

HEPALIFE TECHNOLOGIES INC
Form 10-Q
May 05, 2010

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

FORM 10-Q

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from _____ to _____

Commission File Number: 000-29819

HEPALIFE TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

FLORIDA

(State or other jurisdiction of incorporation or organization)

58-2349413

(I.R.S. Employer Identification No.)

60 State Street, Suite 700, Boston, MA 02109

(Address of principal executive offices)

(800) 518-4879

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required 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 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 ☐ Not Applicable ☒

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 Act).

Yes ☐ No ☒

Number of shares of Common Stock, \$0.001 par value, outstanding as of April 28, 2010: 101,494,158.

TABLE OF CONTENTS
HEPALIFE TECHNOLOGIES, INC.
FORM 10-Q, QUARTER ENDED MARCH 31, 2010

PART I	FINANCIAL INFORMATION	
Item 1.	Financial Statements	
	<u>Consolidated Balance Sheets as of March 31, 2010 (unaudited) and December 31, 2009</u>	<u>4</u>
	<u>Consolidated Statements of Operations (unaudited)</u>	<u>5</u>
	<u>Consolidated Statements of Stockholders' Equity (Deficit) (unaudited)</u>	<u>6</u>
	<u>Consolidated Statements of Cash Flows (unaudited)</u>	<u>7</u>
	<u>Notes to Consolidated Financial Statements</u>	<u>8</u>
	<u>Management's Discussion and Analysis of Financial Condition</u>	
Item 2.	<u>and</u>	<u>15</u>
	<u>Results of Operations</u>	<u>18</u>
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>21</u>
Item 4T.	<u>Controls and Procedures</u>	<u>21</u>
PART II	OTHER INFORMATION	
Item 1.	<u>Legal Proceedings</u>	<u>22</u>
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>22</u>
Item 3.	<u>Defaults Upon Senior Securities</u>	<u>22</u>
Item 5.	<u>Other Information</u>	<u>22</u>
Item 6.	<u>Exhibits</u>	<u>22</u>
	<u>Signatures</u>	<u>24</u>

PART I - FINANCIAL INFORMATION**item 1. FINANCIAL STATEMENTS****HEPALIFE TECHNOLOGIES, INC.**

(A Development Stage Company)

CONSOLIDATED BALANCE SHEETS**March 31, 2010 and December 31, 2009**

	(Unaudited) March 31, 2010	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	\$ 2,077,362	\$ 2,310,200
Prepaid expenses	20,585	44,033
Total current assets	\$ 2,097,947	\$ 2,354,233
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$ 102,568	\$ 98,462
Total current liabilities	102,568	98,462
Warrant liability (Note 8)	11,917	9,815
Total liabilities	114,485	108,277
Commitments and contingencies (Note 6)		
STOCKHOLDERS' EQUITY		
Stockholders' equity (Note 7)		
Preferred stock: \$0.10 par value; Authorized: 1,000,000		
Issued and outstanding: none	-	-
Common stock: \$0.001 par value; Authorized: 300,000,000		
Issued and outstanding: 101,494,158 (2009: 101,494,158)	101,495	101,495
Additional paid-in capital	22,391,817	22,381,577
Loss accumulated during the development stage	(20,509,850)	(20,237,116)
Total stockholders' equity	1,983,462	2,245,956

Total liabilities and stockholders' equity	\$	2,097,947	\$	2,354,233
---	----	-----------	----	-----------

(The accompanying notes are an integral part of these financial statements)

HEPALIFE TECHNOLOGIES, INC.

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF OPERATIONS
For the three months ended March 31, 2010 and 2009
and from inception (October 21, 1997) to March 31, 2010
(Unaudited)

	Three Months Ended		From inception (October 21, 1997) to March 31, 2010
	March 31, 2010	March 31, 2009	
Revenue	\$ -	\$ -	\$ -
Expenses			
Salary and benefits	68,909	200,048	6,240,376
Research and development	-	51,075	2,098,755
Shareholder relations and name branding	7,316	2,280	4,199,276
Administrative and general	56,383	53,966	1,544,316
Professional fees- accounting and legal	103,219	104,254	1,193,852
Director, management and consulting fees (Note 5)	38,740	41,708	1,209,388
Depreciation	-	-	35,410
Stock offering costs	-	-	1,926,713
	274,567	453,331	18,448,086
Operating Loss	(274,567)	(453,331)	(18,448,086)
Other income and (expenses)			
Interest on promissory note	-	-	(355,112)
Interest, bank charges and foreign exchange loss	(950)	(590)	(37,983)
Interest income	4,885	10,540	154,623
Loss on disposal of fixed assets	-	-	(3,061)
Amortization of discount on notes (Note 4)	-	(2,349)	(2,107,522)
Amortization of deferred financing costs	-	-	(293,515)
Change in fair value of warrant liability	(2,102)	(420,891)	1,868,070
Loss on extinguishment of warrant liability	-	-	(1,287,264)
	1,833	(413,290)	(2,061,764)
Net loss available to common stockholders	\$ (272,734)	\$ (866,621)	\$ (20,509,850)
Loss per share - basic and diluted	\$ (0.00)	\$ (0.01)	
Weighted average number of common shares			

outstanding - basic and diluted	101,494,158	91,996,829
--	-------------	------------

(The accompanying notes are an integral part of these financial statements)

HEPALIFE TECHNOLOGIES, INC.

