

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2009

Commission File Number: 0-51891

INTERNATIONAL STEM CELL CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-4494098
(I.R.S. Employer
Identification No.)

2595 Jason Court
Oceanside, CA 92056
(Address of Principal Executive Offices)

(760) 940-6383
(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES ☐ NO ☒

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ☐ NO ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Number of shares outstanding of each of the issuer's classes of common equity, as of August 5, 2009: Common Stock: 47,650,810.

International Stem Cell Corporation and Subsidiary
(A Development Stage Company)
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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

International Stem Cell Corporation and Subsidiary
(A Development Stage Company)
Condensed Consolidated Statements of Financial Condition

	June 30, 2009 (Unaudited)	December 31, 2008
Assets		
Cash and cash equivalents	\$ 1,153,244	\$ 381,822
Accounts receivable	112,790	81,898
Inventory	354,871	417,343
Prepaid assets	190,790	75,428
Total Current Assets	<u>1,811,695</u>	<u>956,491</u>
Property and equipment, net	826,235	625,870
Patent licenses, net	697,140	637,205
Deposits and other assets	23,311	22,186
Total assets	<u><u>\$ 3,358,381</u></u>	<u><u>\$ 2,241,752</u></u>
Liabilities, Stockholders' Equity		
Accounts payable	\$ 561,024	\$ 465,034
Accrued expenses	-	231,488
Convertible debt and advances	250,000	690,994
Related party payables	442,505	420,931
Warrants to purchase common stock	2,660,818	-
Total liabilities	<u>4,731,122</u>	<u>1,808,447</u>
Commitments and contingencies		
Members' Deficit and Stockholders' Equity		
Common Stock, \$.001 par value, 200,000,000 shares authorized, 46,160,112 shares and 38,410,675 shares issued.	46,160	38,410
Preferred Stock, \$.001 par value, 20,000,000 shares authorized, 3,400,040 shares and 3,550,010 shares issued.	3,400	3,550
Preferred Stock Subscriptions	1,000,000	-
Additional paid-in capital	29,282,817	24,491,311
Deficit accumulated during the development stage	(31,705,118)	(24,099,966)
Total members' deficit and stockholders' equity	<u>(1,372,741)</u>	<u>433,305</u>
Total liabilities, stockholders' equity	<u><u>\$ 3,358,381</u></u>	<u><u>\$ 2,241,752</u></u>

See accompanying notes to the unaudited condensed consolidated financial statements.

International Stem Cell Corporation and Subsidiary
(A Development Stage Company)
Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,		Inception (August 2001) through June 30, 2009
	2009	2008	2009	2008	
Revenues					
Sales, net	\$ 388,810	\$ 122,303	\$ 572,109	\$ 154,635	\$ 1,116,630
Development expenses					
Cost of sales	260,179	56,006	550,341	76,865	751,468
Research and development	524,449	662,922	1,072,050	1,250,963	9,393,866
Marketing	128,021	78,647	263,520	227,994	1,275,871
General and administrative	1,574,191	999,688	2,377,379	1,885,347	13,790,190
Total development expenses	<u>2,486,840</u>	<u>1,797,263</u>	<u>4,263,290</u>	<u>3,441,169</u>	<u>25,211,395</u>
Loss from development activities	<u>(2,098,030)</u>	<u>(1,674,960)</u>	<u>(3,691,181)</u>	<u>(3,286,534)</u>	<u>(24,094,765)</u>
Other income (expense)					
Settlement with related company	-	-	-	-	(93,333)
Miscellaneous income	-	-	-	-	9,000
Dividend income	52	4	93	361	55,749
Interest expense	(74,106)	(123,100)	(81,071)	(129,145)	(2,197,480)
Sublease income	2,100	2,100	4,200	4,200	41,329
Change in market value of warrants	(2,055,777)	-	(2,055,777)	-	(2,055,777)
Total other expense	<u>(2,127,731)</u>	<u>(120,996)</u>	<u>(2,132,555)</u>	<u>(124,584)</u>	<u>(4,240,512)</u>
Loss before income taxes	<u>(4,225,761)</u>	<u>(1,795,956)</u>	<u>(5,823,736)</u>	<u>(3,411,118)</u>	<u>(28,335,277)</u>
Provision for income taxes	-	-	-	-	6,800
Net loss	<u>\$ (4,225,761)</u>	<u>\$ (1,795,956)</u>	<u>\$ (5,823,736)</u>	<u>\$ (3,411,118)</u>	<u>\$ (28,342,077)</u>
Deemed dividend on preferred stock	\$ -	\$ 85,230	\$ 1,480,000	\$ 525,106	
Net loss attributable to common shareholders	<u>\$ (4,225,761)</u>	<u>\$ (1,881,186)</u>	<u>\$ (7,303,736)</u>	<u>\$ (3,936,224)</u>	
Net loss per share computation:					
Weighted average shares outstanding	<u>41,263,099</u>	<u>35,590,044</u>	<u>41,684,918</u>	<u>35,422,797</u>	
Net loss per share – Basic and Diluted	<u>\$ (0.10)</u>	<u>\$ (0.05)</u>	<u>\$ (0.18)</u>	<u>\$ (0.11)</u>	

See accompanying notes to the unaudited condensed consolidated financial statements.

International Stem Cell Corporation and Subsidiary
(A Development Stage Company)
Condensed Consolidated Statements of Members' Deficit and Stockholders' Equity

(Unaudited)

	Common Stock		Preferred Stock		Subscribed	Additional	Accumulated	Total	Members'
	Shares	Amount	Shares	Amount					
Balance at August 17, 2001									
Members contribution									\$ 100,000
Net loss for the period from inception									(140,996)
Balance at December 31, 2001									(40,996)
Members contributions									250,000
Net loss for the year ended									(390,751)
Balance at December 31, 2002									(181,747)
Members contributions									195,000
Net loss for the year ended									(518,895)
Balance at December 31, 2003									(505,642)
Members contribution									1,110,000
Net loss for the year ended									(854,718)
Activity through December 31, 2004									(250,360)
Members contributions									780,000
Net loss for the year ended December 31, 2002									(1,385,745)
Balance at December 31, 2005									(856,105)
Members contribution									250,000
Effect of the Reorganization Transactions	20,000,000	20,000				2,665,000	(3,291,105)	(606,105)	606,105
BTHC transactions	2,209,993	2,210				(2,210)		-	
Offering costs						(2,778,082)		(2,778,082)	
Warrants issued for equity placement services						1,230,649		1,230,649	
Warrants issued for services						222,077		222,077	
Warrants issued with promissory note						637,828		637,828	
Common stock issued for services	1,350,000	1,350				1,348,650		1,350,000	
Issuance of common stock	10,436,502	10,436				10,371,512		10,381,948	
Stock-based compensation						842,374		842,374	
Net loss for the year ended December 31, 2006							(6,583,927)	(6,583,927)	
Balance at December 31, 2006	33,996,495	33,996				14,537,798	(9,875,032)	4,696,762	-
Offering costs						(382,124)		(382,124)	
Warrants issued for equity placement services						169,249		169,249	
Issuance of common stock	1,370,000	1,370				1,368,630		1,370,000	
Warrants exercised	3,000	3				2,997		3,000	
Stock-based compensation						427,496		427,496	

Net loss for the quarter
ended December 31,
2007

(6,071,983)

(6,071,983)

Continued

International Stem Cell Corporation and Subsidiary
(A Development Stage Company)
Condensed Consolidated Statements of Members' Deficit and Stockholders' Equity Continued

(Unaudited)

	<u>Common Stock</u>		<u>Preferred Stock</u>		<u>Subscribed</u>	<u>Additional</u>	<u>Accumulated</u>	<u>Total</u>	<u>Members'</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>					
Balance at December 31, 2007	35,369,495	\$ 35,369	-	\$ -		\$ 16,124,046	\$ (15,947,015)	\$ 212,400	-
Issuance of Preferred Stock			3,550,010	3,550		4,546,450		4,550,000	
Warrants issued and beneficial conversion feature						910,963		910,963	
Issuance of Common Stock for services	3,041,180	3,041				593,358		596,399	
Stock-based compensation						734,867		734,867	
Deemed Dividend						1,581,627	(1,581,627)	-	
Net loss for the quarter ended Dec 31, 2008							(6,571,324)	(6,571,324)	
Balance at December 31, 2008	38,410,675	38,410	3,550,010	3,550		24,491,311	(24,099,966)	433,305	
Issuance of Preferred Stock			20			2,000,000		2,000,000	
Preferred Stock Subscription					1,000,000			1,000,000	
Issuance of Common Stock									
From sale of shares	1,170,329	1,170				523,830		525,000	
For services	220,000	220				145,780		146,000	
From conversion of preferred stock	600,000	600	(150,000)	(150)		(450)			
From conversion of debt	2,000,000	2,000				498,000		500,000	
From exercise of warrants	3,759,108	3,760				83,355		87,115	
Stock-based compensation	-					227,145		227,145	
Warrants issued for services	-					281,416		281,416	
Options issued for services	-					106,058		106,058	
Deemed Dividend	-					1,480,000	(1,480,000)	-	
Cumulative effect adjustment - changes in fair value of warrants						(301,413)	(2,357,193)	(301,413)	
Equity placement shares						(250,000)	-	(250,000)	
Reclassification of warrants to liabilities						(303,628)		(303,628)	
Net loss for the six months ended June 30, 2009							(5,823,736)	(5,823,736)	
Balance at June 30, 2009	46,160,112	\$ 46,160	3,400,030	\$ 3,400	\$ 1,000,000	\$29,282,817	\$(31,705,118)	\$(1,372,741)	

See accompanying notes to the unaudited condensed consolidated financial statements.

