BANK OF NOVA SCOTIA /
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Pricing Supplement dated April 22, 2014 to the

Prospectus dated August 1, 2013

Prospectus Supplement and Product Prospectus Supplement (Equity Linked Index Notes, Series A) dated August 8, 2013

The Bank of Nova Scotia

$5,375,000

Capped Buffered Enhanced Participation Notes, Series A

Linked to the MSCI EAFE Index

Due April 27, 2016

The notes will not bear interest. The amount that you will be paid on your notes at maturity is based on the performance of the MSCI EAFE Index (which we refer to as the Reference Asset) as measured from the trade date to and including the valuation date**. If the percentage change (defined below) of the Reference Asset is less than -10.00% (the final level is less than the initial level by more than 10.00%), you will lose a portion of your investment in the notes on an accelerated basis and you may lose all or a substantial portion of your investment depending on the performance of the Reference Asset. Additionally, the amount you may receive for each $1,000 principal amount of your notes at maturity is subject to a maximum redemption amount of $1,186.25. Any payment on your notes is subject to the creditworthiness of The Bank of Nova Scotia.**

To determine your payment at maturity, we will first calculate the percentage increase or decrease in the final level (determined on the valuation date, subject to adjustment) from the initial level of 1,927.00, which we refer to as the percentage change. The percentage change may reflect a positive return (based on any increase in the level of the Reference Asset over the life of the notes) or a negative return (based on any decrease in the level of the Reference Asset over the life of the notes). At maturity, for each $1,000 principal amount of your notes:

If the final level is greater than the initial level (the percentage change is positive), you will receive an amount in cash equal to the sum of (i) $1,000 plus (ii) the product of $1,000 times the percentage change, times the participation rate of 125.00% subject to the maximum redemption amount;
if the final level is *less than or equal to the initial level but not by more than 10.00% (the percentage change is zero or negative, but not below -10.00%) you will receive an amount in cash equal to $1,000; or*
if the final level is less than the initial level by more than 10.00% (the percentage change is *negative and is below -10.00%*), you will receive an amount in cash equal to the sum of: (1) $1,000 plus (2) the *product* of (i) $1,000 *times* (ii) approximately 111.11% times (iii) the sum of the percentage change plus 10.00%. You will receive less than $1,000.

Following the determination of the initial level, the amount you will be paid on your notes at maturity will not be affected by the closing level of the Reference Asset on any day other than the valuation date. You could lose all or a substantial portion of your investment in the notes. Any percentage decrease of more than 10.00% between the initial level and the final level will reduce the payment you will receive at maturity below the principal amount of your notes. Further, the maximum payment that you could receive at maturity with respect to each $1,000 principal amount of your notes (the minimum denomination) is limited to the maximum redemption amount of $1,186.25. In addition, the notes will not bear interest, and no other payments on your notes will be made prior to maturity.

The estimated value of your Notes on the trade date (as determined by reference to pricing models used by Goldman, Sachs & Co. (GS&Co.) and taking into account our credit spreads) is approximately $960 per $1,000 face amount, which is less than the original issue price. The value of your Notes at any time will reflect many factors and cannot be predicted; however, the price (not including GS&Co.'s customary bid and ask spreads) at which GS&Co. would initially buy or sell Notes (if it makes a market, which it is not obligated to do) and the value that GS&Co. will initially use for account statements and otherwise equals approximately $990 per $1,000 face amount, which exceeds the estimated value of your Notes as determined by reference to these models. The amount of the excess will decline on a straight line basis over the period from the trade date through August 22, 2014.

The Capped Buffered Enhanced Participation Notes, Series A Linked to the MSCI EAFE Index Due April 27, 2016 (the "Notes") offered hereunder are unsecured obligations of The Bank of Nova Scotia (the "Bank") and are subject to investment risks including possible loss of the principal amount invested due to the negative performance of the Reference Asset and the credit risk of The Bank of Nova Scotia. As used in this pricing supplement, the "Bank," "we," "us" or "our" refers to The Bank of Nova Scotia.

The Notes will not be listed on any U.S. securities exchange or automated quotation system.

The return on your Notes will relate to the price return of the Reference Asset and will not include a total return or dividend component. The Notes are derivative products based on the performance of the Reference Asset. The Notes do not constitute a direct investment in any of the shares, units or other securities represented by the Reference Asset. By acquiring Notes, you will not have a direct economic or other interest in, claim or entitlement to, or any legal or beneficial ownership of any such share, unit or security and will not have any rights as a shareholder, unitholder or other security holder of any of the issuers including, without limitation, any voting rights or rights to receive dividends or other distributions.

Neither the United States Securities and Exchange Commission ("SEC"), Nor ANY state securities commission has approved or disapproved of the Notes or passed upon the accuracy or the adequacy of this document, the accompanying prospectus, prospectus supplement or product prospectus supplement. Any representation to the contrary is a criminal offense. THE NOTES ARE NOT INSURED by the Canada Deposit Insurance Corporation pursuant to the Canada Deposit Insurance Corporation Act OR THE U.S. FEDERAL DEPOSIT INSURANCE CORPORATION OR ANY OTHER GOVERNMENTAL AGENCY OF CANADA, THE UNITED STATES OR ANY OTHER JURISDICTION.

Scotia Capital (USA) Inc., our affiliate, will purchase the Notes from us for distribution to other registered broker dealers or will offer the Notes directly to investors. Scotia Capital (USA) Inc. or any of its affiliates or agents may use this pricing supplement in market-making transactions in Notes after their initial sale. Unless we, Scotia Capital (USA) Inc. or another of its affiliates or agents selling such Notes to you informs you otherwise in the confirmation of sale, this pricing supplement is being used in a market-making transaction. See "Supplemental Plan of Distribution (Conflicts of Interest)" in this pricing supplement and "Supplemental Plan of Distribution" on page PS-30 of the accompanying product prospectus supplement.

	Per Note	Total

Price to public	100.00%	$5,375,000.00
Underwriting commissions[1]	1.75%	$94,062.50
Proceeds to The Bank of Nova Scotia[2]	98.25%	$5,280,937.50

Investment in the Notes involves certain risks. You should refer to "Additional Risks" in this pricing supplement and "Additional Risk Factors Specific to the Notes" beginning on page PS-5 of the accompanying product prospectus supplement and "Risk Factors" beginning on page S-2 of the accompanying prospectus supplement and on page 6 of the accompanying prospectus.

We may decide to sell additional Notes after the date of this pricing supplement, at issue prices and with underwriting discounts and net proceeds that differ from the amounts set forth above. We will deliver the Notes in book-entry form through the facilities of The Depository Trust Company ("DTC") on or about April 29, 2014 against payment in immediately available funds.

Scotia Capital (USA) Inc. Goldman, Sachs & Co.

[1] Scotia Capital (USA) Inc. or one of our affiliates will purchase the Notes at the Principal Amount and as part of the distribution of the Notes may pay varying discounts and underwriting commissions of up to $17.50 per $1,000 Principal Amount of Notes in connection with the distribution of the Notes. Scotia Capital (USA) Inc. may separately receive a structuring and development fee of up to $0.50 per $1,000 Principal Amount of Notes. See "Supplemental Plan of Distribution (Conflicts of Interest)" in this pricing supplement.

[2] Excludes profits from hedging. For additional considerations relating to hedging activities see "Additional Risks—The Inclusion of Dealer Spread and Projected Profit from Hedging in the Original Issue Price is Likely to Adversely Affect Secondary Market Prices" in this pricing supplement.

The difference between the estimated value of your Notes and the original issue price reflects costs that the Bank or its affiliates expect to incur and profits that the Bank or its affiliates expect to realize in connection with hedging activities related to the Notes. These costs and profits will likely reduce the secondary market price, if any secondary market develops, for the Notes. As a result, you may experience an immediate and substantial decline in the market value of your Notes on the trade date and you may lose all or a substantial portion of your initial investment. The Bank's profit in relation to the Notes will vary based on the difference between (i) the amounts received by the Bank in connection with the issuance and the reinvestment return received by the Bank in connection with those funds and (ii) the costs incurred by the Bank in connection with the issuance of the Notes and the hedging transactions it enters into with its affiliates or Goldman, Sachs & Co. The Bank's affiliates and Goldman, Sachs & Co. will also realize a profit that will be based on the (i) cost of creating and maintaining the hedging transactions minus (ii) the payments received on the hedging transactions.

Summary

The information in this "Summary" section is qualified by the more detailed information set forth in this pricing supplement, the prospectus, the prospectus supplement, and the product prospectus supplement, each filed with the SEC. See "Additional Terms of Your Notes" in this pricing supplement.

Issuer:	The Bank of Nova Scotia (the "Bank")
CUSIP/ISIN:	CUSIP 064159239 / ISIN US0641592391
Type of Notes:	Capped Buffered Enhanced Participation Notes, Series A
Reference Asset:	The MSCI EAFE Index (Bloomberg Ticker: MXEA)
Minimum Investment and Denominations:	$1,000 and integral multiples of $1,000 in excess thereof
Principal Amount:	$1,000 per Note
Original Issue Price:	100% of the Principal Amount of each Note
Currency:	U.S. Dollars
Pricing Date:	April 22, 2014
Trade Date:	April 22, 2014
Original Issue Date:	April 29, 2014
Maturity Date:	April 27, 2016, subject to adjustment as described in more detail in the accompanying product prospectus supplement.
Principal at Risk:	You may lose all or a substantial portion of your initial investment at maturity if there is any percentage decrease from the Initial Level to the Final Level of more than 10.00%.
	Scotia Capital (USA) Inc. or one of our affiliates may pay varying discounts and underwriting commissions of up to $17.50 per $1,000 Principal Amount of Notes in connection with the distribution of the Notes. The underwriting commission set forth on the cover page of this pricing supplement per $1,000 face amount is comprised of $2.50 of underwriting fees and $15.00 of selling commission. Scotia Capital (USA) Inc. may also receive a structuring and development fee of up to $0.50 per $1,000 Principal Amount of Notes.

Fees and Expenses:

The price at which you purchase the Notes includes costs that the Bank or its affiliates expect to incur and profits that the Bank or its affiliates expect to realize in connection with hedging activities related to the Notes, as set forth above. These costs and profits will likely reduce the secondary market price, if any secondary market develops, for the Notes. As a result, you may experience an immediate and substantial decline in the market value of your Notes on the Trade Date. See "Additional Risks—The Inclusion of Dealer Spread and Projected Profit from Hedging in the Original Issue Price is Likely to Adversely Affect Secondary Market Prices" in this pricing supplement.

Payment at Maturity:	The Payment at Maturity will be based on the performance of the Reference Asset and will be calculated as follows: If the Final Level is greater than the Initial Level, then the Payment at Maturity will equal: The lesser of (a) the Principal Amount + (Principal Amount x Percentage Change x Participation Rate) or (b) the Maximum Redemption Amount If the Final Level is greater than or equal to the Buffer Level, but less than or equal to the Initial Level, then the Payment at Maturity will equal the Principal Amount If the Final Level is less than the Buffer Level, then the Payment at Maturity will equal: Principal Amount + [Principal Amount x Buffer Rate x (Percentage Change + Buffer Percentage)] ***In this case you will suffer a loss on your initial investment in an amount equal to the Buffer Rate multiplied by the negative Percentage Change in excess of the Buffer Percentage. Accordingly, you could lose up to 100% of your initial investment.***
Initial Level:	1,927.00
Final Level:	The Final Level of the Reference Asset will be determined based upon the closing level published on the Bloomberg page “MXEA<Index>” or any successor page on Bloomberg or any successor service, as applicable, on the Valuation Date. In certain special circumstances, the final level will be determined by the Calculation Agent, in its discretion, and such determinations will, under certain circumstances, be confirmed by an independent calculation expert. See “General Terms of the Notes—Unavailability of the Level of the Reference Asset on a Valuation Date” and “General Terms of the Notes—Market Disruption Events” beginning on page PS-19 and “Appointment of Independent Calculation Experts” on page PS-22, in the accompanying product prospectus supplement.
Percentage Change:	The Percentage Change, expressed as a percentage, with respect to the Payment at Maturity, is calculated as follows:

Final Level – Initial Level

Initial Level

For the avoidance of doubt, the Percentage Change may be a negative value.

Participation Rate:	125.00%
Buffer Level:	1,734.30
Buffer Percentage:	10.00%
Buffer Rate:	Initial Level , which equals approximately 111.11% Buffer Level

Maximum Redemption Amount:	$1,186.25, which equals Principal Amount x 118.625%. The Maximum Redemption Amount sets a cap on appreciation of the Reference Asset of 14.90%
Valuation Date:	April 22, 2016 The Valuation Date could be delayed by the occurrence of a Market Disruption Event. See "General Terms of the Notes—Market Disruption Events" beginning on page PS-19 in the accompanying product prospectus supplement.
Form of Notes:	Book-entry
Calculation Agent:	Scotia Capital Inc., an affiliate of the Bank
Status:	The Notes will constitute direct, unsubordinated and unsecured obligations of the Bank ranking *pari passu* with all other direct, unsecured and unsubordinated indebtedness of the Bank from time to time outstanding (except as otherwise prescribed by law). Holders will not have the benefit of any insurance under the provisions of the *Canada Deposit Insurance Corporation Act*, the U.S. *Federal Deposit Insurance Act* or under any other deposit insurance regime of any jurisdiction.
Tax Redemption:	The Bank (or its successor) may redeem the Notes, in whole but not in part, at a redemption price determined by the Calculation Agent in a manner reasonably calculated to preserve your and our relative economic positions, if it is determined that changes in tax laws or their interpretation will result in the Bank (or its successor) becoming obligated to pay additional amounts with respect to the Notes. See "Tax Redemption" below.
Listing:	The Notes will not be listed on any securities exchange or quotation system.
Use of Proceeds:	General corporate purposes
Clearance and Settlement:	Depository Trust Company
Business Day:	New York and Toronto
Terms Incorporated:	All of the terms appearing above the item under the caption "General Terms of the Notes" beginning on page PS-14 in the accompanying product prospectus supplement, as modified by this pricing supplement.