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)**from inception (October 21, 1997) to March 31, 2010**

(Unaudited)

	Common Stock Shares	Amount	Additional paid-in capital	Accumulated other comprehensive income	Loss accumulated during development stage	Comprehensive income (loss)
Issued for service rendered share, October 21, 1997	12,000,000	\$ 12,000	\$ (9,000)	\$ -	\$ -	\$ -
Issued for cash share during 1997	1,200,000	1,200	73,800	-	-	-
Income inception (1997) to December 31, 1997	-	-	-	-	42	42
Comprehensive income						42
December 31, 1997	13,200,000	13,200	64,800	-	42	
Issued for service rendered share, December 15, 1998	16,000,000	16,000	384,000	-	-	-
Income (loss) ended December 31, 1998	-	-	-	-	(471,988)	(471,988)
Comprehensive income						(471,988)
December 31, 1998	29,200,000	29,200	448,800	-	(471,946)	
Issued for cash share, March 1999	12,000,000	12,000	288,000	-	-	-
Income (loss) ended December 31, 1999	-	-	-	-	(121,045)	(121,045)
Comprehensive income						(121,045)
December 31, 1999	41,200,000	41,200	736,800	-	(592,991)	
Income (loss)						

Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

ended December 31, 2000	-	-	-	-	(80,608)	(80,608)
Comprehensive income						(80,608)
December 31, 2000	41,200,000	41,200	736,800	-	(673,599)	
Debt to equity at \$0.015 per share, April 1, 2001	8,933,332	8,933	125,067	-	-	-
Comprehensive income (loss) ended December 31, 2001	-	-	-	-	(160,364)	(160,364)
Comprehensive income						(160,364)
December 31, 2001	50,133,332	50,133	861,867	-	(833,963)	
Shares issued for services rendered, April 23, 2002	10,000	10	590	-	-	-
Debt to equity at \$0.05 per share, April 26, 2002	2,160,000	2,160	105,840	-	-	-
Shares issued for investor subscriptions at \$0.05 per share, May 1, 2002	2,390,000	2,390	117,110	-	-	-
Debt to equity at \$0.05 per share, May 18, 2002	1,920,000	1,920	94,080	-	-	-
Comprehensive income (loss) ended December 31, 2002	-	-	-	-	(375,472)	(375,472)
Comprehensive income						(375,472)
December 31, 2002	56,613,332	56,613	1,179,487	-	(1,209,435)	
Shares issued pursuant to exercise of options during the period ending December 31, 2002 at \$0.07 to \$2.11 per share	282,500	283	398,317	-	-	-
Shares issued pursuant to exercise of purchase warrants ending December 31, 2003 at \$0.025 per share	7,300,000	7,300	175,200	-	-	-
Comprehensive income (loss) ended December 31, 2003	-	-	-	-	(1,102,723)	(1,102,723)
Comprehensive income						(1,102,723)
December 31, 2003	64,195,832	64,196	1,753,004	-	(2,312,158)	

issued pursuant to stock options during the period at \$0.07 to \$2.11 per share	1,622,000	1,622	1,339,998	-	-	-
issued pursuant to share purchase warrants in the period at \$0.025 per share	2,000,000	2,000	48,000	-	-	-
Net income (loss) for the period ended December 31, 2004	-	-	-	-	(1,435,613)	(1,435,613)
Comprehensive income						(1,435,613)
December 31, 2004	67,817,832	67,818	3,141,002	-	(3,747,771)	
issued pursuant to exercise of stock options in March 2005 at \$0.07 to \$2.11 per share	50,000	50	154,950	-	-	-
issued pursuant to exercise of share purchase warrants in May 2005 at \$0.025 per share	45,000	45	94,905	-	-	-
issued pursuant to exercise of stock options in June 2005 at \$0.07 to \$2.11 per share	100,000	100	210,900	-	-	-
issued pursuant to exercise of stock options in October 2005 at \$0.07 to \$2.11 per share	40,000	40	84,360	-	-	-
issued pursuant to exercise of stock options in March 2005 at \$0.07 to \$2.11 per share	50,000	50	105,450	-	-	-
issued pursuant to exercise of share purchase warrants at \$0.025 per share	1,250,000	1,250	30,000	-	-	-
Common stock issued in June 2005 pursuant to the purchase agreement	20,000	20	37,580	-	-	-
Common stock issued in July 2005 pursuant to the purchase agreement	691,598	692	1,382,504	-	-	-
Net income (loss) for the period ended December 31, 2005	-	-	-	-	(2,813,602)	(2,813,602)
Comprehensive income						(2,813,602)
December 31, 2005	70,064,430	70,065	5,241,651	-	(6,561,373)	

Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

Common stock issued in January 2006 under the purchase agreement	374,753	375	505,542	-	-	-
Common stock issued in the first quarter of 2006 Capital for cash	431,381	431	449,569	-	-	-
Common stock issued in the second quarter of 2006 Capital for cash	416,303	416	329,584	-	-	-
Common stock issued in the third quarter of 2006 Capital for cash	758,606	759	584,234	-	-	-
Common stock issued in the fourth quarter of 2006 Capital for cash	548,371	548	354,455	-	-	-
Warrant exercise options	175,000	175	12,075	-	-	-
Compensation expenses	-	-	2,607,302	-	-	-
Net income (loss) ended December 31, 2006	-	-	-	-	(4,654,499)	(4,654,499)
Net comprehensive income						(4,654,499)
December 31, 2006	72,768,844	72,769	10,084,412	-	(11,215,872)	
Common stock issued in the first quarter of 2007 Capital for cash	382,000	382	204,619	-	-	-
Common stock issued in the second quarter of 2007 Capital for cash	509,019	509	289,491	-	-	-
Common stock converted from convertible preferred shares	2,604,721	2,605	1,742,395	-	-	-
Compensation expenses	-	-	935,044	-	-	-
Net income (loss) attributable to the warrants issued with convertible preferred shares	-	-	497,689	-	-	-
Net income (loss) for the payment of broker's fees	-	-	64,990	-	-	-
Net income (loss) of the beneficial conversion feature	-	-	1,220,410	-	-	-
Net income (loss)	-	-	-	(3,772)	-	(3,772)
Net income (loss) after currency translation adjustment	-	-	-	(3,772)	-	(3,772)
Net income (loss) ended December 31, 2007	-	-	-	-	(4,438,197)	(4,438,197)