International Stem Cell Corporation and Subsidiary
(A Development Stage Company)
Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended June 30,		Inception (August 2001) through June 30, 2008
	2009	2008	
Net loss	\$ (5,823,736)	\$ (3,411,118)	\$ (28,343,077)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	82,733	79,486	535,205
Accretion of discount on Notes Payable	-	-	103,304
Accretion of discount on bridge loans	-	-	637,828
Non-cash warrants for services	-	-	222,077
Non-cash warrants for equity placement services	281,416	-	503,493
Non-cash compensation expense	333,203	576,384	2,231,881
Common stock issued for services	146,000	95,549	1,976,402
Amortization of Discount on Convertible Notes	67,227	117,004	1,082,005
Change in market value of warrants	2,055,777	-	2,055,777
Changes in operating assets and liabilities			
(Increase) decrease in accounts receivable	(30,892)	(3,886)	(112,790)
(Increase) decrease in inventory	62,472	(56,667)	(354,871)
(Increase) decrease in prepaid assets	(115,362)	(21,877)	(190,790)
(Increase) decrease in deposits and other assets	(1,125)	-	(23,311)
Increase (decrease) in accounts payable	95,990	437,688	561,025
Increase (decrease) in accrued liabilities	335,284	(1,522)	528,330
Increase (decrease) in related party payables	13,353	(372,861)	278,001
Net cash used in operating activities	(2,497,660)	(2,561,821)	(18,309,511)
Investing activities			
Purchases of property and equipment	(255,553)	(18,298)	(1,149,124)
Payments for patent licenses and trademarks	(87,480)	(29,041)	(909,458)
Net cash used in investing activities	(343,033)	(47,339)	(2,058,582)
Financing activities			
Members' contributions	-	-	2,685,000
Proceeds from issuance of common stock, Preferred Stock, and warrant exercises	2,612,115	1,400,000	20,675,598
Proceeds from Preferred Stock Subscribed	1,000,000	-	1,300,000
Proceeds for issuance of convertible promissory notes	-	-	2,099,552
Net proceeds from convertible debt and advances	-	1,080,000	1,080,000
Payment of promissory notes	-	-	(2,202,856)
Payment of loan payable	-	-	(1,125,000)
Payment of offering costs	-	-	(2,990,957)
Net cash provided by financing activities	3,612,115	2,480,000	21,521,337
Net (decrease) increase in cash	771,422	(129,160)	1,153,244
Cash and cash equivalents, beginning of period	381,822	165,344	-
Cash and cash equivalents, end of period	<u>\$ 1,153,244</u>	<u>\$ 36,184</u>	<u>\$ 1,153,244</u>
Supplemental disclosures of cash flow information:			
Cash paid for interest	<u>\$ 277</u>	<u>\$ -</u>	<u>\$ 333,049</u>
Cash paid for income taxes	<u>\$ 3,265</u>	<u>\$ -</u>	<u>\$ 7,400</u>
Non-cash financing activities:			
Warrants issued with promissory notes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 637,828</u>
Warrants issued for placements agent services	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,230,649</u>
Deemed dividend on preferred stock	<u>\$ 1,480,000</u>	<u>\$ 525,106</u>	<u>\$ 3,061,627</u>
Accrual of equity placement costs	<u>\$ 250,000</u>	<u>\$ -</u>	<u>\$ 250,000</u>
Conversion of debt to common stock	<u>\$ 500,000</u>	<u>\$ -</u>	<u>\$ 500,000</u>
Discounts on convertible debt from beneficial conversion feature	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 641,331</u>
Discounts on convertible debt from warrants	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 269,632</u>
Cumulative effect adjustment - warranty to purchase common stock	<u>\$ 605,041</u>	<u>\$ -</u>	<u>\$ 605,041</u>
Conversion of preferred stock	<u>\$ 600</u>	<u>\$ -</u>	<u>\$ 600</u>

See accompanying notes to the unaudited condensed consolidated financial statements.

International Stem Cell Corporation and Subsidiary
(A Development Stage Company)

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization and Significant Accounting Policies

Business Combination and Corporate Restructure

BTHC III, Inc. ("BTHC III" or the "Company") was organized in Delaware in June 2005 as a shell company to effect the reincorporation of BTHC III, Inc., a Texas limited liability company. On December 28, 2006, we effected a Share Exchange pursuant to which we acquired all of the stock of International Stem Cell Corporation, a California corporation ("ISC California"). After giving effect to the Share Exchange, the stockholders of ISC California owned 93.7% of our issued and outstanding shares of common stock. As a result of the Share Exchange, ISC California is now our wholly-owned subsidiary, though for accounting purposes it was deemed to have been the acquirer in a "reverse merger." In the reverse merger, BTHC III is considered the legal acquirer and ISC California is considered the accounting acquirer. On January 29, 2007, we changed our name from BTHC III, Inc. to International Stem Cell Corporation.

Lifeline Cell Technology, LLC ("Lifeline") was formed in the State of California on August 17, 2001. Lifeline is in the business of developing and manufacturing human embryonic stem cells and reagents free from animal protein contamination. Lifeline's scientists have used a technology, called basal medium optimization to systematically eliminate animal proteins from cell culture systems. Lifeline is unique in the industry in that it has in place scientific and manufacturing staff with the experience and knowledge to set up systems and facilities to produce a source of consistent, standardized, animal protein free ES cell products suitable for FDA approval.

On July 1, 2006, Lifeline entered into an agreement among Lifeline, ISC California and the holders of membership units and warrants. Pursuant to the terms of the agreement, all the membership units in Lifeline were exchanged for 20,000,000 shares of ISC California Common Stock and for ISC California assumption of Lifeline's obligations under the warrants. Lifeline became a wholly owned subsidiary of ISC California.

Going Concern

The Company continues in the development stage and as such has accumulated losses from inception and expects to incur additional losses in the near future. The Company needs to raise additional working capital. The timing and degree of any future capital requirements will depend on many factors. There can be no assurance that the Company will be successful in maintaining its normal operating cash flow and the timing of its capital expenditures will result in cash flow sufficient to sustain the Company's operations through 2009. Based on the above, there is substantial doubt about the Company's ability to continue as a going concern. The financial statements were prepared assuming that the Company is a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty. Management's plans in regard to these matters are focused on managing its cash flow, the proper timing of its capital expenditures, and raising additional capital or financing in the future.

Basis of Presentation

International Stem Cell Corporation was formed in June 2006. BTHC III, Inc. was a shell company that had no operations and no net assets. For accounting purposes the acquisition has been treated as a recapitalization of BTHC III with ISC California as the accounting acquirer (reverse acquisition). The historic statements prior to June 2006 are those of Lifeline Cell Technology, the wholly owned subsidiary of ISC California.

The accompanying unaudited condensed consolidated financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q. They do not include all information and notes required by generally accepted accounting principles for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to consolidated financial statements included in the annual report on Form 10-K of International Stem Cell Corporation for the year ended December 31, 2008. When used in these notes, the terms "Company," "we," "us," or "our" mean International Stem Cell Corporation and all entities included in our unaudited condensed consolidated financial statements.

In the opinion of management, the unaudited condensed consolidated financial information for the interim periods presented reflects all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the Company's consolidated results of operations, financial position and cash flows. The unaudited condensed consolidated financial statements and the related notes should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2008 included in the Company's annual report on Form 10-K. Operating results for interim periods are not necessarily indicative of the operating results for any interim period or an entire year.

Principles of Consolidation

The unaudited condensed consolidated financial statements of the Company include the accounts of International Stem Cell Corporation and its subsidiary after intercompany balances and transactions have been eliminated.

Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Inventories

Inventories are stated at the lower of cost or market. Lab supplies used in the research and development process are expensed as consumed. Inventory is reviewed periodically for product expiration and obsolescence and adjusted accordingly.

Property and Equipment

Property and equipment are stated at cost. The provision for depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets, which generally range from three to five years. The costs of major remodeling and leasehold improvements are capitalized and depreciated over the shorter of the remaining term of the lease or the life of the asset.

Patent Licenses

Patent licenses consist of acquired research and development rights used in research and development, which have alternative future uses. Patent licenses are recorded at cost of \$909,458 and \$787,176 at June 30, 2009 and 2008, respectively, and are amortized on a straight-line basis over the shorter of the lives of the underlying patents or the useful life of the license. Amortization expense for the six months ended June 30, 2009 and 2008 amounted to \$27,545 and \$26,733, respectively, and is included in research and development expense. Additional information regarding patent licenses is included in Note 4.

Long-Lived Asset Impairment

The Company reviews long-lived assets for impairment when events or changes in business conditions indicate that their carrying value may not be recovered. The Company considers assets to be impaired and writes them down to fair value if expected associated cash flows are less than the carrying amounts. Fair value is the present value of the associated cash flows. The Company has determined that no material long-lived assets are impaired at June 30, 2009. See Note 4 for a discussion on the Company's patent licenses.

Product Sales

Revenue from product sales is recognized at the time of shipment to the customer provided all other revenue recognition criteria of the Security and Exchange Commission's Staff Accounting Bulletin No. 104, Revenue Recognition, have been met. If the customer has a right of return, in accordance with the provision set forth in the Financial Accounting Standards Board's (FASB) Statement No. 48, Revenue Recognition When Right of Return Exists (SFAS 48), the Company recognizes product revenues upon shipment, provided that future returns can be reasonably estimated. In the case where returns cannot be reasonably estimated, revenue will be deferred until such estimates can be made.

Revenue Arrangements with Multiple Deliverables

The Company sometimes enters into revenue arrangements that contain multiple deliverables in accordance with EITF No. 00-21. This issue addresses the timing and method of revenue recognition for revenue arrangements that include the delivery of more than one product or service. In these cases, the Company recognizes revenue from each element of the arrangement as long as separate value for each element can be determined, the Company has completed its obligation to deliver or perform on that element, and collection of the resulting receivable is reasonably assured.

Cost of Sales

Cost of sales consists primarily of costs and expenses for salaries and benefits associated with employee efforts expended directly on the production of the Company's products and include related direct materials, overhead and occupancy costs. Certain of the agreements under which the Company has licensed technology will require the payment of royalties based on the sale of its future products. Such royalties will be recorded a component of cost of sales. Additionally, the amortization of license fees or milestone payments related to developed technologies used in the Company's products will be classified as a component of cost of sales to the extent such payments become due in the future.

Research and Development Costs

Research and development costs, which are expensed as incurred, are primarily comprised of costs and expenses for salaries and benefits associated with research and development personnel; overhead and occupancy; contract services; and amortization of technology used in research and development with alternative future uses.

Registration Payment Arrangements

The Company adopted FASB Staff Position No. EITF 00-19-2, Accounting for Registration Payment Arrangements ("FSP EITF 00-19-2"), on January 2007. FSP EITF 00-19-2 requires that companies separately recognize and measure registration payment arrangements, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement. Such payments include penalties for failure to effect a registration of securities.