INVESTING IN THE NOTES INVOLVES SIGNIFICANT RISKS. YOU MAY LOSE YOUR ENTIRE PRINCIPAL AMOUNT. THE DOWNSIDE MARKET EXPOSURE TO THE REFERENCE ASSET IS BUFFERED ONLY AT MATURITY. ANY PAYMENT ON THE NOTES, INCLUDING ANY REPAYMENT OF PRINCIPAL, IS SUBJECT TO THE CREDITWORTHINESS OF THE BANK. IF THE BANK WERE TO DEFAULT ON ITS PAYMENT OBLIGATIONS YOU MAY NOT RECEIVE ANY AMOUNTS OWED TO YOU UNDER THE NOTES AND YOU COULD LOSE YOUR ENTIRE INVESTMENT.

Additional Terms Of Your Notes

You should read this pricing supplement together with the prospectus dated August 1, 2013, as supplemented by the prospectus supplement dated August 8, 2013 and the product prospectus supplement (Equity Linked Index Notes, Series A) dated August 8, 2013, relating to our Senior Note Program, Series A, of which these Notes are a part. Capitalized terms used but not defined in this pricing supplement will have the meanings given to them in the product prospectus supplement. In the event of any conflict, this pricing supplement will control. ***The Notes may vary from the terms described in the accompanying prospectus, prospectus supplement, and product prospectus supplement in several important ways. You should read this pricing supplement, including the documents incorporated by reference herein, carefully.***

This pricing supplement, together with the documents listed below, contains the terms of the Notes and supersedes all prior or contemporaneous oral statements as well as any other written materials including preliminary or indicative pricing terms, correspondence, trade ideas, structures for implementation, sample structures, brochures or other educational materials of ours. You should carefully consider, among other things, the matters set forth in "Additional Risk Factors Specific to the Notes" in the accompanying product prospectus supplement, as the Notes involve risks not associated with conventional debt securities. We urge you to consult your investment, legal, tax, accounting and other advisors before you invest in the Notes. You may access these documents on the SEC website at www.sec.gov as follows (or if that address has changed, by reviewing our filings for the relevant date on the SEC website at

http://www.sec.gov/cgi-bin/browse-edgar?action=getcompany&CIK=0000009631):

Prospectus dated August 1, 2013:

http://www.sec.gov/Archives/edgar/data/9631/000089109213006699/e54840_424b3.htm

Prospectus Supplement dated August 8, 2013:

http://www.sec.gov/Archives/edgar/data/9631/000089109213006938/e54968_424b3.htm

Product Prospectus Supplement (Equity Linked Index Notes, Series A), dated August 8, 2013

http://www.sec.gov/Archives/edgar/data/9631/000089109213006939/e54971_424b5.htm

The Bank of Nova Scotia has filed a registration statement (including a prospectus, a prospectus supplement, and a product prospectus supplement) with the SEC for the offering to which this pricing supplement relates. Before you invest, you should read those documents and the other documents relating to this offering that we have filed with the SEC for more complete information about us and this offering. You may obtain these documents without cost by visiting EDGAR on the SEC Website at www.sec.gov, or accessing the links above. Alternatively, The Bank of Nova Scotia, any agent or any dealer participating in this offering will arrange to

send you the prospectus, the prospectus supplement and the product prospectus supplement if you so request by calling 1-416-866-3672.

Investor Suitability

The Notes may be suitable for you if:

- You fully understand the risks inherent in an investment in the Notes, including the risk of losing your entire initial investment.
- You can tolerate a loss of up to 100% of your initial investment and are willing to make an investment that may have an accelerated downside risk greater than the downside market risk of an investment in the Reference Asset or in the Reference Asset constituent stocks, subject to the Buffer Percentage.
- You believe that the Reference Asset will appreciate over the term of the Notes and that the appreciation is unlikely to exceed the cap on appreciation set by the Maximum Redemption Amount.

- You are willing to hold the Notes to maturity, a term of approximately 24 months, and accept that there may be little or no secondary market for the Notes.
- You understand and accept that your potential return is limited to the Maximum Redemption Amount and you would be willing to invest in the Notes based on the Maximum Redemption Amount.
- You can tolerate fluctuations in the price of the Notes prior to maturity that may be similar to or exceed the downside fluctuations in the level of the Reference Asset.
- You do not seek current income from your investment.
- You are willing to assume the credit risk of the Bank for all payments under the Notes, and understand that if the Bank defaults on its obligations you may not receive any amounts due to you including any repayment of principal.

The Notes may not be suitable for you if:

- You do not fully understand the risks inherent in an investment in the Notes, including the risk of losing your entire initial investment.
- You require an investment designed to guarantee a full return of principal at maturity.
- You cannot tolerate a loss of all or a substantial portion of your initial investment and are not willing to make an investment that may have an accelerated downside risk greater than the downside market risk as an investment in the Reference Asset or in the Reference Asset constituent stocks, subject to the Buffer Percentage.
- You believe that the level of the Reference Asset will decline during the term of the Notes and the Final Level will likely decline below the Initial Level by a percentage that is greater than the Buffer Percentage, or you believe the Reference Asset will appreciate over the term of the Notes and that the appreciation is likely to equal or exceed the cap on appreciation set by the Maximum Redemption Amount.
- You seek an investment that has unlimited return potential without a cap on appreciation and you would be unwilling to invest in the Notes based on the Maximum Redemption Amount.
- You cannot tolerate fluctuations in the price of the Notes prior to maturity that may be similar to or exceed the downside fluctuations in the level of the Reference Asset.
- You seek current income from your investment or prefer to receive dividends paid on the stocks included in the Reference Asset.
- You are unwilling to hold the Notes to maturity, a term of approximately 24 months, or you seek an investment for which there will be a secondary market.
- You are not willing to assume the credit risk of the Bank for all payments under the Notes.

The investor suitability considerations identified above are not exhaustive. Whether or not the Notes are a suitable investment for you will depend on your individual circumstances and you should reach an investment decision only after you and your investment, legal, tax, accounting and other advisors have carefully considered the suitability of an investment in the Notes in light of your particular circumstances. You should also review ‘‘Additional Risks’’ in this pricing supplement and the ‘‘Additional Risk Factors Specific to the Notes’’ beginning on page PS-5 of the Product Prospectus Supplement for Equity Linked Index Notes, Series A for risks related to an investment in the Notes.

EVENTS OF DEFAULT AND ACCELERATION

If the Notes have become immediately due and payable following an event of default (as defined in the accompanying prospectus) with respect to the Notes, the Calculation Agent will determine the default amount as described below.

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Default Amount

The default amount for your Notes on any day (except as provided in the last sentence under "Default Quotation Period" below) will be an amount, in the specified currency for the principal of your Notes, equal to the cost of having a qualified financial institution, of the kind and selected as described below, expressly assume all our payment and other obligations with respect to your Notes as of that day and as if no default or acceleration had occurred, or to undertake other obligations providing substantially equivalent economic value to you with respect to your Notes. That cost will equal:

- the lowest amount that a qualified financial institution would charge to effect this assumption or undertaking, plus
- the reasonable expenses, including reasonable attorneys' fees, incurred by the trustees of your Notes in preparing any documentation necessary for this assumption or undertaking.

During the default quotation period for your Notes, described below, the trustees and/or the Bank may request a qualified financial institution to provide a quotation of the amount it would charge to effect this assumption or undertaking. If either party obtains a quotation, it must notify the other party in writing of the quotation. The amount referred to in the first bullet point above will equal the lowest — or, if there is only one, the only — quotation obtained, and as to which notice is so given, during the default quotation period. With respect to any quotation, however, the party not obtaining the quotation may object, on reasonable and significant grounds, to the assumption or undertaking by the qualified financial institution providing the quotation and notify the other party in writing of those grounds within two business days after the last day of the default quotation period, in which case that quotation will be disregarded in determining the default amount.

Default Quotation Period

The default quotation period is the period beginning on the day the default amount first becomes due (the "due day") and ending on the third business day after that day, unless:

- no quotation of the kind referred to above is obtained, or
- every quotation of that kind obtained is objected to within five business days after the due day as described above.

If either of these two events occurs, the default quotation period will continue until the third business day after the first business day on which prompt notice of an objection is given as described above. If that quotation is objected to as described above within five business days after that first business day, however, the default quotation period will continue as described in the prior sentence and this sentence.

Qualified Financial Institutions

For the purpose of determining the default amount at any time, a qualified financial institution must be a financial institution organized under the laws of any jurisdiction in the United States of America, Europe or Japan, which at that time has outstanding debt obligations with a stated maturity of one year or less from the date of issue and that is, or whose securities are, rated either:

- A-1 or higher by Standard & Poor's Ratings Services, or any successor, or any other comparable rating then used by that rating agency, or
- P-1 or higher by Moody's Investors Service or any successor, or any other comparable rating then used by that rating agency.

If the Notes have become immediately due and payable following an event of default, you will not be entitled to any additional payments with respect to the Notes. For more information, see "Description of the Debt Securities We May Offer—Events of Default" beginning on page 22 of the accompanying prospectus.

Tax Redemption

The Bank (or its successor) may redeem the Notes, in whole but not in part, at a redemption price determined by the Calculation Agent in a manner reasonably calculated to preserve your and our relative economic position, upon the giving of a notice as described below, if:

- as a result of any change (including any announced prospective change) in or amendment to the laws (or any regulations or rulings promulgated thereunder) of Canada (or the jurisdiction of organization of the successor to the Bank) or of any political subdivision or taxing authority thereof or therein affecting taxation, or any change in official position regarding the application or interpretation of such laws, regulations or rulings (including a holding by a court of competent jurisdiction), which change or amendment is announced or becomes effective on or after the Pricing Date (or, in the case of a successor to the Bank, after the date of succession), and which in the written opinion to the Bank (or its successor) of legal counsel of recognized standing has resulted or will result (assuming, in the case of any announced prospective change, that such announced change will become effective as of the date specified in such announcement and in the form announced) in the Bank (or its successor) becoming obligated to pay, on the next succeeding date on which a payment is due, additional amounts with respect to the Notes; or

- on or after the Pricing Date (or, in the case of a successor to the Bank, after the date of succession), any action has been taken by any taxing authority of, or any decision has been rendered by a court of competent jurisdiction in, Canada (or the jurisdiction of organization of the successor to the Bank) or any political subdivision or taxing authority thereof or therein, including any of those actions specified in the paragraph immediately above, whether or not such action was taken or decision was rendered with respect to the Bank (or its successor), or any change, amendment, application or interpretation shall be officially proposed, which, in any such case, in the written opinion to the Bank (or its successor) of legal counsel of recognized standing, will result (assuming, that such change, amendment or action is applied to the Notes by the taxing authority and that, in the case of any announced prospective change, that such announced change will become effective as of the date specified in such announcement and in the form announced) in the Bank (or its successor) becoming obligated to pay, on the next succeeding date on which a payment is due, additional amounts with respect to the Notes;

and, in any such case, the Bank (or its successor), in its business judgment, determines that such obligation cannot be avoided by the use of reasonable measures available to it (or its successor).

The redemption price will be determined by the Calculation Agent, in its discretion, and such determination will, under certain circumstances, be confirmed by an independent calculation expert. See “Appointment of Independent Calculation Experts” on page PS-22, in the accompanying product prospectus supplement.

In the event the Bank elects to redeem the Notes pursuant to the provisions set forth in the preceding paragraph, it shall deliver to the trustees a certificate, signed by an authorized officer, stating that the Bank is entitled to redeem such Notes pursuant to their terms in whole only.

The Bank will give notice of intention to redeem such Notes to holders of the Notes not more than 45 nor less than 30 days prior to the date fixed for redemption specifying, among other things, the date fixed for redemption, and on or promptly after the redemption date, it will give notice of the redemption price.

Other than as described above, the Notes are not redeemable prior to their maturity.

Hypothetical Payments AT MATURITY On the Notes

The examples set out below are included for illustration purposes only. The hypothetical Percentage Changes of the Reference Asset used to illustrate the calculation of the Payment at Maturity (rounded to two decimal places) are not estimates or forecasts of the Initial Level, the Final Level or the level of the Reference Asset on the Valuation Date or on any Trading Day prior to the Maturity Date. All examples assume that a holder purchased Notes with an aggregate Principal Amount of $1,000.00, a Buffer Percentage of 10.00% (the Buffer Level is 90.00% of the Initial Level), a Buffer Rate of

approximately 111.11%, a Maximum Redemption Amount of $1,186.25 (118.625% of the Principal Amount) and that no market disruption event occurs on the Valuation Date. Amounts below may have been rounded for ease of analysis.

Example 1—Calculation of the Payment at Maturity where the Percentage Change is positive.

Percentage Change: 5.00%

Payment at Maturity: $1,000.00 + ($1,000.00 x 125.00% x 5.00%) = $1,000.00 + $62.50 = $1,062.50

On a $1,000.00 investment, a 5.00% Percentage Change results in a Payment at Maturity of $1,062.50.