nsive income						(4,441,969)
ber 31, 2007	76,264,584	76,265	15,039,050	(3,772)	(15,654,069)	
converted from convertible s in January 2008	2,342,415	2,343	752,657	-	-	
converted from notes	2,065,412	2,065	975,680	-	-	-
and warrants issued for cash, are in May 2008 and acement and legal fees	10,924,418	10,925	4,519,875	-	-	-
ssued for services received in 2008	400,000	400	169,600	-	-	-
d for purchase of in-process research t in October 2008	-	-	98,325	-	-	-
mpensation expenses	-	-	565,306	-	-	-
income (loss)						
cy translation adjustment	-	-	-	3,391	-	3,391
ed December 31, 2008	-	-	-	-	(3,667,547)	(3,667,547)
nsive income						(3,664,156)
ber 31, 2008	91,996,829	91,998	22,120,493	(381)	(19,321,616)	
ct of change in accounting principle	-	-	(2,461,546)	-	1,932,469	-
ssued for exchange of Series C 1	3,492,505	3,493	904,559	-	-	-
ssued upon exercise of Series C per warrant	6,004,824	6,004	1,555,250	-	-	-
mpensation expenses	-	-	262,821	-	-	-
income (loss)						
cy translation adjustment	-	-	-	381	-	381
ed December 31, 2009	-	-	-	-	(2,847,969)	(2,847,969)
nsive income						\$ (2,847,588)
ber 31, 2009	101,494,158	101,495	22,381,577	-	(20,237,116)	
mpensation expenses	-	-	10,240	-	-	-

Three-months ended March 31, 2010	-	-	-	-	(272,734)	(272,734)
Comprehensive income						\$ (272,734)
March 31, 2010	101,494,158	\$ 101,495	\$ 22,391,817	\$ -	\$ (20,509,850)	

(The accompanying notes are an integral part of these financial statements)

HEPALIFE TECHNOLOGIES, INC.

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three months ended March 31, 2010 and 2009
and from inception (October 21, 1997) to March 31, 2010
(Unaudited)

	Three Months Ended		From inception
	March 31,	March 31,	(October 21, 1997)
	2010	2009	to March 31,
			2010
Cash flows from operating activities:			
Net Loss	\$ (272,734)	\$ (866,621)	\$ (20,509,850)
Adjustments to reconcile net loss to net cash from operating activities:			
Depreciation	-	-	35,410
Amortization of license fees	-	18,750	150,000
Services paid by issuance of common stock	-	-	1,031,100
Stock offering costs paid by issuance of common stock	-	-	1,926,713
In-process research and development partially purchased by issuance of common stock warrants and a contract commitment payable, net of discount	-	-	283,903
Stock based compensation expenses	10,240	140,631	4,380,713
Amortization of discount on notes payable	-	2,349	2,107,522
Amortization of deferred financing costs	-	-	293,515
Loss on disposal of assets	-	-	3,061
Change in fair value of warrant liability	2,102	420,891	(1,868,070)
Loss on settlement of warrant liability	-	-	1,287,264
Change in assets and liabilities:			
Decrease (increase) in prepaid expenses and deposits	23,448	12,568	(95,587)
Increase (decrease) in accounts payable	4,106	(35,443)	102,568
Increase (decrease) in accounts payable - related party	-	-	99,946
Net cash used in operating activities	(232,838)	(306,875)	(10,771,792)
Cash flows from investing activities:			
Purchase of property and equipment	-	-	(38,471)
Purchase of license fees	-	-	(75,000)
Net cash used in investing activities	-	-	(113,471)
Cash flows from financing activities:			
Payment on contract commitment	-	-	(200,000)
Proceeds from issuance of common stock and warrants, net	-	-	9,787,867
Proceeds from issuance of convertible notes	-	-	2,125,000
Net proceeds from promissory notes	-	-	877,800
Proceeds from exercise of warrants	-	-	600,483
Increase in deferred financing cost	-	-	(228,525)
Net cash provided by financing activities	-	-	12,962,625
Increase (decrease) in cash and cash equivalents	(232,838)	(306,875)	2,077,362

Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

Effect of foreign exchange rate	-	381	-
Cash and cash equivalents, beginning of period	2,310,200	3,084,155	-
Cash and cash equivalents, end of period	\$ 2,077,362	\$ 2,777,661	\$ 2,077,362
Supplemental disclosure of cash flow information:			
Interest paid in cash	\$ -	\$ -	\$ 247,575
Income tax paid in cash	\$ -	\$ -	\$ -
Non-cash investing and financing activities:			
Common stock and warrants issued for professional services	\$ -	\$ -	\$ 1,143,078
Issuance of common stock as stock offering costs	\$ -	\$ -	\$ 1,926,713
Issuance of warrants for deferred financing costs	\$ -	\$ -	\$ 64,990
Conversion of note payable and related interest to equity	\$ -	\$ -	\$ 977,745
Conversion of debt to equity	\$ -	\$ -	\$ 2,500,000
Issuance of common stock to extinguish warrant liability	\$ -	\$ -	\$ 581,559

(The accompanying notes are an integral part of these financial statements)

HEPALIFE TECHNOLOGIES, INC.