Prior to the adoption of FSP EITF 00-19-2, the Company accounted for registration rights as separate arrangements. Accordingly, the adoption of FSP EITF 00-19-2 had no impact on the consolidated financial position, operations, or cash flows of the Company for the period ended June 30, 2009.

Fair Value Measurements

On January 1, 2008, the Company adopted SFAS No. 157 (SFAS 157), Fair Value Measurements. SFAS 157 relates to financial assets and financial liabilities. In February 2008, the FASB issued FASB Staff Position (FSP) No. FAS 157-2, Effective Date of FASB Statement No. 157, which delayed the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on at least an annual basis, until January 1, 2009 for calendar year-end entities.

SFAS 157 defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America (GAAP), and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements and are to be applied prospectively with limited exceptions. FSP FAS 157-1 amends SFAS 157 to exclude from the scope of SFAS 157 certain leasing transactions accounted for under Statement of Financial Accounting Standards No. 13, "Accounting for Leases." FSP FAS 157 amends SFAS 157 to defer the effective date of SFAS 157 for all non-financial assets and non-financial liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis to fiscal years beginning after November 15, 2008. In addition, effective for the third quarter of 2008, the Company adopted FASB Staff Position 157-3 "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP FAS 157-3"). FSP FAS 157-3 clarifies the application of SFAS 157 to financial instruments in an inactive market. The adoption of SFAS 157, FSP FAS 157-3 did not have a material impact on the Company's financial statements.

Effective January 1, 2008, the Company also adopted, on a prospective basis, Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The adoption of SFAS 159 did not have a material impact on the Company's consolidated financial statements since the Company elected not to apply the fair value option for any of its eligible financial instruments or other items.

In April 2009, the FASB issued FASB Staff Position (FSP) SFAS No. 157-4, "Determining the Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly," provides additional guidance for estimating fair value in accordance with FASB Statement No. 157, "Fair Value Measurements," when the volume and level of activity for the asset or liability have significantly decreased. SFAS No. 157-4 also provides guidance on identifying circumstances that indicate a transaction is not orderly. FSP SFAS No. 157-4 is effective for interim and periods ending after June 15, 2009, and shall be applied prospectively. This did not have a material impact on the Company's financial statements.

In June 2008, the FASB finalized EITF 07-5. "Determining Whether and Instrument (or Embedded Feature) is indexed to an Entity's Own Stock". The EITF lays out a procedure to determine if any equity-linked financial instrument (or embedded feature) is indexed to its own common stock. The EITF is effective for fiscal years beginning after December 15, 2008.

On June 30, 2009, in connection with our adoption of EITF 07-5, the Company reclassified the fair value of 3,100,000 of our issued and outstanding common stock purchase warrants previously treated as equity pursuant to the derivative treatment exemption to a derivative liability. These common stock purchase warrants do not trade in an active securities market, and as such, we estimated the fair value of these warrants using the Black-Scholes option pricing model and all changes in the fair value of these warrants will be recognized currently in earnings until such time as the warrants are exercised or expire. To recognize the fair value of such warrants on January 1, 2009 we reclassified from additional paid-in capital of \$303,628, and a cumulative effect adjustment to Accumulated deficit of \$301,413 to a long-term warrant liability of \$605,041. For the six months ended June 30, 2009, we recorded an increase in market value of \$2,055,777. The fair value of the outstanding warrants to purchase common stock as of June 30, 2009 was \$2,660,818.

In connection with the Series A and B rounds of financing, each investor received a warrant to purchase up to a number of shares of common stock for \$1.00. Subsequently, the exercised price for those warrants were adjusted down to \$0.25 per share. The following assumptions were used to calculate the fair value of the warrants using the Black-Scholes option pricing model.

	June 30, 2009
Expected life (years)	4.0
Expected volatility	68.1%
Risk-free interest rate	1.3%
Expected dividend yield 0.0%	

During the six months ended June 30, 2009, no Series A or B warrants were exercised and as of June 30, 2009, we had outstanding warrants to purchase an aggregate of 3,100,000 shares of common stock.

FAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FAS 157 are described below:

Level 1	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
Level 2	Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and
Level 3	Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

The following table sets forth the Company's financial assets and liabilities measured at fair value by level within the fair value hierarchy. As required by FAS 157, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

The table below sets forth a summary of the fair values of the Company's warrants as of June 30, 2009.

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
ASSETS:				
Fair value of warrants	\$2,660,818	\$ -	\$ -	\$2,660,818

Equity-linked financial instruments consist of stock warrants issued by the Company that contain a strike price adjustment feature. In accordance with EITF 07-5, we calculated the fair value of warrants using the Black Scholes option pricing model and the assumptions used are described above.

Recent Accounting Pronouncements

In December 2007, the FASB issued Statement No. 141 (revised 2007), Business Combinations.(SFAS 141(r)"). The new standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This statement was effective for the Company beginning January 1, 2009 and did not have an impact on the consolidated financial statements.

In December, 2007, the FASB issued Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51("SFAS 160"). This statement establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective prospectively, except for certain retrospective disclosure requirements, for fiscal years beginning after December 15, 2008. The statement was effective for the Company beginning January 1, 2009 and did not have an impact on its consolidated financial statements.

In December 2007, FASB ratified the consensus reached by EITF on EITF Issue 07-1, Accounting for Collaborative Arrangements, or EITF 07-1. EITF 07-1 requires collaborators to present the results of activities for which they act as the principal on a gross basis and report any payments received from (made to) other collaborators based on other applicable GAAP or, in the absence of other applicable GAAP, based on analogy to authoritative accounting literature or a reasonable, rational, and consistently applied accounting policy election. Further, EITF 07-1 clarified that the determination of whether transactions within a collaborative arrangement are part of a vendor-customer (or analogous) relationship subject to EITF 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)." EITF 07-1 will be effective beginning on January 1, 2008. The Company assessed the potential impact adopting this pronouncement would have on the consolidated financial statements and have concluded that there is no material impact as of December 31, 2008.

In April 2008, the FASB issued FSP FAS 142-3*Determination of the Useful Life of Intangible Assets*.The FSP states that in developing assumptions about renewal or extension options used to determine the useful life of an intangible asset, an entity needs to consider its own historical experience adjusted for entity-specific factors. In the absence of that experience, an entity shall consider the assumptions that market participants would use about renewal or extension options. This FSP is to be applied to intangible assets acquired after January 1, 2009. The adoption of this FSP did not have an impact on the Company's financial statements.

In May 2008, the FASB issued Statement No. 162, The Hierarchy of Generally Accepted Accounting Principles ("SFAS 162"). SFAS 162 identifies a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. generally accepted accounting principles for nongovernmental entities (the "Hierarchy"). The Hierarchy within SFAS 162 is consistent with that previously defined in the AICPA Statement on Auditing Standards No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles ("SAS 69"). SFAS 162 is effective 60 days following the United States Securities and Exchange Commission's (the "SEC") approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The adoption of SFAS 162 will not have a material effect on the consolidated financial statements because the Company has utilized the guidance within SAS 69.

In May 2008, the FASB issued Statement No. 163, Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 163 ("SFAS No. 163"). SFAS 163 requires recognition of an insurance claim liability prior to an event of default when there is evidence that credit deterioration has occurred in an insured financial obligation. SFAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years. Early application is not permitted. This statement was effective for the Company beginning January 1, 2009 and did not have an impact on the consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and Accounting Principles Board (APB) 28-*Interim Disclosures about Fair Value of Financial Instruments*. The FSP amends SFAS No. 107 "Disclosures about Fair Value of Financial Instruments" to require an entity to provide disclosures about fair value of financial instruments in interim financial information. This FSP is to be applied prospectively and is effective for interim and annual periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009. The adoption of this FSP did not have an impact on the Company's financial statements.

In April 2009, the FASB issued FSP FAS 141(R)-1 *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*. This FSP requires that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably estimated. If fair value cannot be reasonably estimated, the asset or liability would generally be recognized in accordance with SFAS No. 5, "Accounting for Contingencies" and FASB Interpretation No. 14, "Reasonable Estimation of the Amount of a Loss". Further, the FASB removed the subsequent accounting guidance for assets and liabilities arising from contingencies from SFAS No. 141(R). The requirements of this FSP carry forward without significant revision the guidance on contingencies of SFAS No. 141, "Business Combinations", which was superseded by SFAS No. 141(R) (see previous paragraph). The FSP also eliminates the requirement to disclose an estimate of the range of possible outcomes of recognized contingencies at the acquisition date. For unrecognized contingencies, the FASB requires that entities include only the disclosures required by SFAS No. 5. This FSP was adopted effective January 1, 2009. There was no impact upon adoption, and its effects on future periods will depend on the nature and significance of business combinations subject to this statement.

In April 2009, the FASB issued FASB Staff Position (FSP) No. FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments," to determine whether the holder of an investment in a debt or equity security for which changes in fair value are not regularly recognized in earnings (such as securities classified as held-to-maturity or available-for-sale) should recognize a loss in earnings when the investment is impaired. FSP No. FAS 115-2 and FAS 124-2 improves the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. The effective date for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. Earlier adoption for periods ending before March 15, 2009, is not permitted. The adoption of this FSP did not have an impact on the Company's financial statements.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events," which requires entities to disclose the date through which they have evaluated subsequent events and whether the date corresponds with the release of their financial statements. The statement establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 is effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively. The adoption of SFAS No. 165 did not have a material impact on the Company's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 166, "Accounting for Transfers of Financial Assets," which is an amendment of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," requires entities to provide more information about sales of securitized financial assets and similar transactions, particularly if the seller retains some risk to the assets. This statement will improve the relevance, representation faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets. It will also take into account the effects of a transfer on its financial position, financial performance, and cash flows, and a transferor's continuing involvement. SFAS No. 166 is effective for annual periods beginning after November 15, 2009. This statement is effective for the Company beginning January 1, 2010 and is expected to have no material impact on the financial statements.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB interpretation No. 46(R)," establishes how a company determines when an entity that is insufficiently capitalized or not controlled through voting should be consolidated. This statement improves financial reporting by enterprises involved with variable interest entities, which addresses the effects on certain provisions of FASB interpretation No. 46, "Consolidation of Variable Interest Entities," as a result of the elimination of the qualifying special-purpose entity concept in FASB No. 166, "Accounting for Transfers of Financial Assets," and constituent concerns about the application of certain key provisions of Interpretation 46(R). SFAS No. 167 is effective after November 15, 2009. This statement is effective for the Company beginning January 1, 2010 and is expected to have no material impact on the financial statements.