Example 2— Calculation of the Payment at Maturity where the Percentage Change is positive (and the Payment at Maturity is subject to the Maximum Redemption Amount).

Percentage Change:	50.00%
Payment at Maturity:	$1,000.00 + ($1,000.00 x 125.00% x 50.00%) = $1,000.00 + $625 = $1,625.00 however, the Maximum Redemption Amount is $1,186.25 and the Payment at Maturity would be $1,186.25.

On a $1,000.00 investment, a 50.00% Percentage Change results in a Payment at Maturity of $1,186.25.

Example 3— Calculation of the Payment at Maturity where the Percentage Change is negative (but not by more than the Buffer Percentage).

Percentage Change:	-5.00%
Payment at Maturity:	$1,000.00 (at maturity, if the Percentage Change is negative BUT the decrease is not more than the Buffer Percentage, then the Payment at Maturity will equal the Principal Amount).

On a $1,000.00 investment, a -5.00% Percentage Change results in a Payment at Maturity of $1,000.00.

Example 4—

Calculation of the Payment at Maturity where the Percentage Change is negative (and the decrease is more than the Buffer Percentage).

Percentage Change: -50.00%

Payment at Maturity:	$1,000.00 + [$1,000.00 x 111.11% x (-50.00% + 10.00%)] = $1,000.00 - $444.44 = $555.56

On a $1,000.00 investment, a -50.00% Percentage Change results in a Payment at Maturity of $555.56.

Accordingly, if the Percentage Change is less than -10.00%, meaning the percentage decline from the Initial Level to the Final Level is greater than 10.00%, the Bank will pay you less than the full Principal Amount, resulting in a loss on your investment that is equal to the Buffer Rate multiplied by the negative Percentage Change in excess of the Buffer Percentage. You may lose up to 100% of your principal.

Any payment on the Notes, including any repayment of principal, is subject to the creditworthiness of the Bank. If the Bank were to default on its payment obligations, you may not receive any amounts owed to you under the Notes and you could lose your entire investment.

The following graph represents hypothetical returns only and is not indicative of actual results. The graph demonstrates the hypothetical return on the Notes at maturity for the set of Percentage Changes of the Reference Asset from -100.00% to 100.00% using the same assumptions as set forth above. Your investment may result in a complete loss of your principal at maturity.

ADDITIONAL RISKS

An investment in the Notes involves significant risks. In addition to the following risks included in this pricing supplement, we urge you to read "Additional Risk Factors Specific to the Notes" beginning on page PS-5 of the accompanying product prospectus supplement and "Risk Factors" beginning on page S-2 of the accompanying prospectus supplement and page 6 of the accompanying prospectus.

You should understand the risks of investing in the Notes and should reach an investment decision only after careful consideration, with your advisors, of the suitability of the Notes in light of your particular financial circumstances and the information set forth in this pricing supplement and the accompanying prospectus, prospectus supplement and product prospectus supplement.

The Estimated Value of Your Notes At the Time the Terms of Your Notes Are Set On the Trade Date (As Determined By Reference to Pricing Models Used By Goldman, Sachs & Co.) Will Be Less Than the Original Issue Price Of Your Notes

The Original Issue Price for your Notes exceeds the estimated value of your Notes as of the time the terms of your Notes were set on the Trade Date, as determined by reference to Goldman, Sachs & Co.'s (as "Dealer" of the Notes) pricing models and taking into account our credit spreads. Such estimated value on the Trade Date is set forth on the cover of this pricing supplement; after the Trade Date, the estimated value as determined by reference to these models will be affected by changes in market conditions, our creditworthiness and other relevant factors. The price at which Goldman, Sachs & Co. would initially buy or sell Notes (if Goldman, Sachs & Co. makes a market, which it is not obligated to do) and the value that Goldman, Sachs & Co. will initially use for account statements and otherwise, also exceeds the estimated value of your Notes, as determined by reference to these models. The amount of the excess will decline on a straight line basis over the period from the date hereof through August 22, 2014. After August 22, 2014, if Goldman, Sachs & Co. buys or sells your Notes it will do so at prices that reflect the estimated value determined by reference to such pricing models at that time. The price at which Goldman, Sachs & Co. will buy or sell Notes at any time also will reflect its then current bid and ask spread for similar sized trades of structured notes.

In estimating the value of the Notes as of the time the terms of the Notes are set on the Trade Date, as disclosed on the front cover of this pricing supplement, Goldman, Sachs & Co.'s pricing models consider certain variables, including principally its credit spreads, interest rates (forecasted, current and historical rates), volatility, price-sensitivity analysis and the time to maturity of the Notes. These pricing models are proprietary and rely in part on certain assumptions about future events, which may prove to be incorrect. As a result, the actual value you would receive if you sold your Notes in the secondary market, if any, to others may differ, perhaps materially, from the estimated value of your Notes determined by reference to Goldman Sachs & Co.'s models due to, among other things, any differences in pricing models or assumptions used by others.

The difference between the estimated value of the Notes as of the time the terms of the Notes are set on the Trade Date and the Original Issue Price is a result of certain factors, including principally the underwriting discount and commissions, the expenses incurred in creating, documenting and marketing the Notes, and an estimate of the difference between the amounts we pay to Goldman, Sachs & Co. and the amounts Goldman, Sachs & Co. pays to us in connection with your Notes. We pay to Goldman, Sachs & Co. amounts based on what we would pay to holders of a non-structured note with a similar maturity. In return for such payment, Goldman, Sachs & Co. pays to us the difference between the total payment amount due at maturity on your Notes and the face amount of your Notes.

In addition to the factors discussed above, the value and quoted price of the Notes at any time will reflect many factors and cannot be predicted. If Goldman, Sachs & Co. makes a market in the Notes, the price quoted by Goldman, Sachs & Co. would reflect any changes in market conditions and other relevant factors, including any deterioration in our creditworthiness or perceived creditworthiness. These changes may adversely affect the value of the Notes, including the price you may receive for the Notes in any market making transaction. To the extent that Goldman, Sachs & Co. makes a market in the notes, the quoted price will reflect the estimated value determined by reference to Goldman, Sachs & Co.’s pricing models at that time, plus or minus its then current bid and ask spread for similar sized trades of structured notes (and subject to the declining excess amount described above).

If at any time a third party dealer quotes a price to purchase your Notes or otherwise values your Notes, that price may be significantly different (higher or lower) than any price quoted by Goldman, Sachs & Co. See "—The Price at Which the Notes may be Sold prior to Maturity will Depend on a Number of Factors and May Be Substantially Less Than the Amount for Which They Were Originally Purchased."

Furthermore, if you sell your Notes, you will likely be charged a commission for secondary market transactions, or the price will likely reflect a dealer discount. This commission or discount will further reduce the proceeds you would receive for your Notes in a secondary market sale.

There is no assurance that Goldman, Sachs & Co. or any other party will be willing to purchase your Notes at any price and, in this regard, Goldman, Sachs & Co. is not obligated to make a market in the Notes. See "—The Notes Lack Liquidity."

The Inclusion of Dealer Spread and Projected Profit from Hedging in the Original Issue Price is Likely to Adversely Affect Secondary Market Prices

Assuming no change in market conditions or any other relevant factors, the price, if any, at which Scotia Capital (USA) Inc. or any other party is willing to purchase the Notes at any time in secondary market transactions will likely be significantly lower than the original issue price, since secondary market prices are likely to exclude underwriting commissions paid with respect to the Notes and the cost of hedging our obligations under the Notes that are included in the original issue price. The cost of hedging includes the projected profit that we and/or our subsidiaries may realize in consideration for assuming the risks inherent in managing the hedging transactions. These secondary market prices are also likely to be reduced by the costs of unwinding the related hedging transactions. In addition, any secondary market prices may differ from values determined by pricing models used by Scotia Capital (USA) Inc. as a result of dealer discounts, mark-ups or other transaction costs.

Risk of Loss at Maturity

Any payment on the Notes at maturity depends on the Percentage Change of the Reference Asset. The Bank will only repay you the full Principal Amount of your Notes if the Percentage Change is equal to or greater than -10.00%. If the Percentage Change is less than -10.00%, meaning the percentage decline from the Initial Level to the Final Level is greater than the 10.00% Buffer Percentage, you will lose a significant portion of your initial investment in an amount equal to the Buffer Rate multiplied by that negative Percentage Change in excess of the Buffer Percentage. ***Accordingly, you may lose your entire investment in the Notes if the percentage decline from the Initial Level to the Final Level is greater than 10.00%.***

The Downside Market Exposure to the Reference Asset is Buffered Only at Maturity

You should be willing to hold your Notes to maturity. If you are able to sell your Notes prior to maturity in the secondary market, you may have to sell them at a loss relative to your initial investment even if the level of the Reference Asset at such time is not below the Initial Level by a percentage greater than the Buffer Percentage.

Your Potential Payment at Maturity Is Limited by the Maximum Redemption Amount

The Payment at Maturity will not exceed the Maximum Redemption Amount. Therefore, if the appreciation of the Reference Asset exceeds the cap on appreciation in the Maximum Redemption Amount, the Notes will provide less opportunity to participate in the appreciation of the Reference Asset than an investment in a security linked to the Reference Asset providing full participation in the appreciation. Accordingly, the return on the Notes may be less than the return would be if you made an investment in a security directly linked to the positive performance of the Reference Asset.

The Notes Differ from Conventional Debt Instruments

The Notes are not conventional notes or debt instruments. The Notes do not provide you with interest payments prior to maturity as a conventional fixed-rate or floating-rate debt security with the same maturity would. The return that you will receive on the Notes, which could be negative, may be less than the return you could earn on other investments. Even if your

return is positive, your return may be less than the return you would earn if you bought a conventional senior interest bearing debt security of the Bank.

No Interest

The Notes will not bear interest and, accordingly, you will not receive any interest payments on the Notes.

Your Investment is Subject to the Credit Risk of The Bank of Nova Scotia

The Notes are senior unsecured debt obligations of the Bank, and are not, either directly or indirectly, an obligation of any third party. As further described in the accompanying prospectus, prospectus supplement and product prospectus supplement, the Notes will rank on par with all of the other unsecured and unsubordinated debt obligations of the Bank, except such obligations as may be preferred by operation of law. Any payment to be made on the Notes, including the Payment at Maturity, depends on the ability of the Bank to satisfy its obligations as they come due. As a result, the actual and perceived creditworthiness of the Bank may affect the market value of the Notes and, in the event the Bank were to default on its obligations, you may not receive the amounts owed to you under the terms of the Notes. If you sell the Notes prior to maturity, you may receive substantially less than the Principal Amount of your Notes.

The Notes are Subject to Market Risk

The return on the Notes is directly linked to the performance of the Reference Asset and indirectly linked to the value of the Reference Asset constituent stocks, and the extent to which the Percentage Change is positive or negative. The levels of the Reference Asset can rise or fall sharply due to factors specific to the Reference Asset constituent stocks, as well as general market factors, such as general market volatility and levels, interest rates and economic and political conditions.

The Participation Rate Applies Only at Maturity

You should be willing to hold your Notes to maturity. If you are able to sell your Notes prior to maturity in the secondary market, the price you receive will likely not reflect the full economic value of the Participation Rate or the Notes themselves, and the return you realize may be less than the Percentage Change even if such return is positive. You may receive the full benefit of the Participation Rate only if you hold your Notes to maturity.

The Payment at Maturity Is Not Linked to the Level of the Reference Asset at Any Time Other Than the Valuation Date

The Payment at Maturity will be based on the Final Level (subject to adjustments as described herein). Therefore, for example, if the closing level of the Reference Asset declined substantially as of the Valuation Date compared to the Trade Date, the Payment at Maturity may be significantly less than it would otherwise have been had the Payment at Maturity been linked to the closing levels of the Reference Asset prior to the Valuation Date. Although the actual level of the Reference Asset at maturity or at other times during the term of the Notes may be higher than the Final Level, you will not benefit from the closing levels of the Reference Asset at any time other than the Valuation Date.

If the Levels of the Reference Asset or the Reference Asset Constituent Stocks Change, the Market Value of Your Notes May Not Change in the Same Manner

Your Notes may trade quite differently from the performance of the Reference Asset or the Reference Asset constituent stocks. Changes in the levels of the Reference Asset or the Reference Asset constituent stocks may not result in a comparable change in the market value of your Notes. We discuss some of the reasons for this disparity under "—The Price at Which the Notes may be Sold prior to Maturity will Depend on a Number of Factors and May Be Substantially Less Than the Amount for Which They Were Originally Purchased" below.

Holding the Notes is Not the Same as Holding the Reference Asset Constituent Stocks

Holding the Notes is not the same as holding the Reference Asset constituent stocks. As a holder of the Notes, you will not be entitled to the voting rights or rights to receive dividends or other distributions or other rights that holders of the Reference Asset constituent stocks would enjoy.

No Assurance that the Investment View Implicit in the Notes Will Be Successful

It is impossible to predict with certainty whether and the extent to which the level of the Reference Asset will rise or fall. There can be no assurance that the level of the Reference Asset will rise above the Initial Level or that the percentage decline from the Initial Level to the Final Level will not be greater than the Buffer Percentage. The Final Level may be influenced by complex and interrelated political, economic, financial and other factors that affect the Reference Asset constituent stocks. You should be willing to accept the risks of the price performance of equity securities in general and the Reference Asset constituent stocks in particular, and the risk of losing some or all of your initial investment.