(A Development Stage Company)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2010

(Unaudited)

Note 1. Description of the Business and Going Concern Uncertainties

HepaLife Technologies, Inc. is a development stage biotechnology company focusing on the development of a cell-based bioartificial liver system.

HepaLife Technologies, Inc. (the Company, we, us and our) was incorporated in the State of Florida on October 21, 1997. The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries HepaLife Biosystems, Inc., Phoenix BioSystems, Inc., and HepaLife Technologies Ltd.

HepaLife Biosystems, Inc. was incorporated in State of Nevada on April 17, 2007 for our research and development efforts with the patented PICM-19 cell line, artificial liver technologies, and in vitro toxicology testing systems.

Phoenix BioSystems, Inc. was incorporated under the laws of the State of Nevada on June 6, 2006 for our research and development efforts with the patented PBS-1 cell line. We terminated the development of the PBS-1 cell line on April 24, 2009. As a result, we dissolved Phoenix BioSystems, Inc. on May 19, 2009.

HepaLife Technologies Ltd. was incorporated on April 11, 2007 in British Columbia, Canada, for the purpose of streamlining business operations in Canada. We ceased to conduct business in Canada on August 31, 2008 and closed this office. As a result, we dissolved HepaLife Technologies, Ltd. on January 1, 2009.

We have incurred net operating losses since inception. We face all the risks common to companies in early stages of development, including undercapitalization and uncertainty of funding sources, high initial expenditure levels, uncertain revenue streams, and difficulties in managing growth. We expect to continue to incur losses from business operations and we believe our cash and cash equivalents balances, anticipated cash flows from operations, and other external sources of credit will be sufficient to meet our cash requirements through March 2012. Our prospects after March 2012 will depend in large part on our ability to successfully raise capital from external sources to pay for planned expenditures and to fund operations.

Principles of Consolidation

These consolidated financial statements presented are those of the Company and its wholly-owned subsidiaries, HepaLife Biosystems, Inc., Phoenix BioSystems, Inc., and HepaLife Technologies Ltd. All significant intercompany transactions and accounts have been eliminated in consolidation.

Note 2. Significant Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (which are of a normal recurring nature) considered necessary for a fair presentation of the financial statements have been included. Operating results for the quarter ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010 or any other interim period. For further information, refer to the consolidated financial statements and notes thereto included in our 2009 Annual Report on Form 10-K for the year ended December 31, 2009 filed with the Securities and Exchange Commission.

References to Authoritative Accounting Literature

In June 2009, the Financial Accounting Standards Board ("FASB") issued the Accounting Standards Codification ("ASC") as the single source of authoritative U.S. GAAP recognized by the FASB to be applied by non-governmental entities in preparation of financial statements in conformity with U.S. GAAP, except for additional authoritative rules and interpretative releases issued by the SEC. While the adoption of the ASC changes how we reference accounting standards, the adoption did not have an impact on our consolidated financial statements.

Accounting Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Areas where management uses subjective judgment include valuation of equity instruments. Actual results may differ from these estimates and assumptions.

Fair Value

We measure fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. We utilize a three-tier hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1. Valuations based on quoted prices in active markets for identical assets or liabilities that an entity has the ability to access. We have no assets or liabilities valued with Level 1 inputs.

Level 2. Valuations based on quoted prices for similar assets or liabilities, quoted prices for identical assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable data for substantially the full term of the assets or liabilities. We have no assets or liabilities valued with Level 2 inputs.

Level 3. Valuations based on inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Liabilities valued with Level 3 inputs are described in Note 8. Warrants.

Warrant Liability Derivative

We evaluate financial instruments for freestanding or embedded derivatives. The warrant liability derivative is recorded at fair value with changes in value recognized as other income (expense) in the consolidated statements of operations in the period of change.

Stock-Based Compensation

We measure all stock-based compensation awards at fair value on the date of grant and recognize such expense in our consolidated financial statements over the requisite service period for awards expected to vest. The Company uses the Black-Scholes pricing model to determine the fair value of stock-based compensation awards on the date of grant. The Black-Scholes pricing model requires management to make assumptions regarding the option lives, expected volatility, and risk free interest rates. See Note 9. Stock Options for additional information on the Company's stock-based compensation plans.

Related Party Transactions

A related party is generally defined as (i) any person who holds 10% or more of the Company's securities and their immediate families, (ii) the Company's management, (iii) someone who directly or indirectly controls, is controlled by or is under common control with the Company, or (iv) anyone who can significantly influence the financial and operating decisions of the Company. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties. (See Note 5. Related Party Transactions).

Recent and Adopted Accounting Pronouncements

We review new accounting standards as issued. Although some of these accounting standards issued or effective after the end of our previous fiscal year may be applicable to us, we have not identified any standards that we believe merit further discussion. We expect that none of the new standards will have a significant impact on our consolidated financial statements.