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles," Replaces SFAS No. 162, establishes the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. On the effective date for financial statements issued for interim and annual periods ending after September 15, 2009, the Codification will supersede all then-existing non-SEC accounting and reporting standards. The Company has determined that the adoption of SFAS No. 168 will not have an impact on the financial statements.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes". FASB No. 109 requires the Company to provide a net deferred tax asset/liability equal to the expected future tax benefit/expense of temporary reporting differences between book and tax accounting methods and any available operating loss or tax credit carryforwards. The Company has available at June 30, 2009, operating loss carryforwards of approximately \$17,821,350, which may be applied against future taxable income and will expire in various years through 2025. At December 31, 2008, the company had operating loss carryforwards of approximately \$15,274,419. The increase in carryforwards for the six months ended June 30, 2009 is approximately \$2,546,931.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the unaudited condensed consolidated financial statements. Significant estimates include patent life (remaining legal life versus remaining useful life) and transactions using the Black-Scholes option pricing model, e.g., promissory notes, warrants, and stock options. Actual results could differ from those estimates.

Concentration of Credit Risk

The Company maintains its cash and cash equivalents in banks located in the United States. Bank accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per financial institution. At June 30, 2009 and December 31, 2008, the Company's cash balances on deposit with the financial institutions in excess of the FDIC insurance limit amounted to \$801,629 and \$131,822, respectively. Excess funds are invested in government securities only.

Income (Loss) Per Common Share

Statement of Financial Accounting Standards No. 128, "Earnings Per Share", requires presentation of basic earnings per share ("Basic EPS") and diluted earnings per share ("Diluted EPS"). The computation of net loss per common share is based on the weighted average number of shares outstanding during each period based on the exchange ratio of shares issued in the merger. The computation of diluted earnings per common share is based on the weighted average number of shares outstanding during the period plus the common stock equivalents, which would arise from the exercise of stock options and warrants outstanding using the treasury stock method and the average market price per share during the period. At March 31, 2009, there were approximately 14,177,820 warrants, 3,300,200 vested stock options and 2,867,300 unvested options outstanding. These options and warrants were not included in the diluted loss per share calculation because the effect would have been anti-dilutive. The weighted average number of shares prior to 2006 was calculated based on the members' contribution, as if converted to shares in the ratio of the share exchange with BTHC III.

Comprehensive Income

The Company displays comprehensive income or loss, its components and accumulated balances in its consolidated financial statements. Comprehensive income or loss includes all changes in equity except those resulting from investments by owners and distributions to owners. The Company did not have any items of comprehensive income or loss for the three months ended June 30, 2009 and 2008 or the period from inception through June 30, 2009.

2. Inventory

Inventories are stated at the lower of cost or market. Lab supplies used in the research and development process are expensed as consumed. Inventory is reviewed periodically for product expiration and obsolete inventory and adjusted accordingly. The components of inventories are as follows:

	June 30, 2009	December 31, 2008
Raw materials	\$ 151,592	\$ 50,529
Work in process	158,850	170,714
Finished goods	44,429	196,100
	<u>\$ 354,871</u>	<u>\$ 417,343</u>

3. Property and Equipment

Property and equipment consists of the following:

	June 30, 2009	December 31, 2008
Machinery and equipment	\$ 778,452	\$ 328,002
Computer equipment	184,217	173,641
Office equipment	70,573	61,956
Leasehold improvements	115,880	329,970
	<u>1,149,122</u>	<u>893,569</u>
Accumulated depreciation and amortization	<u>(322,887)</u>	<u>(267,699)</u>
	<u>\$ 826,235</u>	<u>\$ 625,870</u>

4. Patent Licenses

On December 31, 2003, Lifeline entered into an *Option to License Intellectual Property* agreement with Advanced Cell Technology, Inc. ("ACT") for patent rights and paid ACT \$340,000 in option and license fees. On February 13, 2004, Lifeline and ACT amended the Option agreement and Lifeline paid ACT additional option fees of \$22,500 for fees related to registering ACT's patents in selected international countries.

On May 14, 2004, Lifeline amended the licensing agreement with ACT for the exclusive worldwide patent rights for the following ACT technologies: Infige IP, UMass IP and ACT IP, which terms are summarized below. The license fees aggregate a total of \$400,000 and were secured by separate convertible promissory notes. The notes bear no interest unless they are not repaid at maturity, in which event they shall thereafter bear interest at an annual rate equal the lesser of 10% or the maximum non-usurious rate legally allowed.

The note could be converted at the option of ACT into the first equity financing of Lifeline with cash proceeds in excess of \$5,000,000 under the following conditions: i) Upon the consummation of the First Equity Financing; or ii) Immediately prior to the closing of any merger, sale or other consolidation of the Company or of any sale of all or substantially all assets of the Company which occurs prior to the First Equity Financing (an "Acquisition Event"). Notwithstanding the above, and only in the event that a conversion resulting from such Acquisition Event would result in a security not traded on a national stock exchange (including NASDAQ and NASDAQ Capital market), upon written notice to the Company not later than five days after the consummation of the Acquisition Event and notice of the Acquisition Event to the holder of the note, the holder may elect to receive payment in cash of the entire outstanding principal of this Note. On December 21, 2007, ACT elected to receive payment in cash in lieu of conversion of the notes, which was paid in full.

The Company still maintains an obligation to pay royalties and other fees in accordance with the following schedule:

	UMass IP	ACT IP
License fee	\$ 150,000	\$ 250,000
Royalty rates	3% to 12%	3% to 10%
Minimum royalties		
At 12 months	\$ 15,000	\$ 22,500
At 24 months	\$ 30,000	\$ 45,000
At 36 months	\$ 45,000	\$ 67,500
Annually thereafter	\$ 60,000	\$ 90,000
Milestone payments		
First commercial product	\$ 250,000	\$ 500,000
Sales reaching \$5,000,000	\$ 500,000	\$ 1,000,000
Sales reaching \$10,000,000	\$ 1,000,000	\$ 2,000,000

5. Related Party Payables

The Company has incurred obligations to the following related parties:

	June 30, 2009	December 31, 2008
Management fee	\$ 278,001	\$ 264,648
Commissions payable	37,942	-
Loan payable, net of debt discount of \$8,221 in 2008	126,562	156,283
Related party payables	<u>\$ 442,505</u>	<u>\$ 420,931</u>

SeaCrest Capital and SeaCrest Partners are controlled by Mr. Adams and Mr. Aldrich, YKA Partners is controlled by Mr. Aldrich and the amounts represent advances to the Company for operating expenses. The management fee was paid to Mr. Adams and Mr. Aldrich, who acted as managing members of the Company (and prior to the Share Exchange of ISC California and Lifeline) for management of the Company since inception of Lifeline for an aggregate of \$10,000 per month plus accrued interest at 10% per annum on the unpaid balance. Effective June 1, 2006 the management fee was increased to \$20,000 per month. The management fee ceased on November 1, 2006, at which time Mr. Adams and Mr. Aldrich became employees of ISC.

6. Convertible Debt and Advances

Convertible debt

On May 14, 2008, to obtain funding for working capital, the Company entered into a Securities Purchase Agreement with an accredited investor (Gemini Capital) for the issuance (for total consideration of \$850,000 minus certain expenses of the purchaser) of an OID Senior Secured Convertible Note and warrants. The note was for \$1,000,000 (and was issued with a 15% original issue discount) and was originally due and payable on or before January 31, 2009. The note is convertible into shares of common stock of the company at the rate of \$0.50 per share. The note is guaranteed by the subsidiaries of the Company and secured by certain patents and patent applications. Warrants were issued which permit the holder to purchase up to 2,000,000 shares of common stock from the Company at \$0.25 per share until five years from the issuance of the warrants. The note and the warrants contain anti-dilution clauses whereby, (subject to the exceptions contained in those instruments) if the Company issues equity securities or securities convertible into equity at a price below the respective conversion price of the note or exercise price of the warrant, such conversion and exercise prices shall be adjusted downward to equal the price of the new securities.

In accordance with EITF 98-05, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio", the Company allocated the \$850,000 proceeds according to the value of the convertible note and the warrants based on their relative fair values. Fair value of the warrants was determined using the Black-Scholes valuation model using risk-free interest rate of 3.22%, volatility rate of 59.5%, term of five years, and exercise price of \$0.25.

In accordance with EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments", the reduction in proceeds, value of the beneficial conversion feature, and value of the warrants amounting to \$170,000, \$216,117 and \$266,117, respectively, have been recorded as a discount to convertible notes and were amortized over the term of the notes using the straight-line method. In August 2008, in accordance with the anti-dilution provisions of the debt, the conversion rate and exercise price were reduced to \$0.25. Estimated adjusted fair value of the warrants was determined using the Black-Scholes valuation model using risk-free interest rate of 3%, volatility rate of 57.9%, term of five years, and exercise price of \$0.25.

Advance

On June 18, 2008, the Company entered into an agreement with BioTime, Inc. ("Bio Time"), where Bio Time will pay an advance of \$250,000 to LifeLine Cell Technology ("Lifeline"), a wholly owned subsidiary of International Stem Cell Corporation, to produce, make, and distribute Joint Products. The \$250,000 advance will be paid down with the first \$250,000 of net revenues that otherwise would be allocated to Lifeline under the agreement. As of June 30, 2009, no revenues were realized from this agreement.

	<u>June 30, 2009</u>	<u>December 31, 2008</u>
Gemini Capital, net of debt discount of \$59,006 in 2008	\$ -	\$ 440,994
Bio Time, Inc	250,000	250,000
	<u>\$ 250,000</u>	<u>\$ 690,994</u>

7. Capital Stock

As of December 31, 2006, the Company was authorized to issue 200,000,000 shares of common stock, \$0.001 par value per share, and 20,000,000 shares of preferred stock, \$0.001 par value per share. As of December 31, 2006, the Company has issued and outstanding 33,996,495 shares of common stock and no shares of preferred stock.

In October 2006, the board of directors of BTHC III approved a stock split of 4.42 shares to 1. As a result of the split, the outstanding common stock of BTHC III increased from 500,000 to 2,209,993 shares. Pursuant to the Share Exchange Agreement, each share of International Stem Cell Corporation common stock was exchanged for one share of BTHC III common stock. All numbers in the financial statements and notes to the financial statements have been adjusted to reflect the stock split for all periods presented.

