effect such regulation or legislation may have on our business. If additional regulations are overly onerous or expensive or if health care related legislation makes our business more expensive or burdensome than originally anticipated, we may be forced to significantly downsize our business plans or completely abandon the current business model.

Our products may not be profitable due to manufacturing costs.

Our products may be significantly more expensive to manufacture than other drugs or therapies currently on the market today due to a fewer number of potential manufacturers, greater level of needed expertise and other general market conditions affecting manufacturers of stem cell based products. Accordingly, we may not be able to charge a high enough price for us to make a profit from the sale of our cell therapy products. If we are unable to realize significant profits from our potential product candidates, its business would be materially harmed.

We are dependent on the acceptance of our products by the health care community.

Our proposed products, if approved for marketing, may not achieve market acceptance since hospitals, physicians, patients or the medical community in general may decide not to accept and utilize these products. The products that we are attempting to develop represent substantial departures from established treatment methods and will compete with a number of more conventional drugs and therapies manufactured and marketed by major pharmaceutical companies. The degree of market acceptance will depend on a number of factors, including:

- the clinical efficacy and safety of our proposed products;
- the superiority of our products to alternatives currently on the market;
- the potential advantages of our products over alternative treatment methods; and