Note 3. Net Loss Per Share

Dilutive common stock equivalents include 1,075,000 and 17,176,830 warrants and stock options that are not included in the computation of diluted loss per share because to do so would be anti-dilutive for the three-month periods ended March 31, 2010 and March 31, 2009, respectively. All share and per share information are adjusted retroactively to reflect stock splits and changes in par value, when applicable.

Following is the computation of basic and diluted net loss per share for the three-month periods ended March 31, 2010 and 2009:

	March 31, 2010	March 31, 2009
Numerator - net loss available to common stockholders	\$ (272,734)	\$ (866,621)
Denominator - weighted average number of common shares outstanding	101,494,158	91,996,829
Basic and diluted loss per common share	(\$0.00)	(\$0.01)

Note 4. Purchased In-Process Research and Development

We purchased certain assets from Arbios Systems, Inc. (Arbios) relating to the pig cell based liver device technology known as HepatAssist in October 2008 in order to enhance and strengthen our PICM-19 porcine liver cell line based bioartificial liver. We re-trademarked the device as HepaMate. The effective purchase price of \$548,325 was charged to operations in 2008 as purchased in-process research and development expense. The purchase price consisted of cash for \$250,000, a contract commitment of \$200,000 (the Deferred Cash Purchase Price), and 750,000 Series D warrants valued at \$98,325 using the Black-Scholes pricing model (refer to Note 8. Warrants).

According to the purchase agreement, the Deferred Cash Purchase Price was due and payable on or before April 2010. The Deferred Cash Purchase Price did not bear interest. We discounted the payable with an effective annual interest rate of 5% and the associated amortization of the discount is charged to interest expense over the 18 month expected life of the note.

On April 1, 2009, we entered into a Repurchase Agreement with Arbios whereby we reacquired the Series D Warrants effective April 22, 2009 in consideration for the accelerated payment of the Deferred Cash Purchase Price. Due to the early retirement of the contract commitment, we recognized the full unamortized discount outstanding as of April 22, 2009 in the amount of \$10,524 during the three-month period ended June 30, 2009.

For the three-month periods ended March 31, 2010 and March 31, 2009, we charged to other income and expense nil and \$2,349, respectively, for the amortization on the discount to the Deferred Cash Purchase Price.

Note 5. Related Party Transactions

Executive Management: For the three-month periods ended March 31, 2010 and 2009, we incurred \$21,000 and \$0 in fees paid to Mr. Amit Dang the President, Chief Executive Officer, Chief Financial Officer and Secretary of the Company. In addition, for the three-month periods ended March 31, 2010 and 2009, we recorded \$7,834 and \$0 as stock compensation expense for stock option awards granted to Mr. Dang in October 2009 upon his appointment to the Company.

Director Fees: For the three-month periods ended March 31, 2010 and 2009, we incurred \$7,500 and \$10,000, respectively, in board fees for non-employee directors of the Company. In addition, for the three-month periods ended March 31, 2010 and 2009, we recorded \$2,406 and \$6,508, respectively, as stock compensation expense relating to initial stock option awards granted to non-employee directors for 50,000 shares each (refer to Note 9. Stock Options).

Our Board of Directors recently approved a change of control Severance Plan (the Severance Plan) that affects the Company's Board of Directors. Pursuant to the Severance Plan, if a Director resigns or is removed following a change in control, the Director will be entitled to receive a cash severance payment equal to \$1,200 per month served as a Director, up to a maximum amount of \$24,000.

Legal Fees: Legal fees expensed for the three-month periods ended March 31, 2010 and 2009 that were paid or are due to our attorney who also serves as a board member totaled \$56,143 and \$35,988, respectively.

All related party transactions are recorded at the exchange amount established and agreed to between related parties and are in the normal course of business.

Note 6. Cooperative and License Agreements

USDA, ARS CRADA: In November 2002, we entered into a Cooperative Research and Development Agreement (CRADA) with the U.S. Department of Agriculture (USDA), Agricultural Research Service (ARS) pertaining to the continued development and use of patented liver cell lines in artificial liver devices and in-vitro toxicological testing platforms. This agreement was amended several times, with a final agreement termination date of November 2008.

USDA, ARS License: On November 20, 2007, we exercised our license right under the CRADA by entering into an exclusive license agreement with the USDA, ARS for existing and future patents related to the PICM-19 hepatocyte cell lines. Under this license agreement, we incurred a license execution fee of \$150,000 with \$75,000 paid in December 2007 and \$75,000 paid in November 2008. The license execution fees were capitalized to prepaid license costs when incurred and amortized to operating expense during the years ended December 31, 2009 and 2008 for a total of \$62,500 and \$87,500, respectively. In addition to these payments, we are responsible for annual license maintenance fees commencing in year 2010 for the term of the license, which is until the expiration of the last to expire licensed patents unless terminated earlier. The license agreement also requires certain milestone payments, if and when milestones are reached, as well as royalties on net sales of resulting licensed products, if any. For the three-month period ended March 31, 2010, we incurred \$10,000 in license maintenance fees which were charged to administrative and general expenses.

MSU License: On June 15, 2006, we entered into an exclusive worldwide license agreement with Michigan State University (MSU) through our subsidiary, Phoenix BioSystems, Inc. (PBS), for the development of new cell-culture based flu vaccines to protect against the spread of influenza viruses among humans, including potentially the high pathogenicity H5N1 virus.

In January 2009, we provided notice to MSU to terminate the license agreement effective April 24, 2009. For the three-month period ended March 31, 2009, we incurred \$30,848 in expenses related to this contract. The \$30,848 consisted of a \$15,000 milestone payment charged to research and development and \$15,848 in legal fees. Total costs incurred to date relating to this license agreement are \$104,201.