On December 27, 2006, the Company's Board of Directors and holders of a majority of the outstanding shares approved a change in the Company's name to International Stem Cell Corporation, which change became effective in January 2007. The accompanying financial statements have been changed to reflect this change as if it had happened at the beginning of the periods presented.

On December 27, 2006, the Company's Board of Directors and holders of a majority of the outstanding shares approved an increase in the authorized capital stock of the Company to 200,000,000 shares of Common Stock, \$0.001 par value per share, and 20,000,000 shares of preferred stock, \$0.001 par value per share. The increase did not become effective until January 2007.

In November and December of 2006, ISC California issued 9,880,950 shares of common stock for cash at \$1.00 per share for net proceeds after commission and expenses of \$8,334,515, net of cash expenses totaling \$1,547,433. In addition, ISC California issued 555,552 shares of common stock for \$500,000. The holders of the shares are entitled to the following registration rights with respect to the shares: (1) the Company must file a registration statement for the resale of the shares within 60 days from final closing date of February 13, 2007; (2) the registration statement must be declared effective by the SEC no later than 150 days from the final closing date of February 13, 2007; (3) the Company must reply to SEC staff comments within 30 days of receipt; and (4) the Company must maintain the effectiveness of the registration statement for 12 months from the final closing date of February 13, 2007. The first day after failing to perform any of the above is known as the first determination date. The Company is required to deliver penalty shares equal to 1% of the original number of shares entitled to such registration rights, 30 days after the first determination date, and additional shares equal to 1% of the original number of shares entitled to such registration rights each week thereafter, not to exceed 10% except with respect to replying to SEC staff comments within 30 days, which shall not exceed 20%. The Company filed its registration statement on Form SB-2 within 60 days from the final closing and believes the effects of the above penalties are remote. The Company periodically reviews its obligations and corresponding penalties under FAS 5, Accounting for Contingencies, and FSP EITF 00-19-2. Paragraph B9 of FSP EITF 00-19-2, states that entities should recognize and measure the contingent obligation to transfer consideration under a registration payment arrangement using the guidance in Statement 5, instead of requiring that a liability be recognized and measured at fair value at inception.

In December 2006, the Company issued 1,350,000 shares of common stock, 350,000 of such shares in consideration for legal consulting services relating to the reverse merger and 1,000,000 shares in consideration for a contract to provide investor relations services which commenced September 1, 2006 for a period of one year.

In January and February 2007, ISC California completed the Brookstreet financing and issued 1,370,000 shares of common stock that was part of a private placement of securities by ISC California during the second half of 2006. The net proceeds from the shares whose sale was finalized in 2007 was \$1,157,120, net of cash fees and expenses. In connection with the final settlement in 2007, the selling agent for the private placement received 274,000 additional warrants, which entitle the holder thereof to purchase the number of shares of common stock for \$1.00 each.

On January 15, 2008, to raise funds, the Company entered into a subscription agreement with accredited investors for the sale between one million and five million of Series A Preferred Stock ("Series A Preferred"). Series A Units consists of one share of Series A Preferred and two Warrants ("Series A Warrants") to purchase Common Stock for each \$1.00 invested. The Series A Preferred was convertible into shares of common stock at market price on the date of the first finance closing, but not to exceed \$1 per share and the Series A Warrants are exercisable at \$0.50 per share. The Series A Preferred has an anti-dilution clause whereby, if the Company issues \$1 million or more of equity securities or securities convertible into equity at a price below the respective exercise prices of the Series A Preferred or the Series A Warrant shall be adjusted downward to equal the price of the new securities. The Series A Preferred has priority on any sale or liquidation of the Company equal to the purchase price of the Series A Units, plus a liquidation premium of 6% per year. If the Company elects to declare a dividend in any year, it must first pay to the Series A Preferred a dividend of the amount of the dividend the Series A Preferred holder would receive if the shares were converted just prior to the dividend declaration. Each share of Series A Preferred has the same voting rights as the number of shares of Common Stock into which it would be convertible on the record date.

On May 12, 2008, to obtain funding for working capital, the Company entered into a series of subscription agreements with a total of five accredited investors for the sale of a total of 400,000 Series B Units, each Series B Unit consisting of one share of Series B Preferred Stock ("Series B Preferred") and two Series B Warrants ("Series B Warrants") to purchase Common Stock for each \$1.00 invested. The total purchase price received by the Company was \$400,000. The Series B Preferred is convertible into shares of common stock at the initial conversion ratio of two shares of common stock for each share of Series B Preferred converted (which was established based on an initial conversion price of \$0.50 per share), and the Series B Warrants are exercisable at \$0.50 per share until five years from the issuance of the Series B Warrants. The Series B Preferred and Series B Warrants contain anti-dilution clauses whereby (subject to the exceptions contained in those instruments) if the Company issues equity securities or securities convertible into equity at a price below the respective conversion price of the Series B Preferred or the exercise price of the Series B Warrant, such conversion and exercise prices shall be adjusted downward to equal the price of the new securities. The Series B Preferred has a priority (senior to the shares of common stock, but junior to the shares of Series A Preferred Stock) on any sale or liquidation of the Company equal to the purchase price of the Series B Units, plus a liquidation premium of 6% per year. If the Company elects to declare a dividend in any year, it must first pay to the Series B Preferred holder a dividend equal to the amount of the dividend the Series B Preferred holder would receive if the Series B Preferred were converted just prior to the dividend declaration. Each share of Series B Preferred has the same voting rights as the number of shares of Common Stock into which it would be convertible on the record date.

On July 30, 2008, to obtain funding for working capital, the Company entered into a series of subscription agreements with a total of two accredited investors for the sale of a total of 150,000 Series B Units. The total purchase price received by the Company was \$150,000. The Series B Preferred is convertible into shares of common stock at the initial conversion ratio of two shares of common stock for each share of Series B Preferred converted (which was established based on an initial conversion price of \$0.50 per share), and the Series B Warrants will be exercisable at \$0.50 per share until five years from the issuance of the Series B Warrants. The Series B Preferred and Series B Warrants contain anti-dilution clauses whereby, (subject to the exceptions contained in those instruments) if the Company issues equity securities or securities convertible into equity at a price below the respective conversion price of the Series B Preferred or the exercise price of the Series B Warrant, such conversion and exercise prices shall be adjusted downward to equal the price of the new securities. The Series B Preferred has a priority (senior to the shares of common stock, but junior to the shares of Series A Preferred Stock) on any sale or liquidation of the Company equal to the purchase price of the Series B Units, plus a liquidation premium of 6% per year. If the Company elects to declare a dividend in any year, it must first pay to the Series B Preferred a dividend equal to the amount of the dividend the Series B Preferred holder would receive if the Series B Preferred were converted just prior to the dividend declaration. Each share of Series B Preferred has the same voting rights as the number of shares of Common Stock into which it would be convertible on the record date.

In accordance with EITF 98-05, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios" (the "Abstract"), the Company allocated the proceeds of the Series A and B preferred stock according to the value of the convertible preferred stock and the warrants based on their relative fair values. Fair value of the warrants for Series A and Series B were determined using the Black-Scholes valuation model using risk-free interest rates of 3% and 3.37%, volatility rate of 65.0% and 57.9%, term of five years, and exercise price of \$0.50.

In August 2008, in accordance with the anti-dilution provisions of the securities, the conversion rates and exercise price were reduced to \$0.25. Estimated adjusted fair value of the warrants was determined using the Black-Scholes valuation model using risk-free interest rate of 3%, volatility rate of 57.9%, term of five years, and exercise price of \$0.25. For Series A and Series B, the beneficial conversion feature and warrants were adjusted to \$553,320 and \$193,321, and \$308,307 and \$110,307, respectively.

On August 20, 2008, to obtain funding for working capital, the Company entered into a subscription agreement with an accredited investor (the "Series C Investor") to sell for three million dollars (\$3,000,000) up to three million (3,000,000) shares of Series C Preferred Stock ("Series C Preferred") at a price of \$1.00 per Series C Preferred share. The Series C Preferred will be convertible into shares of common stock at \$0.25 per share. The Series C Preferred has an anti-dilution clause whereby, if the Company issues 250,000 shares or more of equity securities or securities convertible into equity at a price below the conversion price of the Series C Preferred, the conversion price of the Series C Preferred shall be adjusted downward to equal the price of the new securities. The Series C Preferred shall have priority over the Common Stock on any sale or liquidation of the Company equal to the purchase price of the Units, plus a liquidation premium of 6% per year. If the Company elects to declare a dividend in any year, it must first pay to the Series C Preferred a dividend in the amount of the dividend the Series C Preferred holder would receive if converted just prior to the dividend declaration. Each share of Series C Preferred shall have the same voting rights as the number of shares of Common Stock into which it would be convertible on the record date. Subject to determination by the Investor that there has been no material adverse event, the sale of the Series C Preferred is scheduled to close on the following schedule: (1) 700,000 shares were sold on August 20, 2008, and (2) 1,300,000 shares were sold September 23, 2008. The beneficial conversion feature for the Series C preferred stock is \$720,000. The beneficial conversion feature from the Series A, Series B and Series C preferred stock are recognized as deemed dividend totaling \$1,581,627.

On December 30, 2008, to obtain funding for both working capital and the eventual repayment of the outstanding obligation under the OID Senior Secured Convertible Note with a principal amount of \$1,000,000 issued in May 2008, International Stem Cell Corporation (the "Company") entered into a Series D Preferred Stock Purchase Agreement (the "Series D Agreement") with accredited investors (the "Investors") to sell for up to five million dollars (\$5,000,000) up to fifty (50) shares of Series D Preferred Stock ("Series D Preferred") at a price of \$100,000 per Series D Preferred share. The sale of the Preferred Stock is scheduled to close on the following schedule: (1) 10 shares were sold December 30, 2008; (2) subject to determination by the Investors that there has been no material adverse event with respect to the Company, 10 shares will be sold February 5, 2009; and (3) at the Investors' sole discretion 10 shares will be sold on each of March 20, 2009, June 30, 2009 and September 20, 2009. If the Investors decide not to purchase shares in any of the later three discretionary tranches then their rights to purchase shares in future tranches shall terminate. As of December 31, 2008, the Company received \$1 million from the Series D financing and issued 10 shares of Series D Preferred Stock.