Furthermore, we cannot give you any assurance that the future performance of the Reference Asset or the Reference Asset constituent stocks will result in your receiving an amount greater than or equal to the Principal Amount of your Notes. Certain periods of historical performance of the Reference Asset or the Reference Asset constituent stocks would have resulted in you receiving less than the Principal Amount of your Notes if you had owned notes with terms similar to these Notes in the past. See “Information Regarding The Reference Asset” in this pricing supplement for further information regarding the historical performance of the Reference Asset.

The Reference Asset Reflects Price Return Only and Not Total Return

The return on your Notes is based on the performance of the Reference Asset, which reflects the changes in the market prices of the Reference Asset constituent stocks. It is not, however, linked to a ‘‘total return’’ index or strategy, which, in addition to reflecting those price returns, would also reflect dividends paid on the Reference Asset constituent stocks. The return on your Notes will not include such a total return feature or dividend component.

Past Performance is Not Indicative of Future Performance

The actual performance of the Reference Asset over the life of the Notes, as well as the amount payable at maturity, may bear little relation to the historical performance of the Reference Asset or to the hypothetical return examples set

forth elsewhere in this pricing supplement. We cannot predict the future performance of the Reference Asset.

We May Sell an Additional Aggregate Principal Amount of the Notes at a Different Issue Price

We may decide to sell an additional aggregate principal amount of the Notes subsequent to the date of this pricing supplement. The issue price of the Notes in the subsequent sale may differ substantially (higher or lower) from the original issue price you paid as provided on the cover of this pricing supplement.

Changes Affecting the Reference Asset Could Have an Adverse Effect on the Value of the Notes

The policies of MSCI Inc., the sponsor of the Reference Asset (the ‘‘Sponsor’’ or “MSCI”), concerning additions, deletions and substitutions of the Reference Asset constituent stocks and the manner in which the Sponsor takes account of certain changes affecting those Reference Asset constituent stocks may adversely affect the level of the Reference Asset. The policies of the Sponsor with respect to the calculation of the Reference Asset could also adversely affect the level of the Reference Asset. The Sponsor may discontinue or suspend calculation or dissemination of the Reference Asset. Any such actions could have a material adverse effect on the value of the Notes.

The Bank Cannot Control Actions by the Sponsor and the Sponsor Has No Obligation to Consider Your Interests

The Bank and its affiliates are not affiliated with the Sponsor and have no ability to control or predict its actions, including any errors in or discontinuation of public disclosure regarding methods or policies relating to the calculation of the Reference Asset. The Sponsor is not involved in the Notes offering in any way and has no obligation to consider your interest as an owner of the Notes in taking any actions that might negatively affect the market value of your Notes.

The Notes are Subject to Currency Exchange Rate Risk

The MSCI EAFE Index invests in securities that are traded and quoted in foreign currencies on non-U.S. markets. The prices of the constituent country indices are converted into U.S. dollars for purposes of calculating the value of the MSCI EAFE Index. As a result, holders of the Notes will be exposed to currency exchange rate risk with respect to each of the currencies represented in the index. The values of the currencies of the countries in which the MSCI EAFE Index may invest may be subject to a high degree of fluctuation due to changes in interest rates, the effects of monetary policies issued by the United States, foreign governments, central banks or supranational entities, the imposition of currency controls or other national or global political or economic developments. An investor's net exposure will depend on the extent to which the relevant non-U.S. currencies strengthen or weaken against the U.S. dollar and the relative weight of each non-U.S. security in the portfolio of the MSCI EAFE Index. If, taking into account such weighting, the U.S. dollar strengthens against the relevant non-U.S. currencies, the value of securities in which the MSCI EAFE Index invests will be adversely affected and the value of the Notes may decrease.

It has been reported that the U.K. Financial Conduct Authority and regulators from other countries are in the process of investigating the potential manipulation of published currency exchange rates. If such manipulation has occurred or is continuing, certain published exchange rates may have been, or may be in the future, artificially lower (or higher) than they would otherwise have been. Any such manipulation could have an adverse impact on any payments on, and the value of, your notes and the trading market for your notes. In addition, we cannot predict whether any
chang> **Three months ended June 30, Six months ended June 30, 2009 2008 2009 2008**

Research and development expense
$525,304 $475,980 $986,573 $956,329
General and administrative expense
494,160 487,859 983,299 978,437

Total employee stock-based compensation expense and effect on net loss
$1,019,464 $963,839 $1,969,872 $1,934,766

Effect on basic and diluted net loss per common share
$(0.01) $(0.01) $(0.02) $(0.02)

As of June 30, 2009, we had approximately $7,047,000 of total unrecognized compensation expense related to unvested awards of stock options and restricted stock units granted under our various stock-based plans that we expect to recognize over a weighted-average vesting period of 2.6 years.

Incentive Stock Options

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

A summary of our stock option activity for the three months ended June 30, 2009 is as follows:

	Number of options	**Weighted-average exercise price ($)**
Balance at March 31, 2009	8,355,287	2.32
Granted	1,255,800	1.73
Exercised	(185,623)	0.54
Cancelled	(45,267)	2.48
Outstanding options at June 30, 2009	9,380,197	2.27

The estimated weighted-average fair value of options granted in the three months ended June 30, 2009 and 2008 was approximately $1.41 and $1.19 per share respectively. The fair value of options granted is estimated as of the date of grant using the Black-Scholes option pricing model, which requires certain assumptions as of the date of grant. The weighted-average assumptions used as of June 30, 2009 and 2008 were as follows:

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	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Expected life (years)(1)	7.39	7.97	7.44	6.36
Risk-free interest rate(2)	2.81%	3.85%	2.72%	2.89%
Expected volatility(3)	93.52%	94.52%	94.17%	93.87%
Expected dividend yield(4)	0%	0%	0%	0%

(1) The expected term represents the period during which our stock-based awards are expected to be outstanding. We estimated this amount based on historical experience of similar awards, giving consideration to the contractual terms of the awards, vesting requirements, and expectation of future employee behavior, including post-vesting terminations.

(2) The risk-free interest rate is based on U.S. Treasury debt securities with maturities close to the expected term of the option as of the date of grant.

(3) Expected volatility is

based on historical volatility over the most recent historical period equal to the length of the expected term of the option as of the date of grant.

(4) We have not historically issued any dividends, and we do not expect to in the foreseeable future.

At the end of each reporting period we estimate forfeiture rates based on our historical experience within separate groups of employees and adjust the stock-based compensation expense accordingly.

A summary of changes in unvested options for the three months ended June 30, 2009 is as follows:

	Number of options	Weighted-average grant date fair value ($)
Unvested options at March 31, 2009	2,320,361	1.80
Granted	1,255,800	1.41
Vested	(310,677)	2.12
Cancelled		
Unvested options at June 30, 2009	3,265,484	1.62

The estimated fair value of shares vested were approximately $659,000 in the three months ended June 30, 2009.

Restricted Stock Units

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

A summary of our restricted stock unit activity for the three months ended June 30, 2009 is as follows:

	Number of RSUs	Weighted-average grant date fair value ($)
Balance at March 31, 2009 (1)	1,350,000	1.30
Granted (2)	953,068	1.75
Vested and converted to common shares		
Cancelled		

Balance unvested at June 30, 2009	2,303,068	1.49

(1) 1,100,000 of these restricted stock units vest and convert into shares of our common stock over a three year period from the date of grant: one-third of the award will vest on each grant date anniversary over the following three years. 250,000 of these restricted stock units will vest and convert into shares of our common stock subject to attainment of certain performance criteria and will be forfeited if not met by March 31, 2011.

(2) These restricted stock units vest and convert into shares of our common stock over a four year period from the date of grant: one-fourth of the award will vest on each grant date anniversary over the following four years.

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Stock Appreciation Rights

In July 2006, we granted cash-settled Stock Appreciation Rights (SARs) to certain employees that give the holder the right, upon exercise, to the difference between the price per share of our common stock at the time of exercise and the exercise price of the SARs. The SARs have a maximum term of ten years with an exercise price of $2.00, which is equal to the market price of our common stock at the date of grant. The SARs vest 25% on the first anniversary of the grant date and 75% vest monthly over the remaining three-year service period. Compensation expense is based on the fair value of SARs which is calculated using the Black-Scholes option pricing model. The stock-based compensation expense and liability are re-measured at each reporting date through the date of settlement.

A summary of the changes in SARs for the three months ended June 30, 2009 is as follows:

	Number of SARs
Outstanding at March 31, 2009	1,430,849
Granted	
Exercised	
Forfeited and expired	
Outstanding SARs at June 30, 2009	1,430,849
SARs exercisable at June 30, 2009	1,043,322

For the three months ended June 30, 2009, we re-measured the compensation expense and liability related to the SARs and recorded compensation expense of approximately $96,000. For the same period in 2008, due to forfeitures and a decrease in our common stock price, the re-measured fair value reduced compensation expense by approximately $116,000.

At June 30, 2009, approximately $300,000 of unrecognized compensation expense related to SARs is expected to be recognized over a weighted average vesting period of approximately 1.0 year. The resulting effect on net loss and net loss per share attributable to common stockholders is not likely to be representative of the effects in future periods, due to changes in the fair value calculation which is dependent on the stock price, volatility, interest and forfeiture rates, additional grants and subsequent periods of vesting.

Note 5. Wind-Down Expenses

Rhode Island

In October 1999, we relocated to California from Rhode Island and established a wind down reserve for the estimated lease payments and operating costs of the scientific and administrative facility in Rhode Island. Even though we intend to dispose of the facility at the earliest possible time, we cannot determine with certainty a fixed date by which such disposal will occur. In light of this uncertainty, we periodically re-evaluate and adjust the reserve. We consider various factors such as our lease payments through to the end of the lease, operating expenses, the current real estate market in Rhode Island, and estimated subtenant income based on actual and projected occupancy.

The summary of the changes to our wind-down reserve related to this facility as of June 30, 2009 and December 31, 2008 were as follows:

	January to March 31, 2009	**April to June 30, 2009**	**January to June 30, 2009**	**January to December 31, 2008**
Accrued wind-down reserve at beginning of period	$ 4,448,000	$ 4,323,000	$ 4,448,000	$ 4,875,000
Less actual expenses recorded against estimated reserve during the period	(331,000)	(293,000)	(624,000)	(1,293,000)
	206,000	30,000	236,000	866,000

Additional expense recorded to revise estimated reserve at period-end				
Revised reserve at period-end	4,323,000	4,060,000	4,060,000	4,448,000
Add deferred rent at period-end	1,014,000	962,000	962,000	1,065,000
Total accrued wind-down expenses at period-end (current and non current)	$ 5,337,000	$ 5,022,000	$ 5,022,000	$ 5,513,000
Accrued wind-down expenses, current	$ 1,496,000	$ 1,438,000	$ 1,438,000	$ 1,420,000
Accrued wind-down expenses, non-current	3,841,000	3,584,000	3,584,000	4,093,000
Total accrued wind-down expenses	$ 5,337,000	$ 5,022,000	$ 5,022,000	$ 5,513,000

Australia

On April 1, 2009, as part of our acquisition of the SCS operations, we acquired operations near Melbourne, Australia. In order to reduce operating complexity and expenses, we made the decision to close our site in Australia and consolidate personnel and programs to our Cambridge, U.K. and Palo Alto, California sites. In accordance with SFAS No. 146. *Accounting for Costs Associated with Exit*

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or Disposal Activities (SFAS 146), we established a short-term reserve of approximately $310,000 for the estimated costs to close down and exit our Australia operations. The reserve reflects the estimated cost to terminate our facility lease in Australia (with an original termination date of December 31, 2010), employee termination benefits and other liabilities associated with the wind-down and relocation of our operations in Australia.

A summary of our reserve for the wind-down of our operations in Australia is as follows:

Early termination facility costs	$ 86,000
Employee termination costs	127,000
Other expenses	97,000
Total accrued wind-down expenses at June 30, 2009	$ 310,000

Note 6. Commitments and Contingencies

Leases

Capital leases

We entered into direct financing transactions with the State of Rhode Island and received proceeds from the issuance of industrial revenue bonds totaling $5,000,000 to finance the construction of our pilot manufacturing facility in Rhode Island. The related lease agreements are structured such that lease payments fully fund all semiannual interest payments and annual principal payments through maturity in August 2014. The interest rate for the remaining bond series is 9.5%. The bond contains certain restrictive covenants which limit, among other things, the payment of cash dividends and the sale of the related assets. The outstanding principal was approximately $937,000 at June 30, 2009 and $1,009,000 at December 31, 2008.

Operating leases

We entered into a fifteen-year lease agreement for a scientific and administrative facility in Rhode Island in connection with a sale and leaseback arrangement in 1997. The lease term expires June 30, 2013. The lease contains escalating rent payments, which we recognize on a straight-line basis. Deferred rent expense for this facility was approximately $962,000 at June 30, 2009 and $1,065,000 at December 31, 2008, and is included as part of the wind-down accrual on the accompanying condensed consolidated balance sheet.

We entered into and amended a lease agreement for an approximately 68,000 square foot facility located at the Stanford Research Park in Palo Alto, California. The facility includes space for animals, laboratories, offices, and a GMP (Good Manufacturing Practices) suite. GMP facilities can be used to manufacture materials for clinical trials. The lease term expires March 31, 2010. Under the term of the agreement we were required to provide a letter of credit for a total of approximately $778,000, which serves as a security deposit for the duration of the lease term. The letter of credit issued by our financial institution is collateralized by a certificate of deposit for the same amount, which is reflected as restricted cash in other assets, non-current on our condensed consolidated balance sheets. The lease contains escalating rent payments, which we recognize as operating lease expense on a straight-line basis. Deferred rent was approximately $271,000 as of June 30, 2009 and $437,000 as of December 31, 2008, and is reflected as deferred rent on our condensed consolidated balance sheet. As of June 30, 2009, we had a space-sharing agreement covering approximately 10,451 square feet of this facility, under which we receive base payments plus a proportionate share of the operating expenses based on square footage over the term of the agreement.