Note 7. Stockholders Equity

We completed a private placement of 10,660,705 units at a price of \$0.425 per unit or \$4,530,800 in the aggregate in May 2008. Each unit consists of one share of our common stock and one Series C stock purchase warrant (Series C warrant) to purchase a share of common stock at the initial exercise price of \$0.55 per share for a period of two years from the date of issuance. The relative fair value of the common stock was estimated to be \$2,972,407 and the relative fair value of the warrants was estimated to be \$1,558,393 as determined based on the relative fair value allocation of the proceeds received. The warrants were valued on the transaction date using the Black-Scholes pricing model. In

conjunction with our completion of the acquisition of the HepatAssist related assets in October 2008, we reduced the initial exercise price of the Series C warrants to \$0.34 per share. In connection with the private placement, the agent was due a sales commission equal to \$90,828 or two (2%) percent of the gross proceeds, which was settled by issuing to the agent 213,713 units. In addition, we issued an aggregate of 50,000 units in payment of legal fees in the amount of \$21,250. There were also 2,065,412 Series C warrants issued in connection with a loan conversion agreement in 2008. These units were otherwise issued on the same terms and conditions as the units sold in the private placement.

Pursuant to the Subscription Agreement and the Registration Rights Agreement relating to the private placement, we and the investor parties made other covenants and representations and warranties regarding matters that are customarily included in financings of this nature. In the event that during the twelve month period following the closing date we issue shares at a price per share which is less than \$0.425 per share (the *Base Share Price*), then we are required to issue to the investors the number of shares equal to (1) the quotient of the aggregate purchase price payable under the Securities Purchase Agreement divided by *Base Share Price* less (2) the quotient of the aggregate purchase price divided by the per share purchase price under the Securities Purchase Agreement (the *Dilutive Issuance Adjustment*).

Note 8. Warrants

Warrants

On May 11, 2007, we entered into a Warrant Agreement whereby we issued warrants to purchase 670,000 shares of our common stock at a price of \$1.50 per share (the "Warrants") for a term of five years. We also issued warrants to a

broker/dealer to purchase 67,000 shares of our common stock at a price of \$1.50 per share for a term of five years. The Warrant Agreement states that the warrant purchase price is subject to adjustment, including if the Company issues any shares of common stock or common stock equivalents for consideration less than the then market price at the date of issuance subject to a 1% adjustment floor. The Warrant Agreements were issued in connection with the Securities Purchase Agreement, also dated May 11, 2007, for the sale of a convertible note with a \$2,500,000 principal amount and maturity date of May 11, 2009. The convertible note was fully converted into 2,604,721 and 2,342,415 shares of common stock during 2007 and 2008, respectively.

A registration statement relating to the resale of the common shares issuable under the conversion of the convertible note and exercise of the warrants was declared effective on July 5, 2007.

As a result of the purchase price adjustments defined in the Warrant Agreement, the warrant purchase price is subject to adjustment if the Company issues any shares of common stock or common stock equivalents for consideration less than the then market price at the date of issuance subject to a 1% adjustment floor. The May 2008 issuance of common stock resulted in an adjustment of the Warrant exercise price to \$1.45, with an offsetting share adjustment which increased the number of warrants to 757,192 shares. The October 2009 settlement of the Series C warrants (see Series C Warrants below) also resulted in a potential adjustment to the Warrant exercise price to \$1.34, with an offsetting share adjustment which increased the number of warrants to 825,000.

Series C Warrants

As stated in Note 7. Stockholders' Equity, as part of the May 2008 private placement, we issued 12,989,930 Series C warrants convertible into one share of the Company's common stock at an exercise price of \$0.34. On October 27, 2009, we consummated the transactions contemplated by the Warrant Exchange/Exercise Agreement between us and each of the holders of the Series C Warrants. Pursuant to the terms of the Warrant Exchange/Exercise Agreement we issued 3,492,505 shares of restricted stock in exchange for 6,985,010 Series C Warrants and issued an aggregate of 6,004,824 shares of common stock in connection with the exercise of the balance of the Series C Warrants at a price of \$0.10 per share. We received aggregate proceeds of \$600,483 from the exercise of the Series C Warrants. Upon completion of the Warrant Exchange/Exercise Agreement, there were no Series C Warrants outstanding.

The fair value of the Series C Warrant Liability at October 27, 2009, the effective date of the Warrant Exchange/Exercise Agreement, using the Black-Scholes pricing-model (Level 3 inputs) was \$581,559, of which \$268,838 was allocated to the 6,004,824 warrant shares exercised and \$312,721 was allocated to the 6,985,010 warrant shares exchanged, using the following assumptions: exercise price of \$0.34, dividend yield of 0%, expected volatility of 88.25%, risk-free interest rate of 0.17%, and expected term of 0.58 years.

We received total cash proceeds of \$600,483 from the 6,004,824 warrant shares exercised at \$0.10 per warrant share as part of the Warrant Exchange/Exercise Agreement. The fair value of the Series C Warrant liability attributable to the Warrants exercised was \$268,838, prior to the impact of the reduction in exercise price. The fair value of the warrant liability increased by \$691,934 and resulted in a carrying value of \$960,772 from the reduction in exercise price. The increase in the fair value of the warrant liability of \$691,934 was recorded as a component of the loss on extinguishment of warrant liability in 2009.