On December 29, 2008 the Company issued a total of 2,121,180 restricted shares of common stock to six executive officers and directors and one employee at \$0.25 per share. The shares are subject to stock restriction provisions and vest upon the third anniversary of the date of grant, subject to accelerated vesting upon certain changes of control or terminations of service. The Company will reacquire any unvested shares for no cost upon the termination of the recipient's service to the Company. These shares were issued to the individuals in recognition of the fact that they had previously agreed to reduce (and in some cases completely eliminate) the cash compensation that would have otherwise been payable to them in 2008.

During the quarter ended June 30, 2009, the Company issued a total of 3,610,206 shares of common stock which related to warrants originally issued to Brookstreet and to Gemini Master Fund, Ltd. Brookstreet converted a total of 612,267 warrants into 584,675 shares of common stock at an average cashless conversion price of \$0.95 per share. Gemini Master Fund, Ltd., converted 4,000,000 warrants into 3,025,531 share of common stock at an average cashless conversion price of \$0.78 per share.

The number of warrants converted into common stock by Brookstreet was 584,675. On January and February 2007, to Brookstreet for the completion of the Brookstreet financing and issued 1,370,000 shares of common stock that was part of a private placement of securities by ISC California during the second half of 2006. The net proceeds from the shares whose sale was finalized in 2007 was \$1,157,125 net of cash fees and expenses. In connection with the final settlement in 2007, the selling agent for the private placement received 274,000 additional warrants, which entitle the holder thereof to purchase the number of shares of common stock for \$1.00 each.

On June 30, 2009, the Company entered into a definitive agreement with Optimus Capital Partners, LLC ("Investor") for a \$5 million investment commitment. The deal is structured where by the Company may draw down funds as needed, but has no obligations to make draws or use these funds if not needed. As funds are drawn down, the Company will issue Series E Preferred Stock (the "Preferred Stock"). The Preferred Stock will not be convertible into common stock and may be redeemed by the Company after one year. Each issue of Preferred Stock will be accompanied by the issuance of five-year warrants to purchase common stock at 100% of the closing price of the company's common stock on the day prior to the date the company gives notice of its election to draw funds. The total exercise value of warrants issued will equal 135% of the drawdown amount. Dividends on the Preferred Stock are payable in additional shares of non-convertible Preferred Stock at the rate of 10% per annum. A commitment fee of \$250,000, payable in shares of common stock, was made to the Investor. As part of the agreement, the Company filed an S-1 on July 31, 2009, see foot note 11 "Subsequent Events" for more details. The Investment will be used to fund operations and working capital needs of the company and expand its scientific research. Proceeds of the investment provide a valuable addition to the company's capital structure.

During the quarter ended June 30, 2009, the Company raised a total of \$2,000,000 in the Series D Preferred Stock round and was recorded as a Preferred Stock.

8. Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes". FASB No. 109 requires the Company to provide a net deferred tax asset/liability equal to the expected future tax benefit/expense of temporary reporting differences between book and tax accounting methods and any available operating loss or tax credit carryforwards. The Company has available at June 30, 2009, operating loss carryforwards of approximately \$17,281,350, which may be applied against future taxable income and will expire in various years through 2025. At December 31, 2008, the company had operating loss carryforwards of approximately \$15,274,419. The increase in carryforwards for the six months ended June 30, 2009 is approximately \$2,546,931.

The amount of and ultimate realization of the benefits from the operating loss carryforwards for income tax purposes is dependent, in part, upon the tax laws in effect, the future earnings of the Company, and other future events, the effects of which cannot be determined at this time. Because of the uncertainty surrounding the realization of the loss carryforwards, the Company has established a valuation allowance equal to the tax effect of the loss carryforwards, R&D credits, and accruals; therefore, no net deferred tax asset has been recognized. A reconciliation of the statutory Federal income tax rate and the effective income tax rate for the six months ended June 30, 2009 and year ended December 31, 2008 as follows:

	June 30, 2009	December 31, 2008
Statutory federal income tax rate	(35)%	(35)%
State income taxes, net of federal taxes	(6)%	(6)%
Valuation allowance	41%	41%
Effective income tax rate	0%	0%

The Company files income tax returns in the U.S. federal jurisdiction, and various states. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2005.

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"), on January 1, 2007, with no material impact to the financial statements.

The company may be subject to IRC code section 382 which could limit the amount of the net operating loss and tax credit carryovers that can be used in future years.

Significant components of deferred tax assets and liabilities are as follows:

	June 30, 2009	December 31, 2008
Deferred tax assets (liabilities)		
Net operating loss carryforwards	\$ 3,144,088	\$ 4,531,000
Accrued expenses	206,774	231,490
Research and Development tax credit (Fed and St.)	39,470	286,469
Deferred tax assets	3,390,332	5,048,959
Valuation allowance	(3,390,332)	(5,048,959)
Net deferred tax assets	\$ —	\$ —

The components of the provisions for income taxes were as follows:

	June 30, 2009	December 31, 2008
Current	\$ 0	\$ 0
Deferred	0	0
Total	\$ 0	\$ 0

9. Stock Options and Warrants

The Company has adopted the 2006 Equity Participation Plan (the "Plan"). The options granted under the Plan may be either qualified or non-qualified options. Up to 15,000,000 options may be granted to employees, directors and consultants under the Plan. Options may be granted with different vesting terms and expire no later than 10 years from the date of grant.

The Company implemented Statement of Financial Accounting Standard No. 123R ("SFAS No. 123R"), *Share-Based Payment*, which is a revision of Statement of Financial Accounting Standard No. 123 ("SFAS No. 123"), *Accounting For Stock-Based Compensation*. SFAS No. 123R requires the Company to establish assumptions and estimates of the weighted-average fair value of stock options granted, as well as using a valuation model to calculate the fair value of stock-based awards. The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods.

Expected Life - The expected life of options granted represents the period of time for which the options are expected to be outstanding. The Company estimates the expected life of options granted to be 3.75 years.

Expected Volatility - The expected volatility is based on the historical volatility of the Company's common stock over the estimated expected life of the options. The Company does not have enough trading history of its common stock to develop a volatility rate to use in the SFAS No. 123R analysis. Therefore the Company analyzed two competitor's volatility rates over a five year period and averaged them into one rate, which was 68% for the quarter ended June 30, 2009, and for the year ended December 31, 2008.

Risk-Free Interest Rate - The risk-free interest rate is derived from the U.S. Treasury yield curve in effect at the date of grant.

Dividends - The Company does not currently anticipate paying any cash dividends on its common stock. Consequently, the Company uses an expected dividend yield of zero in the Black-Scholes option valuation model.

Forfeitures - SFAS No. 123R requires the Company to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. To determine an expected forfeiture rate, the Company examined the historical employee turnover rate over the prior years as a proxy for forfeitures. Based on the internal analysis, the expected forfeiture rate was determined to be 10.0%.

The fair value of options granted is estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions for the quarter ended June 30, 2009:

	Three Months Ended March 31, 2009	Six Months Ended June 30, 2009
Risk free interest rate	1.27%	1.37%
Dividend yield	0.0%	0.0%
Volatility factor of the expected market price of the Company's common stock	68.45%	68.10%
Weighted-average expected life of options	3.75 Years	3.75 Years

Compensation expense is recognized only for those options expected to vest, with forfeitures estimated at the date of grant based on the Company's historical experience and future expectations. For the six months ended June 30, 2009 and 2008, \$227,144 and \$580,012 was recognized as stock-based compensation expense under SFAS No. 123R, respectively. Unrecognized compensation cost related to stock options as of June 30, 2009 was \$1,646,592 and the weighted average life of these outstanding stock options is approximately 8.71 years.

Stock Options

Transactions involving stock options issued to employees, directors and consultants under the Plan are summarized below. Options issued under the plan have a maximum life of 10 years. The following table summarizes the changes in options outstanding and the related exercise prices for the shares of the Company's common stock issued under the Plan and as of June 30, 2009:

Options Outstanding				Options Exercisable	
Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$1.00	3,087,500	7.75	\$1.00	2,634,300	\$1.00
\$3.20	230,000	8.00	\$3.20	85,500	\$3.20
\$1.45	300,000	8.08	\$1.45	138,000	\$1.45
\$1.00	190,000	8.50	\$1.00	61,200	\$1.00
\$0.45	1,865,000	8.92	\$0.45	505,400	\$0.45
\$0.39	490,000	9.17	\$0.39	98,000	\$0.39
\$0.22	145,000	9.33	\$0.22	23,100	\$0.22
\$0.49	720,000	9.58	\$0.49	14,400	\$0.49

	Number of Shares	Weighted Average Price Per Share
Outstanding at December 31, 2008	6,167,500	\$ 0.61
Granted	720,000	\$ 0.49
Exercised	-	-
Canceled/forfeited	-	-
Outstanding at June 30, 2009	6,887,500	\$ 0.75

Warrants

During 2008, the Company raised additional capital by issuing Preferred Series A, B C and D stock. This issuance of the Preferred Series C triggered an anti-dilutive clause in the Brookstreet warrant agreement, where Brookstreet would receive an adjustment downward in the price they pay for converting their warrants. In 2007, Brookstreet Securities Corporation earned 274,000 warrants as compensation for its services as placement agent for the raising of equity capital for the quarter. Brookstreet earned 1,976,190 warrants in 2006. Brookstreet earned a total of 2,250,190 warrants in 2006 and 2007 in connection with the Company's private placement. Each Warrant entitles the holder thereof to purchase one share of common stock for \$1.00, revalued to \$0.56 per warrant. The Company recognized the value attributable to the warrants in the amount of \$1,230,649 in 2006 and \$169,249 in 2007 as a component of additional paid-in capital with a corresponding reduction in additional paid-in capital to reflect the issuance as a non-cash cost of the offering. The Company valued the Brookstreet warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, a average risk free interest rate of 4.58%, a dividend yield of 0% and 0%, and volatility of 70.57%.

As part of the capital raising efforts, the Company issued during the quarter ended March 31, 2008 two warrants to purchase shares of common stock with the purchase of one Series A Preferred Stock issued, there were an additional 2,000,000 common stock warrants outstanding relating to the Series A Preferred Stock.