On April 1, 2009, as part of our acquisition of the operations of SCS, we acquired operations in Cambridge, U.K.. Our wholly-owned subsidiary, Stem Cell Sciences UK Ltd, has two lease agreements with Babraham Bioscience Technologies Ltd., for approximately 3,900 square feet in total of office and lab space in Cambridge, U.K. The lease term for one ends on February 28, 2010, and the other on March 26, 2011, with annual lease payments of approximately 59,000 U.K. pounds (GBP) and 51,000 GBP, respectively.

On April 1, 2009, as part of our acquisition of the operations of SCS, we acquired operations near Melbourne, Australia. Our wholly-owned subsidiary, Stem Cell Sciences (Australia) Pty Ltd, is in a lease agreement with Monash University for approximately 1,938 square feet of office and lab space in Victoria, Australia. The lease term ends on December 31, 2010. In order to reduce operating complexity and expenses, we made the decision to close our site in

Australia and consolidate personnel and programs to our Cambridge, U.K. and Palo Alto, California sites. We expect to pay approximately $86,000 for an early termination of the lease and is included as part of the wind-down accrual on the accompanying condensed consolidated balance sheet.

Contingencies

In July 2006, we filed suit against Neuralstem, Inc. in the Federal District Court for the District of Maryland, alleging that Neuralstem s activities violate claims in four of the patents we exclusively licensed from NeuroSpheres. In December 2006, Neuralstem petitioned the U.S. Patent and Trademark Office (PTO) to reexamine two of the patents in our infringement action against Neuralstem, namely U.S. Patent No. 6,294,346 (claiming the use of human neural stem cells for drug screening) and U.S. Patent No. 7,101,709 (claiming the use of human neural stem cells for screening biological agents). In April 2007, Neuralstem petitioned the PTO to reexamine the remaining two patents in the suit, namely U.S. Patent No. 5,851,832 (claiming methods for proliferating human neural stem cells) and U.S. Patent No. 6,497,872 (claiming methods for transplanting human neural stem cells). These requests were

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granted by the PTO and, in June 2007, the parties voluntarily agreed to stay the pending litigation while the PTO considered these reexamination requests.. In April 2008, the PTO upheld the 832 and 872 patents, as amended, and issued Notices of Intent to Issue an Ex Parte Reexamination Certificate for both. In May 2009, the PTO upheld the 346 and 709 patents, as amended, and issued Notices of Intent to Issue an Ex Parte Reexamination Certificate for both.

In May 2008, we filed a second patent infringement suit against Neuralstem and its two founders, Karl Johe and Richard Garr. In this suit, which we filed in the Federal District Court for the Northern District of California, we allege that Neuralstem s activities infringe claims in two patents we exclusively license from NeuroSpheres, specifically U.S. Patent No. 7,361,505 (claiming composition of matter of human neural stem cells derived from any source material) and U.S. Patent No. 7,115,418 (claiming methods for proliferating human neural stem cells). In addition, we allege various state law causes of action against Neuralstem arising out of its repeated derogatory statements to the public about our patent portfolio. Also in May 2008, Neuralstem filed suit against us and NeuroSpheres in the Federal District Court for the District of Maryland seeking a declaratory judgment that the 505 and 418 patents are either invalid or are not infringed by Neuralstem and that Neuralstem has not violated California state law. In August 2008, the California court transferred our lawsuit against Neuralstem to Maryland for resolution on the merits. In July 2009, the Maryland District Court granted our motion to consolidate these two cases with the litigation we initiated against Neuralstem in 2006. In August 2009, the Maryland District Court approved a scheduling order submitted by the parties for discovery and trial.

Indemnification Agreement

In July 2008, we amended our 1997 and 2000 license agreements with NeuroSpheres. NeuroSpheres is the holder of certain patents exclusively licensed by us, including the six patents that are the basis of our patent infringement suits against Neuralstem. As part of the amendment, we agreed to pay all reasonable litigation costs, expenses and attorney s fees incurred by NeuroSpheres in the declaratory judgment suit between us and Neuralstem. In return, we are entitled to off-set all litigation costs incurred in that suit and any successor suit against amounts that would otherwise be owed under the license agreements, such as annual maintenance fees, milestones and royalty payments. At this time, we cannot estimate the likely total costs of our pending litigation with Neuralstem, given the unpredictable nature of such proceedings, or the total amount we may ultimately owe under the NeuroSpheres license agreements. However, the ability to apply the offsets will run for the entire term of each license agreement. For these reasons, we have chosen to approximate the potential value of the offset receivable by assuming that all litigation charges actually incurred in the declaratory judgment action as of June 30, 2009, will ultimately be offset against royalties owed. Management will reevaluate this assumption on a quarterly basis based on actual costs and other relevant factors.

Note 7. Warrant Liability

In November 2008, we sold 13,793,104 units to institutional investors at a price of $1.45 per unit, for gross proceeds of $20,000,000. The units, each of which consisted of one share of common stock and a warrant to purchase 0.75 shares of common stock at an exercise price of $2.30 per share, were offered as a registered direct offering under an effective shelf registration statement previously filed with and declared effective by the Securities and Exchange Commission. We received total proceeds, net of offering expenses and placement agency fees, of approximately $18,637,000. We recorded the fair value of the warrants to purchase 10,344,828 shares of our common stock as a liability. The fair value of the warrant liability is revalued at the end of each reporting period, with the change in fair value of the warrant liability recorded as a gain or loss in our Consolidated Statement of Operations. We used the Black-Scholes option pricing model to estimate the fair value of these warrants. In using this model, we make certain assumptions about risk-free interest rates, dividend yields, volatility and expected term of the warrants. Risk-free interest rates are derived from the yield on U.S. Treasury debt securities. Dividend yields are based on our historical dividend payments, which have been zero to date. Volatility is derived from the historical volatility of our common stock as traded on Nasdaq. The expected term of the warrants is based on the time to expiration of the warrants from the date of measurement.

The assumptions used for the Black-Scholes option pricing model at June 30, 2009 are as follows:

Expected life (years)	4.87
Risk-free interest rate	2.08%
Expected volatility	87.4%
Expected dividend yield	0%

	At June 30, 2009	At March 31, 2009	Change in Fair Value
Fair value of warrant liability	$11,092,862	$11,195,379	$(102,517)

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The fair value of the warrants will continue to be classified as a liability until such time as the warrants are exercised, expire or an amendment of the warrant agreement renders these warrants to be no longer classified as a liability.

Note 8. Common Stock

Major transactions involving our common stock for the three-month period ended June 30, 2009 include the following:

On April 1, 2009, we acquired the operations of SCS. As consideration, we issued to SCS 2,650,000 shares of common stock and waived certain commitments of SCS to repay approximately $709,000 in principal and accrued interest owed to us. The closing price of our common stock was $1.67 per share on April 1, 2009.

On June 8, 2009, we filed a prospectus supplement that relates to the issuance and sale of up to $30,000,000 of our common stock, from time to time through our sales agent Cantor Fitzgerald & Co (Cantor). These sales will be made pursuant to the terms of a sales agreement with Cantor, under which we will pay Cantor a fee of 3.0% of the gross proceeds. The prospectus is a part of a registration statement that we filed with the SEC on June 25, 2008, using a shelf registration process. Under this shelf registration process, we may offer to sell in one or more offerings up to a total dollar amount of $100,000,000.

In the second quarter of 2009, we sold an aggregate 4,937,400 shares of common stock at an average price of approximately $1.75 per share for gross proceeds of approximately $8,655,000. Of the 4,937,400 shares sold, 4,662,400 shares were sold pursuant to a sales agreement we entered into with Cantor in December 2006. Cantor was paid compensation equal to 5.0% of the gross proceeds and the total number of shares available to be sold under that agreement have been sold. The remaining 275,000 shares were sold pursuant to the sales agreement we entered into with Cantor in June 2009 and Cantor was paid compensation equal to 3.0% of the gross proceeds under the terms of this second agreement.

Note 9. Acquisition of SCS Operations

On April 1, 2009, we acquired the operations of SCS for an aggregate purchase price of approximately $5,135,000. The acquired operations includes proprietary cell technologies relating to embryonic stem cells, induced pluripotent stem (iPS) cells, and tissue-derived (adult) stem cells; expertise and infrastructure for providing cell-based assays for drug discovery; a media formulation and reagent business; and an intellectual property portfolio with claims relevant to cell processing, reprogramming and manipulation, as well as to gene targeting and insertion. These acquired operations will help us pursue applications of our cell technologies to develop cell-based research tools, which we believe represent nearer-term commercial opportunities.

As consideration for the acquired operations, we issued to SCS 2,650,000 shares of common stock and waived certain commitments of SCS to repay approximately $709,000 in principal and accrued interest owed to us. The closing price of our common stock on April 1, 2009 was $1.67 per share.

This transaction has been accounted for as a business purchase pursuant to SFAS 141(R). We have evaluated the acquired assets and liabilities and believe that the historical cost of the net tangible assets acquired approximated fair market value. The primary method used to calculate the fair value of the intangible assets was the Excess Earnings Method . These assets will be amortized over their estimated lives.

The purchase price has been allocated as follows:

	Allocated purchase price	Estimated life of intangible assets in years
Net tangible assets	$ 36,000	
Intangible assets:		
Customer relationships and developed technology	1,310,000	6 to 9

In process research and development		1,340,000	13 to 19
Trade name		310,000	15
Goodwill		2,139,000	N/A
Total	$	5,135,000	

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In connection with our acquisition of the operations of SCS, and in accordance with SFAS 141 (R), acquisition costs of approximately $539,000 and $710,000, which primarily consists of legal and other professional fees, were expensed in the three and six-month periods ended June 30, 2009, respectively. These costs were reported in our condensed consolidated statements of operations as part of our general & administrative expense.

Note 10. Subsequent Events

Subsequent events have been evaluated through August 7, 2009, which represents the issuance date of these unaudited condensed consolidated financial statements.

In July 2009, we sold 1,555,000 shares of common stock at an average price of approximately $1.80 per share for gross proceeds of approximately $2,800,000. The shares were sold pursuant to a sales agreement we entered into with Cantor in June 2009, under which Cantor was paid compensation equal to 3.0% of the gross proceeds.

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

This report contains forward looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act that involve substantial risks and uncertainties. Such statements include, without limitation, all statements as to expectation or belief and statements as to our future results of operations; the progress of our research, product development and clinical programs; the need for, and timing of, additional capital and capital expenditures; partnering prospects; costs of manufacture of products; the protection of, and the need for, additional intellectual property rights; effects of regulations; the need for additional facilities; and potential market opportunities. Our actual results may vary materially from those contained in such forward-looking statements because of risks to which we are subject, including the fact that additional trials will be required to confirm the safety and demonstrate the efficacy of the Company s HuCNS-SC cells for the treatment of Batten or any other disease; uncertainty as to whether the U.S. Food and Drug Administration (FDA) or other regulatory authorities will permit us to proceed with clinical testing of proposed products despite the novel and unproven nature of our technologies; the risk that one or more of our clinical trials or studies could be substantially delayed beyond their expected dates or cause us to incur substantial unanticipated costs; uncertainties in our ability to obtain the capital resources needed to continue our current research and development operations and to conduct the research, preclinical development and clinical trials necessary for regulatory approvals; uncertainties about the design of future clinical trials and whether the Company will receive the necessary support of a clinical trial site and its institutional review board to pursue future clinical trials in NCL, PMD or in proposed therapies for other diseases or conditions; the uncertainty regarding our ability to obtain a corporate partner or partners, if needed, to support the development and commercialization of our potential cell-based therapeutics products; the uncertainty regarding the outcome of our clinical trials or studies we may conduct in the future; the uncertainty regarding the validity and enforceability of our issued patents; the risk that we may not be able to manufacture additional master and working cell banks when needed; the uncertainty whether any products that may be generated in our cell-based therapeutics programs will prove clinically safe and effective; the uncertainty whether we will achieve significant revenue from product sales or become profitable; uncertainties regarding our obligations with respect to our former encapsulated cell therapy facilities in Rhode Island; obsolescence of our technologies; competition from third parties; intellectual property rights of third parties; litigation risks; and other risks to which we are subject. All forward-looking statements attributable to us or to persons acting on our behalf are expressly qualified in their entirety by the cautionary statements and risk factors set forth in Risk Factors in Part II, Item 1A of this report and Part I, Item 1A included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

Overview

The Company

We are focused on developing and commercializing cell-based technologies. Our research and development (R&D) programs are primarily focused on identifying and developing potential cell-based therapeutics which can either restore or support organ function. In particular, since we relocated our corporate headquarters and research laboratories to California in 1999, our R&D efforts have been directed at refining our methods for identifying, isolating, culturing, and purifying the human neural stem cell and human liver engrafting cells (hLEC) and developing these as potential cell-based therapeutics for the central nervous system (CNS) and the liver, respectively. In our CNS

Program, our HuCNS-SC® product candidate (purified human neural stem cells) is in clinical development for two indications. In January 2009, we completed a six patient Phase I clinical trial of HuCNS-SC cells in infantile and late infantile neuronal ceroid lipofuscinosis (NCL), two forms of a group of disorders often referred to as Batten disease. The data from this Phase I trial showed that the HuCNS-SC cells were well tolerated, and there was evidence that the donor cells engrafted and survived. In December 2008, the FDA approved our IND to initiate a Phase I clinical trial of HuCNS-SC cells in a second indication, Pelizeaus-

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Merzbacher Disease (PMD), a fatal myelination disorder in the brain. We expect the PMD trial to begin enrolling patients in 2009 and that the trial will take 12-18 months to complete. In addition, our HuCNS-SC cells are in preclinical development for spinal cord injury and retinal disorders. In our Liver Program, we are in preclinical development with our human liver engrafting cells and we plan to seek the necessary approvals to initiate a clinical study to evaluate hLEC as a potential cellular therapy, with the initial indication likely to be liver-based metabolic disorders. For a brief description of our significant therapeutic research and development programs see Overview Research and Development Programs in the Business Section of Part I, Item 1 included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008. We have also conducted research on several other cell types and in other areas, which could lead to other possible product candidates, process improvements or further research activities.