The fair value of the 3,492,505 shares of common stock issued to settle the exchange for 6,985,010 warrant shares was \$908,952 based on the closing price of the Company's common stock of \$0.26 per share on October 27, 2009 as quoted on the Over the Counter Bulletin Board. The Company recorded a loss on extinguishment of warrant liability on the shares exchanged for common stock in the amount of \$595,330 on October 27, 2009 as a result of the excess of the consideration provided in the form of common stock over the fair value of the Series C Warrant Liability.

Series D Warrants

As stated in Note 4. Purchased In-Process Research and Development, we entered into a Repurchase Agreement on April 22, 2009 with Arbios whereby we repurchased all of the 750,000 shares outstanding of the Series D warrants from Arbios in consideration for the early payment of the Deferred Cash portion of the Purchase Price.

Warrant Liability

The potential of a dilutive adjustment to the Warrants' exercise prices and number of underlying shares of common stock may result in a settlement amount that does not equal the difference between the fair value of a fixed number of the Company's common stock and a fixed exercise price. Accordingly, the Warrants are not considered indexed to the Company's own stock and, therefore, are accounted for as a derivative pursuant to ASC 815-40 *Contracts in an Entity's Own Equity* which became

effective January 1, 2009. Upon the adoption of this guidance, we recognized a one-time adjustment to opening loss accumulated during the development stage in the amount of \$1,932,469 resulting from accounting for the Warrants and Series C warrants as a liability.

At March 31, 2010, we valued the warrant liability for the Warrants using the Black-Scholes pricing-model (Level 3 inputs) containing the following assumptions: volatility 101.53%, risk-free rate 1.02%, and term of 2.10 years. The following reconciles the Warrant liability for the three-months ended March 31, 2010:

Beginning balance, December 31, 2009	\$	9,815
Change in fair value of warrant liability		2,102
Ending balance, March 31, 2010	\$	11,917

As a result of adjusting the warrant liability to fair value, we recorded a non-cash loss in other income and expense of \$2,102 relating to the Warrants for the three-month period ended March 31, 2010.

Note 9. Stock Options

We have an active stock option plan that provides shares available for option grants to employees, directors and others. The Company's stock option plan provides for the granting of stock options to purchase a maximum of 40,000,000 shares of the Company's common stock. Options granted under our option plan generally vest over two to five years or as otherwise determined by the Board of Directors, have exercise prices equal to the fair market value of the common stock on the date of grant, and expire no later than ten years after the date of grant.

The per share exercise price for each stock option is determined by the Board and may not be below fair market value on the date of grant. The fair market value of the Company's common stock is the closing price of the common stock as listed on the OTCBB on the date of grant or, if the Company's common stock is not traded on the date of grant, the first day of active trading following the date of grant.

The Company measures all stock-based compensation awards using a fair value method on the date of grant and recognizes such expense in its consolidated financial statements over the requisite service period. The grant date fair value of stock options is based on the price of a share of the Company's common stock on the date of grant. In determining the grant date fair value of stock options, the Company uses the Black-Scholes option pricing model which requires management to make assumptions regarding the option lives, expected volatility, and risk free interest rates, all of which impact the fair value of the option and, ultimately, the expense that will be recognized over the life

of the option.

The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for a bond with a similar term. The Company does not anticipate declaring dividends in the foreseeable future. Volatility is calculated based on the historical weekly closing stock prices for the same period as the expected life of the option. The Company uses the simplified method for determining the expected term of its plain vanilla stock options. The Company recognizes compensation expense for only the portion of stock options that are expected to vest.

Stock option activity for the three-month period ended March 31, 2010 is summarized as follows:

	Number of options	Weighted average exercise price	Remaining contractual term	Aggregate intrinsic value
Outstanding at December 31, 2009 and March 31, 2010	250,000	\$ 0.35	6.84	\$ -
Exercisable at March 31, 2010	30,000	0.38	8.37	\$ -
Available for grant at March 31, 2010	37,548,000			

The aggregate intrinsic value in the table above represents the total pretax intrinsic value for all in-the-money options (i.e. the difference between the Company's closing stock price on the last trading day of the period ended March 31, 2010 and the exercise price, multiplied by the number of shares) that would have been received by the option holders had all option holders exercised their options on March 31, 2010. This amount is based on the fair market value of the Company's stock. The

intrinsic value changes based on the fair market value of the Company's common stock.

During the three-month period ended March 31, 2010, total stock option compensation expense charged to operations was \$10,240 included in director, management and consulting fees.

During the three-month period ended March 31, 2009, total compensation expense charged to operations was \$140,631 with \$134,123 classified as salaries and benefits and \$6,508 included in director fees. Of the amount classified as salaries, \$96,940 was due to early achievement of milestone based options related to a grant in October 2006.

For the three-month period ended March 31, 2010, we had \$26,048 of total unrecognized compensation cost related to unvested stock options, which is expected to be recognized over a weighted average period of approximately 2.32 years.

We do not repurchase shares to fulfill the requirements of options that are exercised. Further, we issue new shares when options are exercised.

item 2. management's discussion and analysis of financial condition and results of operations.

Forward-Looking Statements

Except for the historical information presented in this document, the matters discussed in this Form 10-Q for the three-months ending March 31, 2010, this report contains forward-looking statements. Such forward-looking statements include statements regarding, among other things, (a) our projected sales and profitability, (b) our growth strategies, (c) anticipated trends in our industry, (d) our future financing plans, and (e) our anticipated needs for working capital. Forward-looking statements, which involve assumptions and describe our future plans, strategies, and expectations, are generally identifiable by use of the words may, will, should, expect, anticipate, estimate, believe, intend, or project or the negative of these words or other variations on these words or comparable terminology. This information may involve known and unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from the future results, performance, or achievements expressed or implied by any forward-looking statements. These statements may be found under Management's Discussion and Analysis of Financial Condition and Results of Operations, Business, Properties, as well as in this report generally.