As part of the capital raising efforts, the Company issued two warrants to purchase shares of common stock with the purchase of one Series B Preferred Stock. As of September 30, 2008, there were an additional 1,100,000 common stock warrants outstanding relating to the Series B Preferred Stock.

During the second quarter, the Company entered into an agreement to borrow \$1.0 million and as part of this agreement, the Company issued warrants where the holder can purchase up to 2,000,000 shares of common stock from the Company at \$0.25 per share until five years from the issuance of the warrants. The note and the warrants contain anti-dilution clauses whereby, (subject to the exceptions contained in those instruments, if the Company issues equity securities or securities convertible into equity at a price below the respective conversion price of the note or exercise price of the warrant, such conversion and exercise prices shall be adjusted downward to equal the price of the new securities.

During June 2008, the Company entered into an agreement with BioTime, Inc. ("Bio Time"), where Bio Time will pay an advance of \$250,000 to LifeLine Cell Technology ("Lifeline"), a wholly owned subsidiary of International Stem Cell Corporation, to produce, make, and distribute Joint Products. As part of the agreement, the Company will issue warrants for Bio Time to purchase 30,000 shares of the Company's common stock at \$0.25 per share. These warrants expire 4 years from date of grant.

10. Commitments and Contingencies

Leases

The Company leases office space under a non-cancelable operating lease. Future minimum lease payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of March 31, 2009, are as follows:

	Amount
2009	\$ 88,016
2010	163,133
2011	86,479
2012	--
2013	--
Total	<u>\$ 337,628</u>

11. Subsequent Events

On July 31, 2009, the Company filed an S-1 with the Securities and Exchange Commission as part of the Preferred Stock Purchase Agreement the company signed on June 30, 2009, between International Stem Cell Corporation and a biotechnology-focused fund. See note 7 for details regarding this agreement. Per the agreement, the Company will use its best efforts to promptly file (but in no event later than 30 days after the Effective Date) and cause to become effective as soon as possible a Registration Statement for the sale of all Common Shares. Each Registration Statement shall comply when it becomes effective, and, as amended or supplemented, at the time of any Tranche Notice Date, Tranche Closing Date, or issuance of any Common Shares, and at all times during which a prospectus is required by the Act to be delivered in connection with any sale of Common Shares, will comply, in all material respects, with the requirements of the Act. As of to date, the Company is in compliance with all requirement per the agreement.

In July, the Company expanded its senior management team to include greater capacity and flexibility as it expands its therapeutic and commercial activities for the remainder of 2009 and beyond. Professor Andrei Semetchkine, Ph.D., will assume the duties of Executive Vice President of ISCO, with broad responsibility for the strategy, financial, and business affairs of the company. Jeffrey Janus, will continue to be CEO and President of Lifeline Cell Technology the revenue generating subsidiary of ISCO, and will also serve as Senior Vice President of Operations for the parent Company, ISCO. In a final change, R. Wood, who had been the controller of the company, has been promoted to Vice President, Finance and Principal Financial Officer. Mr. Wood's appointment will also permit William Adams, a founder of the Company to step down from his role as CFO as of June 30, 2009.

Management performed an evaluation of Company activity through August 14, 2009, the date the unaudited condensed consolidated financial statements were issued. The Company concluded that there are no other significant subsequent events requiring disclosure.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes and other financial information included elsewhere herein. This information should also be read in conjunction with our audited historical consolidated financial statements which are included in our Form 10-K for the fiscal year ended December 31, 2008. The discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties, such as our plans, expectations and intentions. Our actual results may differ significantly from management's expectations. This discussion should not be construed to imply that the results discussed herein will necessarily continue into the future, or that any conclusion reached herein will necessarily be indicative of actual operating results in the future. Such discussion represents only represents our management's best present assessment.

Overview

We were originally incorporated in Delaware on June 7, 2005 as BTHC III, Inc. to effect the reincorporation of BTHC III, LLC, a Texas limited liability company, mandated by a plan of reorganization. Pursuant to the plan of reorganization, an aggregate of 500,000 shares of our common stock were issued to holders of administrative and tax claims and unsecured debt, of which 350,000 shares were issued to Halter Financial Group. The plan of reorganization required BTHC III, Inc. to consummate a merger or acquisition prior to June 20, 2007. Until the Share Exchange Agreement described below, BTHC III, Inc. conducted no operations. In October 2006, BTHC III, Inc. effected a 4.42-for-one stock split with respect to the outstanding shares of common stock.

On December 28, 2006, pursuant to a Share Exchange Agreement, BTHC III, Inc. issued 33,156,502 shares of common stock, representing approximately 93.7% of the common stock outstanding immediately after the transaction, to the shareholders of International Stem Cell Corporation, a California corporation ("ISC California"), in exchange for all outstanding stock of ISC California. This transaction is being accounted for as a "reverse merger" for accounting purposes. Consequently, the assets and liabilities and the historical operations that are reflected in our financial statements are those of ISC California.

ISC California was incorporated in California in June 2006 for the purpose of restructuring the business of Lifeline Cell Technology, LLC, which was organized in California in August 2001. As a result of the restructuring, Lifeline became wholly-owned by ISC California, which in turn is wholly-owned by us. Our principal executive offices are located at 2595 Jason Court, Oceanside, California 92056, and our telephone number is (760) 940-6383.

Results of Operations

Revenues

We are a development stage company and as such have generated nominal revenues. For the three months ended June 30, 2009, our product sales have continued to increase. We recognized \$388,810 of product revenue, compared to \$122,303 for the three months ended June 30, 2008. The primary reason for the increase is due to collaboration agreements we signed during later part of 2008 and early 2009 to provide stem cells and reagents, as well as the increased efforts by our sales and marketing teams.

Product revenue recognized for the six months ended June 30, 2009, amount to \$572,109, compared to \$154,635 for the six months ended June 30, 2008. The primary reason for the increase is due to collaboration agreements we signed during later part of 2008 and early 2009 to provide stem cells and reagents, as well as our increased efforts by our sales and marketing teams.

Cost of sales

Cost of sales for the quarter ended June 30, 2009 were \$260,179, compared to \$56,606 for the quarter ended June 30, 2008. As our revenues increased so has the cost of manufacturing our products. During the quarter, are cost of manufacturing including some one time costs for manufacturing specialty products.

Cost of sales for the six months ended June 30, 2009 were \$550,341, compared to \$76,865 for the six months ended June 30, 2008. As our revenues increased so has the cost of manufacturing our products. During the six months ended June 30, 2009, in our cost of sales amount, we recorded an inventory adjustment of approximately, \$181,500. The inventory adjustment related to a physical inventory and revaluation of inventory costs. We do not anticipate significant inventory adjustments to reoccur in the future, but we do anticipate some inventory adjustments to occur during the year. Excluding the inventory adjustment, cost of sales for the six months ended June 30, 2009 were \$368,841, or 64% of sales, compared to \$76,865, or 50% of sales for the six months ended June 30, 2008. As we refine our manufacturing processes, and our volume continues to increase, we anticipate our cost of sales to continue to decrease.

General and Administrative Expenses

General and administrative expenses were \$1,574,191 for the three months ended June 30, 2009, an increase of \$574,503 or 57%, compared to \$999,688 for the three months ended June 30, 2008. The reason for this increase primarily relates to the issuance of common stock and warrants and the recording of stock-based compensation for services rendered for general corporate purposes. Although general and administrative expenses increased for the quarter, other general and administrative expenses continue to decrease as a result of the company's overall cost cutting measures put into place at the end of 2008. The Company has made efforts to reduce expenses in salaries, consultants and other administrative expenses. We continue to incur general and administrative expenses related to the development of our support staff and other corporate services needed to develop our business and general corporate expenses related to being a public company.

General and administrative expenses for the six months ended June 30, 2009 were \$2,377,379, an increase of \$492,032, or 26%, compared to \$1,885,347 for the same period ended June 30, 2008. The reason for this increase primarily relates to the issuance of common stock and warrants and the recording of stock-based compensation for services rendered for general corporate purposes. Although general and administrative expenses increased for the quarter, other general and administrative expenses decreased as a result of the company's overall cost cutting measures put into place at the end of 2008. The Company has made efforts to reduce expenses in salaries, consultants and other administrative expenses. We continue to incur general and administrative expenses related to the development of our support staff and other corporate services needed to develop our business and general corporate expenses related to being a public company.

Research and Development

Research and development expenses were \$524,449 for the three months ended June 30, 2009, a decrease of \$138,473, or 21%, compared to \$662,922 for the three months ended June 30, 2008. During the quarter in an effort to manage our cash position, we continued to review all research and development expenses for cost savings opportunities. During the three months ended June 30, 2009, the decrease in research and development costs is primarily due to a decrease in research being conducted at our Russian Lab and reduced expenses related to our research consultants, as well as our reduced research efforts and expenses on certain collaboration activities. We gained efficiencies in our laboratory activities and streamlined our production activities to reduce costs for our labs located in Oceanside, California and Walkersville, Maryland.

Research and development expenses for the six months ended June 30, were \$1,072,050 a decrease of \$178,913, or 14%, compared to \$1,250,963 for the six months ended June 30, 2008. During the first half of the year, in an effort to manage our cash position, we continued to review all research and development expenses for cost savings opportunities. During this time we have decreased our research and development costs primarily due to a decrease in research being conducted at our Russian Lab and reduced expenses related to our research consultants, as well as our reduced research efforts and expenses on certain collaboration activities. We gained efficiencies in our laboratory activities and streamlined our production activities to reduce costs for our labs located in Oceanside, California and Walkersville, Maryland.

Research and development expenses are expensed as they are incurred, and are not yet accounted for on a project by project basis since, to date, all of our research has had potential applicability to each of our projects.

Marketing Expense

Marketing expenses were \$128,021 for the three months ended June 30, 2009, an increase of \$49,374, compared to \$78,647, or 63%, for the three months ended June 30, 2008. During 2009, we increased our marketing efforts in marketing consultants, trade shows and the cost of advertising. We continued to develop our marketing and sales strategies, as well as, our marketing infrastructure to support our sales team and our sales goals. Our primary marketing expenses for the three months ended June 30, 2009, related to our professional sales representatives, sales literature, development and placement of print ads for trade journals, trade shows and marketing consultants.