On April 1, 2009, we acquired the operations of Stem Cell Sciences Plc (SCS). The acquired business includes proprietary cell technologies relating to embryonic stem cells, induced pluripotent stem (iPS) cells, and tissue-derived (adult) stem cells; expertise and infrastructure for providing cell-based assays for drug discovery; a media formulation and reagent business; and an intellectual property portfolio with claims relevant to cell processing, reprogramming and manipulation, as well as to gene targeting and insertion. These acquired operations will help us pursue applications of our cell technologies to develop cell-based research tools, which we believe represent nearer-term commercial opportunities. See Note 9 Acquisition of SCS Operations in the notes to condensed financial statements of Part I, Item 1 of this form 10-Q for further information.

We have not derived any revenue or cash flows from the sale or commercialization of any therapeutic products. Through our acquisition of the SCS operations, we derived revenue from sales and royalties on sales of media. We have also derived revenue from licensing rights to our intellectual property. To date, all such revenue has been limited and there can be no assurance that these revenues will increase. As a result, we have incurred annual operating losses since inception and expect to incur substantial operating losses in the future. Therefore, we are dependent upon external financing from equity and debt offerings and revenue from collaborative research arrangements with corporate sponsors to finance our operations. We have no such collaborative research arrangements at this time and there can be no assurance that such financing or partnering revenue will be available when needed or on terms acceptable to us.

Before we can derive revenue or cash inflows from the commercialization of any of our therapeutic product candidates, we will need to: (i) conduct substantial *in vitro* testing and characterization of our proprietary cell types, (ii) undertake preclinical and clinical testing for specific disease indications; (iii) develop, validate and scale-up manufacturing processes to produce these cell-based therapeutics, and (iv) pursue required regulatory approvals. These steps are risky, expensive and time consuming.

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

ongoing assessment of the regulatory requirements and each product candidate s commercial potential.

There can be no assurance that we will be able to develop any product successfully, or that we will be able to recover our development costs, whether upon commercialization of a developed product or otherwise. We cannot provide assurance that any of these programs will result in products that can be marketed or marketed profitably. If certain of our development-stage programs do not result in commercially viable products, our results of operations could be materially adversely affected.

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Significant Events

In April 2009, we announced that a major international pharmaceutical company acquired a non-exclusive license to our Internal Ribosome Entry Site (IRES) technology, which we acquired as part of the SCS operations. The IRES technology enables researchers to genetically modify any mammalian cell and to monitor the activity of a particular gene of interest without blocking the normal function of the gene. The IRES technology is particularly important for evaluating the success of gene knock-outs or knock-ins in stem cells, as well as for the successful creation of transgenic mouse and rat disease models.

In May 2009, the U.S. Patent and Trademark Office (PTO) upheld the validity of the remaining two neural stem cell patents which were subjected to reexamination proceedings commenced by Neuralstem, Inc. The upheld patents are the subject of two related lawsuits initiated by us against Neuralstem, which allege infringement of a total of six patents. These six patents collectively claim the manufacture and use of human neural stem and progenitor cells as tools for drug discovery and as therapeutic agents. The PTO s decision to uphold the two patents is final and cannot be appealed.

In May 2009, our collaborators at Oregon Health & Science University Casey Eye Institute presented data showing our human central nervous system stem cells, when transplanted in an animal model of retinal degeneration, engraft long-term and can protect the retina from progressive degeneration. Retinal degeneration leads to loss of vision in diseases such as age-related macular degeneration.

In June 2009, we announced positive results from our Phase I clinical trial of our HuCNS-SC product candidate in infantile and late infantile neuronal ceroid lipofuscinosis (NCL), often referred to as Batten disease. This first Phase I trial was designed primarily to assess the safety of HuCNS-SC cells as a potential cell-based therapeutic. Overall, the trial data demonstrated that the HuCNS-SC cells, the transplantation procedure and the immunosuppression regimen were well tolerated by all six patients enrolled in the trial, and the patients medical, neurological and neuropsychological conditions, following transplantation, appeared consistent with the normal course of the disease. In addition to this favorable safety profile, there was evidence of engraftment and long-term survival of the HuCNS-SC cells.

In June 2009, we were added to the Russell 3000® Index, a broad market index that measures the performance of the 3000 largest companies in the United States. As part of our membership in the Russell 3000, we are also included in the Russell 2000® Index, which is a subset of the Russell 3000 representing the small capitalization segment of the U.S. equity market.

Critical Accounting Policies and the Use of Estimates

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

Stock-Based Compensation

Effective January 1, 2006, we apply Statement of Financial Accounting Standards 123 (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R requires us to recognize expense related to the fair value of our stock-based payment awards, including employee stock options. Under the provisions of SFAS 123R, employee stock-based payment is estimated at the date of grant based on the award s fair value using the Black-Scholes-Merton (Black-Scholes) option-pricing model and is recognized as expense ratably over the requisite service period. The Black-Scholes option-pricing model requires the use of certain assumptions, the most significant of which are our estimates of the expected volatility of the market price of our stock and the expected term of the award. Our estimate of the expected volatility is based on historical volatility. The expected term represents the period during which our stock-based awards are expected to be outstanding. From January 1, 2006 to December 31, 2007, and in accordance

with Staff Accounting Bulletin 107, *Share-Based Payment* (SAB 107), the expected term was equal to the average of the contractual life of the stock option and its vesting period as of the date of grant (the simplified method). In December 2007, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 110, *Share-Based Payment* (SAB 110), extending the availability of SAB 107 beyond its original deadline of December 31, 2007. The extension is available for companies under specified conditions that include a lack of sufficient historical exercise data related to their stock-based awards. Effective January 1, 2008, in accordance with SAB 110, we no longer use the simplified method and estimate the expected term based on historical experience of similar awards, giving consideration to the

contractual terms of the awards, vesting requirements, and expectation of future employee behavior, including post-vesting terminations. The change of method in estimating the expected term did not have a material impact on our condensed consolidated financial statements.

As required under SFAS 123R, we review our valuation assumptions at each grant date and, as a result, our assumptions in future periods may change. As of June 30, 2009, total compensation cost related to unvested stock-based awards not yet recognized was approximately $7,047,000, which is expected to be recognized as expense over a weighted-average period of 2.6 years. See also Note 4, Stock-Based Compensation, in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Wind-down expenses Rhode Island

In connection with exiting our research and manufacturing operations in Lincoln, Rhode Island, and the relocation of our corporate headquarters and remaining research laboratories to California in October 1999, we provided a reserve for our estimate of the exit cost obligation in accordance with EITF 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)*. The reserve reflects estimates of the ongoing costs of our former scientific and administrative facility in Lincoln, which we hold on a lease that terminates on June 30, 2013. We are seeking to sublease, assign, sell, or otherwise divest ourselves of our interest in the facility at the earliest possible time, but we cannot determine with certainty a fixed date by which such events will occur, if at all.

In determining the facility exit cost reserve amount, we are required to consider our lease payments through to the end of the lease term and estimate other relevant factors such as facility operating expenses, real estate market conditions in Rhode Island for similar facilities, occupancy rates, and sublease rental rates projected over the course of the leasehold. We re-evaluate the estimate each quarter, taking account of changes, if any, in each underlying factor. The process is inherently subjective because it involves projections over time from the date of the estimate through the end of the lease and it is not possible to determine any of the factors, except the lease payments, with certainty over that period.

Management forms its best estimate on a quarterly basis, after considering actual sublease activity, reports from our broker/realtor about current and predicted real estate market conditions in Rhode Island, the likelihood of new subleases in the foreseeable future for the specific facility and significant changes in the actual or projected operating expenses of the property. We discount the projected net outflow over the term of the leasehold to arrive at the present value, and adjust the reserve to that figure. The estimated vacancy rate for the facility is an important assumption in determining the reserve because changes in this assumption have the greatest effect on estimated sublease income. In addition, the vacancy rate estimate is the variable most subject to change, while at the same time it involves the greatest judgment and uncertainty due to the absence of highly predictive information concerning the future of the local economy and future demand for specialized laboratory and office space in that area. The average vacancy rate of the facility over the last six years (2003 through 2008) was approximately 74%, varying from 66% to 89%. As of June 30, 2009, based on current information available to management, the vacancy rate is projected to be approximately 78% for 2009, approximately 75% for 2010 and approximately 70% from 2011 through the end of the lease. These estimates are based on actual occupancy as of June 30, 2009, predicted lead time for acquiring new subtenants, historical vacancy rates for the area, and assessments by our broker/realtor of future real estate market conditions. If the assumed vacancy rate from 2010 to the end of the lease had been 5% higher or lower at June 30, 2009, then the reserve would have increased or decreased by approximately $180,000. Similarly, a 5% increase or decrease in the operating expenses for the facility from 2010 on would have increased or decreased the reserve by approximately $91,000, and a 5% increase or decrease in the assumed average rental charge per square foot would have increased or decreased the reserve by approximately $45,000. Management does not wait for specific events to change its estimate, but instead uses its best efforts to anticipate them on a quarterly basis. See Note 5 Wind-down expenses, in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Wind-down expenses Australia

On April 1, 2009, as part of our acquisition of the operations of SCS, we acquired operations near Melbourne, Australia. In order to reduce operating complexity and expenses, we made the decision to close our site in Australia

and consolidate personnel and programs to our Cambridge, U.K. and Palo Alto, California sites. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146), we established a short-term reserve of approximately $310,000, for the estimated costs to close down and exit our Australia operations. This reserve reflects the estimated cost to terminate our facility lease in Australia (with an original termination date of December 31, 2010), employee termination benefits and other liabilities associated with the wind-down and relocation of our operations in Australia.

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Business Combinations

We account for acquisitions using the purchase method of accounting under FASB statement No. 141 (R), *Business Combinations* (SFAS 141 (R)). The operating results of acquired companies or operations are included in our consolidated financial statements starting on the date of acquisition. We account for goodwill and other intangible assets in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS142). Goodwill is recorded at the time of an acquisition and is calculated as the difference between the aggregate consideration paid for an acquisition and the fair value of the net tangible and intangible assets acquired. Accounting for acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired, including in-process research and development (IPR&D). Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to annual impairment tests. If the assumptions and estimates used to allocate the purchase price are not correct, or if business conditions change, purchase price adjustments or future asset impairment charges could be required. In accordance with SFAS No. 142, we test goodwill for impairment on an annual basis or more frequently if we believe indicators of impairment exist. Impairment evaluations involve management estimates of asset useful lives and future cash flows. Significant management judgment is required in the forecasts of future operating results that are used in the evaluations. It is possible, however, that the plans and estimates used may be incorrect. If our actual results, or the plans and estimates used in future impairment analysis, are lower than the original estimates used to assess the recoverability of these assets, we could incur additional impairment charges in a future period.

Results of Operations

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

Revenue and Cost of Product Sales

Revenue for the three months and six months ended June 30, 2009, as compared with the same periods in 2008, is summarized in the table below:

	Three months ended, June 30		Change in 2009 versus 2008		Six months ended, June 30		Change in 2009 versus 2008	
	2009	2008	$	%	2009	2008	$	%
Revenue:								
Licensing agreements and grants	$ 144,851	$ 29,832	$ 115,019	386%	$ 201,453	$ 47,182	$ 154,271	327%
Product sales	120,600		120,600	*	120,600		120,600	*
Total revenues	265,451	29,832	235,619	790%	322,053	47,182	274,871	583%
Cost of product sales	(59,525)		(59,525)	*	(59,525)		(59,525)	*
Gross Profit	$ 205,926	$ 29,832	$ 176,094	590%	$ 262,528	$ 47,182	$ 215,346	456%

* Calculation is not meaningful

Total revenue in the second quarter of 2009 was approximately $265,000, which was 790% higher than total revenue in the second quarter of 2008. The increase in 2009 compared to 2008 was primarily attributable to consolidation of revenues from the acquired SCS operations in the second quarter of 2009, which were not part of our operations in the same period in 2008.

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Second quarter ended June 30, 2009 versus second quarter ended June 30, 2008. Licensing and grant revenue for the second quarter of 2009 were approximately $145,000, or 386%, higher as compared to the same period in 2008. This increase was primarily attributable to approximately $90,000 in grant revenue recognized and consolidated as part of our acquisition of the SCS operations. Licensing and grant revenue for 2009 also includes approximately $21,000 from an existing grant from the National Institute of Diabetes and Digestive and Kidney Diseases to research and develop a potential cell-based therapeutic for liver disease. The remaining revenue under licensing and grant revenue for the second quarter of 2009 and 2008 consist of licensing fees from existing licensing agreements. In the second quarter of 2009, we recognized and consolidated approximately $121,000 and $60,000 as revenue from product sales and cost of product sales, respectively, in connection with our acquisition of the SCS operations, compared to none in the same period of 2008.

Six-month period ended June 30, 2009 versus six-month period ended June 30, 2008. Licensing and grant revenue for the second quarter of 2009 were approximately $201,000, or 326%, higher as compared to the same period in 2008. This increase was primarily attributable to approximately $90,000 in grant revenue recognized and consolidated as part of our acquisition of the SCS operations. Licensing and grant revenue for 2009 also includes approximately $51,000 from an existing grant from the National Institute of Diabetes and Digestive and Kidney Diseases to research and develop a potential cell-based therapeutic for liver disease. The remaining revenue under licensing and grant revenue for the six months ended June 30, 2009 and 2008 consist of licensing fees from existing licensing agreements. For the six months ended June 30, 2009, we recognized and consolidated approximately $121,000 and $60,000 as revenue from product sales and cost of product sales, respectively, in connection with of our acquisition of the SCS operations, compared to none in the same period of 2008.

Operating Expenses

Operating expenses for the three and six month periods ended June 30, 2009, as compared with the same periods in 2008, are summarized in the table below:

	Three months ended, June 30		Change in 2009 versus 2008		Six months ended, June 30		Change in 2009 versus 2008	
	2009	**2008**	**$**	**%**	**2009**	**2008**	**$**	**%**
Operating expenses:								
Research & development	$ 5,054,600	$ 4,415,615	$ 638,985	14%	$ 9,290,389	$ 8,915,366	$ 375,023	4%
General & administrative	2,201,974	2,345,846	(143,872)	(6)%	4,740,886	4,600,049	140,837	3%
Wind-down expenses	340,064	167,250	172,814	103%	545,500	327,500	218,000	67%
Total operating expenses	$ 7,596,638	$ 6,928,711	$ 667,927	10%	$ 14,576,775	$ 13,842,915	$ 733,860	5%

Research and Development Expenses

Our R&D expenses consist primarily of salaries and related personnel expenses, costs associated with clinical trials and regulatory submissions; costs associated with preclinical activities such as toxicology studies; costs associated with cell processing and process development; certain patent-related costs such as licensing; facilities related costs such as depreciation; lab equipment and supplies. Clinical trial expenses include payments to vendors such as clinical research organizations, contract manufacturers, clinical trial sites, laboratories for testing clinical samples and consultants. Cumulative R&D costs incurred since we refocused our activities on developing cell-based therapeutics (fiscal years 2000 through the six months ended June 30, 2009) were approximately $101 million. Over this period, the majority of these cumulative costs were related to: (i) characterization of our proprietary HuCNS-SC cell,

(ii) expenditures for toxicology and other preclinical studies, preparation and submission of applications to regulatory agencies to conduct clinical trials and obtaining regulatory clearance to initiate such trials, all with respect to our HuCNS-SC cells, (iii) preclinical studies and development of our human liver engrafting cells; and (iv) costs associated with cell processing and process development.

We use and manage our R&D resources, including our employees and facilities, across various projects rather than on a project-by-project basis for the following reasons. The allocations of time and resources change as the needs and priorities of individual projects and programs change, and many of our researchers are assigned to more than one project at any given time. Furthermore, we are exploring multiple possible uses for each of our proprietary cell types, so much of our R&D effort is complementary to and supportive of each of these projects. Lastly, much of our R&D effort is focused on manufacturing processes, which can result in process improvements useful across cell types. We also use external service providers to assist in the conduct of our clinical trials, to manufacture certain of our product candidates and to provide various other R&D related products and services. Many of these costs

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and expenses are complementary to and supportive of each of our programs. Because we do not have a development collaborator for any of our product programs, we are currently responsible for all costs incurred with respect to our product candidates.

R&D expenses totaled approximately $5,055,000 in the second quarter of 2009 compared with $4,416,000 in the second quarter of 2008, and $9,290,000 for the six-month period ended June 30, 2009 compared with $8,915,000 for the six-month period ended June 30, 2008.

Second quarter ended June 30, 2009 versus second quarter ended June 30, 2008. R&D expense totaled approximately $5,055,000 in the second quarter of 2009, as compared to $4,416,000 for the same period in 2008. The increase of approximately $639,000, or 14%, from 2008 to 2009 was primarily attributable to increased R&D operations from our acquisition of the SCS operations. The R&D activity associated with the SCS operations is primarily focused on developing cell technologies for non-therapeutic applications, such as use in cell-based assays for drug discovery.

Six-month period ended June 30, 2009 versus six-month period ended June 30, 2008. R&D expense totaled approximately $9,290,000 in the six-month period ended June 30, 2009, as compared to $8,915,000 for the same period in 2008. The increase of approximately $375,000, or 4%, from 2008 to 2009 was primarily attributable to approximately $648,000 of additional R&D operations from our acquisition of the SCS operations. This increase was partially offset by a decrease in expenses for external services, including expenses related to manufacturing and testing of our cells and for our six-patient Phase I clinical trial for NCL, which was completed in January 2009.

At June 30, 2009, we had 68 full-time employees working in research and development and laboratory support services as compared to 45 at June 30, 2008.

General and Administrative Expenses

General and administrative (G&A) expenses totaled approximately $2,202,000 in the second quarter of 2009 compared with $2,346,000 in the second quarter of 2008, and $4,741,000 for the six-month period ended June 30, 2009 compared with $4,600,000 for the six-month period ended June 30, 2008.

Second quarter ended June 30, 2009 versus second quarter ended June 30, 2008. G&A expenses totaled approximately $2,202,000 in the second quarter of 2009, compared with $2,346,000 for the same period in 2008. The decrease of approximately $144,000, or 6%, from 2008 to 2009 was primarily attributable to a decrease in external services of approximately $484,000, mainly due to a decrease in legal expenses. This decrease was partially offset by approximately $172,000 of acquisition costs related to the acquisition of the SCS operations, an increase in personnel expenses of $124,000 primarily related to stock based compensation and an increase in other operating expenses of approximately $44,000.

Six-month period ended June 30, 2009 versus six-month period ended June 30, 2008. G&A expenses totaled approximately $4,741,000 in the six-month period ended June 30, 2009, compared with $4,600,000 for the same period in 2008. The increase of approximately $141,000, or 3%, from 2008 to 2009 was primarily attributable to approximately $710,000 of acquisition costs related to the acquisition of the SCS operations, an increase in personnel expenses of $235,000 primarily related to stock based compensation and an increase in other operating expenses of approximately $10,000. The increase was partially offset by a decrease in external services of approximately $814,000 primarily attributable to a decrease in legal fees.

Wind-down Expenses

	Three months ended, June 30		Six months ended, June 30	
	2009	**2008**	**2009**	**2008**
Rhode Island	$ 29,795	$ 167,250	$ 235,231	$ 327,500
Australia	310,269		310,269	
Total wind-down expenses	$ 340,064	$ 167,250	$ 545,500	$ 327,500

Rhode Island

In 1999, in connection with exiting our former research facility in Rhode Island, we created a reserve for the estimated lease payments and operating expenses related to it. The reserve has been re-evaluated and adjusted based on assumptions relevant to real estate market conditions and the estimated time until we could either fully sublease, assign or sell our remaining interests in the property. The reserve was approximately $5,513,000 at December 31, 2008. Payments net of subtenant income of approximately

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$293,000 for the second quarter and $624,000 for the six months ended June 30, 2009 were recorded against this reserve. At June 30, 2009, we re-evaluated the estimate and adjusted the reserve to approximately $5,022,000 by recording in aggregate, additional wind-down expenses of approximately $30,000 in the second quarter of 2009, for a total of approximately $235,000 for the six months ended June 30, 2009. Payments recorded against the reserve were approximately $288,000 in the second quarter and $619,000 for the six months ended June 30, 2008 and additional expenses recorded to adjust the reserve were approximately $167,000 in the second quarter and $327,000 for the six months ended June 30, 2008. Expenses for this facility will fluctuate based on changes in tenant occupancy rates and other operating expenses related to the lease. Even though it is our intent to sublease, assign, sell, or otherwise divest ourselves of our interests in the facility at the earliest possible time, we cannot determine with certainty a fixed date by which such events will occur. In light of this uncertainty, based on estimates, we will periodically re-evaluate and adjust the reserve, as necessary. See Note 5 Wind-down expenses, in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Australia

On April 1, 2009, as part of our acquisition of the operations of SCS, we acquired operations near Melbourne, Australia. In order to reduce operating complexity and expenses, we made the decision to close our site in Australia and consolidate personnel and programs to our Cambridge, U.K. and Palo Alto, California sites. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146), we established a short-term reserve of approximately $310,000, for the estimated costs to close down and exit our Australia operations. The reserve reflects the estimated cost to terminate our facility lease in Australia (with an original termination date of December 31, 2010), employee termination benefits and other liabilities associated with the wind-down and relocation of our operations in Australia. See Note 5 Wind-down expenses, in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Other Income (Expense)

Other income totaled approximately $24,000 in the second quarter of 2009 compared with $183,000 in the same period of 2008, and other expense of $2,334,000 for the six months ended June 30, 2009 compared with other income of $536,000 for the six months ended June 30, 2008.

	Three months ended, June 30		Change in 2009 versus 2008		Six months ended, June 30		Change in 2009 versus 2008	
	2009	2008	$	%	2009	2008	$	%
Other income (expense):								
Gain on sale of marketable securities					$ 397,866		$ 397,866	*
Change in fair value of warrant liability	102,517		102,517	*	(2,652,931)		(2,652,931)	*
Interest income	8,338	216,109	(207,771)	(96)%	50,285	599,774	(549,489)	(92)%
Interest expense	(29,074)	(28,970)	(104)	0%	(57,250)	(57,161)	(89)	0%
Other expense, net	(57,424)	(3,736)	(53,688)	1,437%	(71,634)	(7,345)	(64,289)	875%
Total other income	$ 24,357	$ 183,403	$ (159,046)	(87)%	$ (2,333,664)	$ 535,268	$ (2,868,932)	(536)%

* Calculation is not meaningful.

Gain on Sale of Marketable Equity Securities

In the first quarter of 2009, we sold in aggregate 2,900,000 shares of ReNeuron and received proceeds of approximately $510,000. We recognized a realized gain of approximately $398,000 for the quarter. We did not sell any ReNeuron shares in the second quarter of 2009. We owned 1,921,424 ordinary shares of ReNeuron at June 30, 2009.

Change in fair value of warrant liability

In connection with our financing in November 2008, we issued warrants to purchase in aggregate 10,344,828 shares of common stock at an exercise price of $2.30 per share and recorded the fair value of these warrants as a liability. The fair value of the warrant liability is revalued at the end of each reporting period, with the change in fair value of the warrant liability recorded as a gain or loss in our Consolidated Statements of Operations. We used the Black-Scholes option pricing model to estimate the fair value of these warrants and in using this model, we make certain assumptions about risk-free interest rates, dividend yields, volatility and expected

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term of the warrants. See Note 7 Warrant Liability in the Notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Fair value of warrant liability at December 31, 2008	$ 8,439,931
Change in fair value at March 31, 2009	2,755,448
Fair value of warrant liability at March 31, 2009	$ 11,195,379
Change in fair value at June 30, 2009	$ (102,517)
Fair value of warrant liability at June 30, 2009	$ 11,092,862

Interest Income

Interest income for the three months ended June 30, 2009 decreased by approximately $208,000, or 96%, compared to the same period in 2008. For the six months ended June 30, 2009, interest income decreased by approximately $549,000, or 92%, compared to the same period in 2008. The decreases in 2009 were primarily due to a lower average yield. See Cash Used in Investing Activities, in Liquidity and Capital Resources below for further information.

Interest Expense

Interest expense for the three and six months ended June 30, 2009, was relatively flat when compared to similar periods in 2008. Interest expense is primarily for outstanding debt and capital lease balances. See Note 6 Commitment and Contingencies, in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Liquidity and Capital Resources

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

	June 30, 2009	December 31, 2008	Change $	Change %
Cash, cash equivalents and marketable debt securities	$36,760,470	$34,037,775	$2,722,695	8%

In summary, our cash flows were:

	Six months ended June 30, 2009	Six months ended June 30, 2008	Change in 2009 Versus 2008 $	Change in 2009 Versus 2008 %
Net cash used in operating activities	$(12,382,825)	$(12,226,271)	$ (156,554)	1%
Net cash provided by investing activities	$ 4,038,189	$ 21,010,191	$(16,972,002)	(81)%
Net cash provided by financing activities	$ 15,208,452	$ 49,634	$ 15,158,818	30,541%

Net Cash Used in Operating Activities

Net cash used in operating activities in the first six months of 2009 was up slightly compared to the same period of 2008. Cash used in operating activities is primarily driven by our net loss but operating cash flows differ from net loss due to non-cash charges or differences in the timing of cash flows.

Net Cash Provided by Investing Activities

The decrease of approximately $16,972,000 or 81% from 2008 to 2009 for net cash provided by investing activities, was primarily attributable to a higher number of marketable debt securities maturing in the first six months of 2008 as compared to the similar period in 2009.