Marketing expenses for the six months ended June 30, were \$263,520 for the three months ended June 30, 2009, a decrease of \$35,526, or 16% compared to \$227,994. During 2009, in an effort to increase sales, we continued our marketing strategies and expenses related to our marketing consultants, trade shows and advertising. We are still in the process of developing our marketing and sales strategies, as well as, our marketing infrastructure to support our sales team and our sales goals. Our primary marketing expenses for the six months ended June 30, 2009, related to our professional sales representatives, sales literature, development and placement of print ads for trade journals, trade shows and marketing consultants.

Liquidity and Capital Resources

At June 30, 2009, we had an increase in cash of \$771,422 for the six month period ended June 30, 2009, resulting from \$3,660,000 million of cash provided by our financing activities, \$2,545,542 million cash used in operating activities and \$343,036 used in investment activities. The funds generated from financing activities during the first two quarters of 2009 were used mainly to support our operating losses.

Operating Cash Flows

Net cash used in operating activities of \$2,545,542 for the six months ended June 30, 2009 was primarily attributable to a net loss of \$5,823,736. The adjustments to reconcile the net loss to net cash used in operating activities primarily include depreciation and amortization expense of \$82,733, amortization of discounts of \$67,227, non-cash stock option expense of \$227,145, non-cash warrants for services of \$281,416, change in market value of warrants of \$2,055,077, stock issued for services of \$252,058, an increase in accounts receivable of \$32,128, a decrease in inventory of \$62,472, an increase in prepaid assets of \$115,362, a decrease in deposits and other assets of \$111, an increase in accounts payable of \$95,991, a increase in accrued expenses of \$287,339, and a increase in related party payables of \$13,353, attributable to repayments. The major portion of this increase in cash used resulted from increased spending in general and administrative expenses.

Investing Cash Flows

Net cash used in investing activities of \$343,036 for the six months ended June 30, 2009 was primarily attributable to purchases of property and equipment of \$255,556 consisting primarily of laboratory equipment for use in a variety of research projects and building leasehold improvements related to new research labs. In addition we made payments for patent licenses of \$87,480 for the six months ending June 30, 2009.

Financing Cash Flows

Net cash provided by financing activities of \$4,160,000 for the six months ended June 30, 2009 was attributable to closing a Series D Preferred Stock financing round during the two quarters. The Series D Preferred financing during the quarter was part of an existing agreement to rise between one million and five million dollars by issuing Series D Preferred Stock. A total of \$4,160,000 had been raised through June 30, 2009.

Management is currently reviewing different financing sources to raise working capital to help fund our current operations. We will need to obtain significant additional capital resources from sources including equity and/or debt financings, license arrangements, grants and/or collaborative research arrangements in order to develop products. Thereafter, we will need to raise additional working capital. The timing and degree of any future capital requirements will depend on many factors, including:

- the accuracy of the assumptions underlying our estimates for capital needs in 2009 and beyond;
- scientific progress in our research and development programs;
- the magnitude and scope of our research and development programs and our ability to establish, enforce and maintain strategic arrangements for research, development, clinical testing, manufacturing and marketing;
- our progress with preclinical development and clinical trials;
- the time and costs involved in obtaining regulatory approvals;
- the costs involved in preparing, filing, prosecuting, maintaining, defending and enforcing patent claims; and
- the number and type of product candidates that we pursue.

Additional financing through strategic collaborations, public or private equity financings or other financing sources may not be available on acceptable terms, or at all. Additional equity financing could result in significant dilution to our stockholders. Additional debt financing may be expensive and require us to pledge all or a substantial portion of our assets. Further, if additional funds are obtained through arrangements with collaborative partners, these arrangements may require us to relinquish rights to some of our technologies, product candidates or products that we would otherwise seek to develop and commercialize on our own. If sufficient capital is not available, we may be required to delay, reduce the scope of or eliminate one or more of our product lines.

We do not currently have any obligations for milestone payments under any of our licensed patents other than annual payments of \$150,000 due each May, plus payments that are specifically related to sales and are therefore unpredictable as to timing and amount. Royalties on sales range of 3% to 12%, and milestone payments do not begin until our first therapeutic product is launched. No licenses are terminable at will by the licensor. For further discussion of our patents, see Note 4 to our condensed consolidated financial statements.

Based on the above, there is substantial doubt about the Company's ability to continue as a going concern.

Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements.

Not Required.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. The Securities and Exchange Commission defines the term "disclosure controls and procedures" to mean company's controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Our chief executive officer and our chief financial officer have concluded, based on the evaluation of the effectiveness of our disclosure controls and procedures by our management, with the participation of our chief executive officer and our chief financial officer, as of the end of the period covered by this report, that our disclosure controls and procedures were effective for this purpose.

Changes in Internal Controls Over Financial Reporting. There was no change in our internal control over financial reporting for the six months ended June 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. However, during second quarter, we implemented a new accounting system which allows us to develop better internal controls around issuing purchase orders, processing accounts payable, accounts receivable, inventory, manufacturing and reporting.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable assurance, and not absolute assurance, that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals in all future circumstances.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

Not required.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the first two quarters ended June 30, 2009, we sold 40 shares of Series D Preferred Stock for a total of \$4,000,000 to purchasers who were parties to the Series D Preferred Stock Purchase Agreement of December 30, 2008. Each shares of Series D Preferred Stock is convertible into 400,000 shares of common stock, subject to adjustment.

During the quarter ended June 30, 2009, Gemini Capital converted an aggregate principal amount of \$500,000 of the OID Senior Secured Convertible Note that had been issued in May 2008 into a total of 5,025,531 shares of common stock during 2009.

On June 30, 2009 we entered into a Preferred Stock Purchase Agreement with an institutional investor to sell up to \$5 million dollars of Series E Preferred Stock. We have not sold any shares of Series E Preferred Stock as of the date of this filing. As part of that transaction, we issued the purchaser a warrant to purchase 7,848,837 shares of common stock at \$0.86 per share. The warrant will become exercisable based on the amount of Series E Preferred Stock that we sell; and the number of shares of stock subject to the warrant and the purchase price of those shares will be adjusted based on market prices for the shares of common stock at the time we sell shares of Series E Preferred Stock. The investor is an accredited investor and the shares were sold in a private placement transaction exempt from registration under the Securities Act pursuant to Section 4(2) and Rule 506 promulgated thereunder.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description
3.1	Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.4 of the Registrant's Form 10-SB filed on April 4, 2006).
3.2	Certificate of Amendment of Certificate of Incorporation (incorporated by reference to Exhibit 3.1 of the Registrant's Preliminary Information Statement on Form 14C filed on December 29, 2006).
3.3	Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit 3.2 of the Registrant's Preliminary Information Statement on Form 14C filed on December 29, 2006).
4.1	Form of Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 of the Registrant's Annual Report on Form 10-K filed on March 30, 2009).
4.2	Form of Lifeline Warrant (incorporated by reference to Exhibit 4.1 of the Registrant's Form 8-K filed on December 29, 2006).
4.3	Form of Lifeline Warrant held by ISC Bridge lenders (incorporated by reference to Exhibit 4.2 of the Registrant's Form 8-K filed on December 29, 2006).
4.4	Placement Agents Warrant (incorporated by reference to Exhibit 4.3 of the Registrant's Form 8-K filed on December 29, 2006).
4.5	Certificate of designation or rights, preferences, privileges and restrictions of Series A Preferred Stock of International Stem Cell Corporation dated January 17, 2008
4.6	Certification of Designation of Series B Preferred Stock (incorporated by reference to Exhibit 4.1 of the Issuer's Form 8-K filed on May 12, 2008).
4.7	Certification of Designation of Series C Preferred Stock (incorporated by reference to Exhibit 10.2 of the Issuer's Form 8-K filed on August 21, 2008).
4.8	Certification of Designation of Series D Preferred Stock (incorporated by reference to Exhibit 10.2 of the Issuer's Form 8-K filed on January 5, 2009).
4.9	Warrant Certificate for warrants in connection with Series A Preferred Stock (incorporated by reference to Exhibit 10.2 of the Issuers Form 8-K filed on January 17, 2008).
4.10	Warrant Certificate for warrants in connection with Series B Preferred Stock (incorporated by reference to Exhibit 10.2 of the Issuers Form 8-K filed on May 12, 2008).
4.11	Certificate of Designation of Series E Preferred Stock (incorporated by reference to Exhibit 10.2 of the Issuer's Form 8-K filed on July 6, 2009).
10.22	Preferred Stock Purchase Agreement dated June 30, 2009 (incorporated by reference to Exhibit 10.1 of the Issuer's Form 8-K filed on July 6, 2009).
31.1	Rule 13a-14(a)/15d-14a(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14a(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INTERNATIONAL STEM CELL CORPORATION

Dated: August 14, 2009

By: /s/ Kenneth C. Aldrich ^{[[1]]}_{SEP}
Name: Kenneth C. Aldrich ^{[[1]]}_{SEP}
Title: Chief Executive Officer and Director

By: /s/ Ray Wood ^{[[1]]}_{SEP}
Name: Ray Wood
Title: Vice President of Finance (Principal Financial Officer and Principal Accounting Officer)

EXHIBIT 31.1
CERTIFICATION PURSUANT TO
FORM OF RULE 13a-14(a)
AS ADOPTED PURSUANT TO
SECTION 302(A) OF THE SARBANES-OXLEY ACT OF 2002

I, Kenneth C. Aldrich, Chief Executive Officer of International Stem Cell Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of International Stem Cell Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2009

By: /s/ Kenneth C. Aldrich
Kenneth C. Aldrich
Chief Executive Officer

CERTIFICATION PURSUANT TO
FORM OF RULE 13a-14(a)
AS ADOPTED PURSUANT TO
SECTION 302(A) OF THE SARBANES-OXLEY ACT OF 2002

I, Ray Wood, Vice President of Finance of International Stem Cell Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of International Stem Cell Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2009

By: /s/ Ray Wood
Ray Wood
Vice President of Finance

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q (the "Report") of International Stem Cell Corporation (the "Company") for the six months ended June 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Kenneth C. Aldrich, Chief Executive Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, that as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002:

- (1) the Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2009

By: /s/ Kenneth C. Aldrich
Kenneth C. Aldrich
Chief Executive Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q (the "Report") of International Stem Cell Corporation (the "Company") for the six months ended June 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ray Wood, Vice President of Finance of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, that as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002:

- (1) the Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2009

By: /s/ Ray Wood
Ray Wood
Vice President of Finance