Net Cash Provided by Financing Activities

The increase from 2008 to 2009 of approximately $15,159,000 for net cash provided by financing activities was primarily attributable to net proceeds of approximately $14,987,000 from the sale of approximately 8,262,000 shares of common stock at an

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average price of $1.89 per share in the six months ended June 30, 2009. These shares were sold under sales agreements with Cantor Fitzgerald & Co. (Cantor).

Listed below are key financing transactions entered into by us in the last three years:

In June 2009, we sold a total of 275,000 shares of common stock under a sales agreement with Cantor, which we entered into and filed a Prospectus Supplement to announce, in June 2009. These shares were sold at an average price of $1.79 per share for gross proceeds of approximately $491,000. Under the terms of the agreement, up to $30,000,000 worth of shares may be sold from time to time under a shelf registration statement and Cantor is paid compensation equal to 3.0% of the gross proceeds of such sales.

From January 2007 through June 2009, we sold a total of 10,000,000 shares of common stock under a sales agreement with Cantor, which we entered into and filed a Prospectus Supplement to announce, in December 2006. These shares were sold at an average price of $2.06 per share for gross proceeds of approximately $20,555,000. Under the terms of this agreement, up to 10,000,000 shares could be sold from time to time under a shelf registration statement and Cantor was paid compensation equal to 5.0% of the gross proceeds.

In November 2008, we sold 13,793,104 units to institutional investors at a price of $1.45 per unit, for gross proceeds of $20,000,000. The units, each of which consisted of one share of common stock and a warrant to purchase 0.75 shares of common stock at an exercise price of $2.30 per share, were offered as a registered direct offering under an effective shelf registration statement previously filed with and declared effective by the SEC. We received total proceeds net of offering expenses and placement agency fees of approximately $18,637,000.

In April 2007, a warrant issued as part of our June 2004 financing was exercised to purchase an aggregate of 575,658 shares of our common stock at $1.90 per share. We issued 575,658 shares of our common stock and received proceeds of approximately $1,094,000.

In April 2006, we sold 11,750,820 shares of our common stock to institutional investors at a price of $3.05 per share, for gross proceeds of approximately $35,840,000. The shares were offered as a registered direct offering under an effective shelf registration statement previously filed with and declared effective by the SEC. We received total proceeds, net of offering expenses and placement agency fees, of approximately $33,422,000. No warrants were issued as part of this financing transaction.

In March 2006, a warrant issued as part of our June 2004 financing was exercised to purchase an aggregate of 526,400 shares of our common stock at $1.89 per share. We issued 526,400 shares of our common stock and received proceeds of approximately $995,000.

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 proceeds from equity and debt offerings, proceeds from the transfer or sale of our intellectual property rights, equipment, facilities or investments, and government grants and funding from collaborative arrangements, if obtainable, to fund our operations.

We intend to pursue opportunities to obtain additional financing in the future through equity and debt financings, grants and collaborative research arrangements. On June 25, 2008 we filed with the SEC a universal shelf registration statement, declared effective July 18, 2008, which permits us to issue up to $100 million worth of registered debt and

equity securities. Under this effective shelf registration, we have the flexibility to issue registered securities, from time to time, in one or more separate offerings or other transactions with the size, price and terms to be determined at the time of issuance. Registered securities issued using this shelf may be used to raise additional capital to fund our working capital and other corporate needs, for future acquisitions of assets, programs or businesses, and for other corporate purposes. As of August 3, 2009, we had approximately $61 million under our universal shelf registration statement available for issuing debt or equity securities; approximately $24 million of this $61 million has been reserved for the potential exercise of the warrants issued in connection with our November 2008 financing.

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

Commitments

See Note 6, Commitments and Contingencies in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

Off-Balance Sheet Arrangements

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

Operating Leases

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

Operating Leases California

We entered into and amended a lease agreement for an approximately 68,000 square foot facility located at the Stanford Research Park in Palo Alto, California. At June 30, 2009, we had a space-sharing agreement covering approximately 10,451 square feet of this facility. We receive base payments plus a proportionate share of the operating expenses based on square footage over the term of the agreement. We expect to receive, in aggregate, approximately $304,000 as part of the space-sharing agreement for the remainder of 2009. As a result of the above transactions, our estimated net cash outlay for rent and operating expenses will be approximately $1,600,000 for the remainder of 2009.

Operating Leases Rhode Island

We continue to have outstanding obligations in regard to our former facilities in Lincoln, Rhode Island. In 1997, we had entered into a fifteen-year lease for a scientific and administrative facility in a sale and leaseback arrangement. The lease includes escalating rent payments. We expect to pay approximately $586,000 in operating lease payments and estimated operating expenses of approximately $299,000, before receipt of sub-tenant income, for the remainder of 2009. We expect to receive, in aggregate, approximately $147,000 in sub-tenant rent and operating expense for the remainder of 2009. As a result of the above transactions, our estimated cash outlay net of sub-tenant rent for the facility will be approximately $738,000 for the remainder of 2009.

Operating Leases United Kingdom

On April 1, 2009, as part of our acquisition of the operations of SCS, we acquired operations in Cambridge, U.K.. Our wholly-owned subsidiary, Stem Cell Sciences UK Ltd, has two lease agreements with Babraham Bioscience Technologies Ltd., for in aggregate space of approximately 3,900 square feet of office and lab space in Cambridge, U.K.. The lease term for one ends on February 28, 2010 and the other on March 26, 2011. For these two leases, at June 30, 2009, we expect to pay approximately 55,000 U.K. pounds (GBP) as rental payments for the remainder of 2009.

Operating Leases Australia

On April 1, 2009, as part of our acquisition of the operations of SCS, we acquired operations near Melbourne, Australia. Our wholly-owned subsidiary, Stem Cell Sciences (Australia) Pty Ltd, is in a lease agreement with Monash University for approximately 1,938 square feet of office and lab space in Victoria, Australia. The lease term ends on December 31, 2010. In order to reduce operating complexity and expenses, we made the decision to close our site in Australia and consolidate personnel and programs to our

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Cambridge, U.K. and Palo Alto, California sites. We expect to pay approximately $86,000 for an early termination of the lease. See Note 5 Wind-down expenses, in the notes to condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q for further information.

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

Contractual Obligations

During the first six months of 2009, we believe that there have been no significant changes in our payments due under contractual obligations, as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008.

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued SFAS No. 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 establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with GAAP in the United States. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165). SFAS 165 establishes establish principles and requirements for subsequent events. It incorporates the accounting and disclosure requirements for subsequent events into GAAP in the United States. It defines a date through which management must evaluate subsequent events and lists the circumstances under which an entity must recognize and disclose events or transactions occurring after the balance sheet date but before financial statements are issued. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009. The adoption of this accounting standard will not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued the following new accounting standards:

FASB Staff Position No. 107-1 (FSP 107-1) and Accounting Principles Board (APB) Opinion No. 28-1 (APB 28-1), *Interim Disclosures about Fair Value of Financial Instruments,* which amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments* (SFAS 107) and APB Opinion No. 28, *Interim Financial Reporting* (APB 28)*,* to require disclosures about the fair value of financial instruments for interim as well as in annual financial statements. FSP 107-1 and APB 28-1 will be effective for interim reporting periods ending after June 15, 2009. The adoption of this accounting standard did not have a material impact on our consolidated financial statements.

FASB Staff Position No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP 157-4). FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157, *Fair Value Measurements, w*hen the volume and level of activity for the asset or liability have significantly decreased. FSP 157-4 will be applied prospectively and will be effective for interim and annual reporting periods ending after June 15, 2009. The adoption of FSP 157-4 did not have a material impact on our consolidated financial statements.

FASB Staff Position No. 115-2, (FSP 115-2) and FASB Staff Position No. 124-2 (FSP124-2), *Recognition and Presentation of Other-Than-Temporary Impairments,* which amends the other-than-temporary impairment guidance for debt and equity securities. FSP 115-2 and FSP 124-2 shall be effective for interim and annual reporting periods ending after June 15, 2009. The adoption of FSP 115-2 and FSP 124-2 did not have a material impact on our consolidated financial statements.

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FASB Staff Position No. FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (FSP 141 (R)-1). FSP 141 (R)-1 amends and clarifies FASB statement No. 141 (R), *Business Combinations* (SFAS 141 (R)), to address issues related to the recognition and measurement of assets and liabilities arising from contingencies in a business combination. Assets and liabilities assumed in a business combination that arise from contingencies should be recognized at fair value on the acquisition date if fair value can be reasonably estimated during the measurement period. If fair value cannot be reasonably estimated, companies should typically account for the acquired contingencies using existing guidance. We adopted SFAS 141(R) and FSP 141(R)-1 on January 1, 2009. We expect SFAS 141(R) and FSP 141(R) -1 will have an impact on our consolidated financial statements; however, the nature and magnitude of the impact will depend upon the nature, terms and size of the acquisition we consummate after the effective date.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risks at June 30, 2009 have not changed materially from those discussed in Item 7A of our Form 10-K for the year ended December 31, 2008 on file with the U.S. Securities and Exchange Commission.

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

ITEM 4. CONTROLS AND PROCEDURES

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

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

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In July 2006, we filed suit against Neuralstem, Inc. in the Federal District Court for the District of Maryland, alleging that Neuralstem s activities violate claims in four of the patents we exclusively licensed from NeuroSpheres. In December 2006, Neuralstem petitioned the U.S. Patent and Trademark Office (PTO) to reexamine two of the patents in our infringement action against Neuralstem, namely U.S. Patent No. 6,294,346 (claiming the use of human neural stem cells for drug screening) and U.S. Patent No. 7,101,709 (claiming the use of human neural stem cells for screening biological agents). In April 2007, Neuralstem petitioned the PTO to reexamine the remaining two patents in the suit, namely U.S. Patent No. 5,851,832 (claiming methods for proliferating human neural stem cells) and U.S. Patent No. 6,497,872 (claiming methods for transplanting human neural stem cells). These requests were granted by the PTO and, in June 2007, the parties voluntarily agreed to stay the pending litigation while the PTO considered these reexamination requests. In April 2008, the PTO upheld the 832 and 872 patents, as amended, and issued Notices of Intent to Issue an Ex Parte Reexamination Certificate for both. In May 2009, the PTO upheld the 346 and 709 patents, as amended, and issued Notices of Intent to Issue an Ex Parte Reexamination Certificate for both.

In May 2008, we filed a second patent infringement suit against Neuralstem and its two founders, Karl Johe and Richard Garr. In this suit, which we filed in the Federal District Court for the Northern District of California, we allege that Neuralstem s activities infringe claims in two patents we exclusively license from NeuroSpheres, specifically U.S. Patent No. 7,361,505 (claiming composition of matter of human neural stem cells derived from any source material) and U.S. Patent No. 7,115,418 (claiming methods for proliferating human neural stem cells). In addition, we allege various state law causes of action against Neuralstem arising out of its repeated derogatory statements to the public about our patent portfolio. Also in May 2008, Neuralstem filed suit against us and NeuroSpheres in the Federal District Court for the District of Maryland seeking a declaratory judgment that the 505 and 418 patents are either invalid or are not infringed by Neuralstem and that Neuralstem has not violated California state law. In August 2008, the California court transferred our lawsuit against Neuralstem to Maryland for resolution on the merits. In July 2009, the Maryland District Court granted our motion to consolidate these two cases with the litigation we initiated against Neuralstem in 2006. In August 2009, the Maryland District Court approved a scheduling order submitted by the parties for discovery and trial.

ITEM 1A. RISK FACTORS

There have been no material change from the risk factors disclosed in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 and Part II, Item 1A, of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2009

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

On June 29, 2009, we held our Annual Meeting of Stockholders. Mr. Martin McGlynn and Dr. Roger Perlmutter were re-elected to the Board as Class III directors, with terms expiring in 2012. The remaining members of the Board, whose terms continued after the Annual Meeting, are Mr. Eric Bjerkholt and Drs. Ricardo Levy, John Schwartz and Irving Weissman. The shareholders also ratified the selection of Grant Thornton LLP as StemCells independent public accountants for the fiscal year ending December 31, 2009.

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The number of proxies finally tabulated represented 79,855,320 of the 103,198,126 eligible shares, or 77.38 percent of eligible shares. The votes on each of the proposals were as follows:

	For	Authority Withheld	Against	Abstain
Election of Martin McGlynn, as director	74,847,727	5,007,593		
Election of Roger Perlmutter, M.D., Ph.D., as director	75,766,424	4,088,896		
Ratification of Grant Thornton LLP as independent accountants for 2009	77,551,202		1,721,152	582,966

ITEM 5. OTHER INFORMATION

In May 2009, we terminated an agreement to purchase a building in Sunnyvale, California which we had entered into with North Pastoria Sunnyvale, LLC in March 2009. Our obligation to purchase the building was subject to due diligence and other pre-closing conditions, and we decided not to purchase the building.

In August 2009, we amended the employment agreement between us and Ken Stratton, our General Counsel. Under the terms of the amendment, if Mr. Stratton s employment is involuntarily terminated by us other than for cause, Mr. Stratton would be entitled to receive salary and benefits continuation at his then-current base salary rate for a period of six months. In the event of a termination following a change of control of the Company, Mr. Stratton would be entitled to receive salary and benefits continuation at his then-current base salary rate for a period of 12 months.

ITEM 6. EXHIBITS

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

Exhibit 31.2 Certification of Rodney K. B. Young under Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Certification of Martin McGlynn Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2 Certification of Rodney K. B. Young Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

STEMCELLS, INC.
(name of Registrant)

August 7, 2009

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

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Exhibit Index

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Exhibit 32.2 Certification of Rodney K. B. Young Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002