The following discussion and analysis is based upon our interim unaudited consolidated financial statements, which have been prepared in accordance with Form 10-Q instructions and accounting principles generally accepted in the United States of America, and should be read in conjunction with those financial statements and related notes. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Overview

We are a development stage biotechnology company focusing on the development of a cell-based bioartificial liver system, HepaMate™, as a potentially lifesaving treatment for liver failure patients. The technology has previously been successfully tested in a clinical phase I study. As an extracorporeal cell-based bioartificial liver system, HepaMate™ is designed to combine blood detoxification with liver cell therapy to provide whole liver function in patients with the most severe forms of liver failure.

On October 3, 2008, we acquired HepatAssist Related Assets from Arbios, which included over 12 patents and patent licenses; miscellaneous scientific equipment; FDA Investigative New Drug (IND) application, including orphan drug and fast track designation; phase I and phase II/III clinical protocols and clinical data; and standard operating procedures for manufacturing and quality control. The acquired assets relate to a bioartificial liver device formerly known as HepatAssist. HepatAssist passed clinical phase I studies was evaluated in the largest-ever phase II/III clinical study (prospective, randomized, multicenter, controlled trial involving over 170 patients) to test the safety and efficacy of a bioartificial liver assist device. The clinical data was published in 2004 and showed for bioartificial liver device treated patients in fulminant and sub-fulminant hepatic failure a significant survival advantage compared with the patient control group receiving standard-of-care treatment.

We are working towards optimizing the former HepatAssist bioartificial liver device for utilization in a new clinical phase II/III study followed, if warranted, by commercialization upon final regulatory approval.

Previously we focused our research, development and commercialization efforts on the development of a porcine stem cell line, and subclones thereof, which we refer to as the PICM-19 cell line for use in a bioartificial liver and in-vitro toxicology testing, and on the commercialization of a chicken cell line, and subclones thereof, which we refer to as the PBS-1 cell line. The PBS-1 cell line was developed for potential use in cell-based vaccine production and was exclusively licensed from Michigan State University (MSU) in June 2006. In January 2009, we provided written notice to MSU terminating the license agreement effective April 24, 2009.

The PICM-19 cell line was developed for potential use in a bioartificial liver device and in-vitro toxicology platforms and was exclusively licensed from USDA Agricultural Research Service on November 2007. In September 2008 the license was amended for the expanded field-of-use as in-vitro infection host systems for viral and protozoan agents such as malaria.

On May 23, 2008, we completed a private placement of securities for an aggregate purchase price of \$4,530,800. Simultaneously with the completion of the private placement, in satisfaction of the \$877,800 outstanding principal amount of

the promissory note which we previously issued, we issued 2,065,412 Units consisting of 2,065,412 shares and 2,065,412 Series C Warrants; the note holder agreed to accept \$150,000 in full payment and satisfaction of the accrued and unpaid interest on the note payable in the amount of \$249,945.

Asset Purchase Agreement

On October 3, 2008, we entered into and consummated the transactions contemplated by a purchase agreement with Arbios pursuant to which, we purchased certain specified assets of Arbios relating to the pig cell based liver device technology that was being developed by Arbios.

The purchase price of the acquired assets consisted of: \$450,000 in cash, of which \$250,000 was paid at the closing and \$200,000 was deferred for up to 18 months; a Series D Stock Purchase Warrant to purchase up to 750,000 shares of the Company's common stock at an exercise price of \$0.35 per share for a period of 5 years. The Deferred Cash Purchase Price of \$200,000 was due and payable on or before April 2010.

Warrant Repurchase Agreement

On April 22, 2009, we consummated the transactions contemplated by a Warrant Repurchase Agreement between us and Arbios. Pursuant to the Repurchase Agreement, we repurchased the Series D stock purchase warrant previously issued to Arbios as partial consideration pursuant to the Asset Purchase Agreement. The Series D Warrant entitled the holder to purchase up to 750,000 shares of our common stock at a price of \$0.35 per share for a period of 5 years. In consideration thereof we accelerated payment of the Deferred Cash Purchase Price to April 22, 2009.

May 2008 Private Placement

On May 23, 2008, we completed a private placement (May 2008 Private Placement) pursuant to which we sold 10,660,705 units (Units) at a price of \$0.425 per Unit or \$4,530,800 in the aggregate. Each Unit consists of one share of our common stock (the Unit Shares) and one Series C stock purchase warrant (Series C warrant) to purchase a share of common stock at the initial exercise price of \$0.55 per share for a period of two years from the date of issuance. In conjunction with our completion of the acquisition of the HepatAssist Related Assets in October 2008, we reduced the initial exercise price of the Series C warrants to \$0.34 per share. We also issued an additional 263,713 Units in payment of placement and legal fees relating to this transaction.

Loan Conversion

Simultaneously with the completion of the May 2008 Private Placement, we entered into an agreement with Mr. Harmel S. Rayat, our former Chief Financial Officer, Director and Controlling Shareholder, pursuant to which Mr. Rayat (i) converted the entire outstanding principal amount (\$877,800) of his loan to us into an aggregate of 2,065,412 Units, each Unit consisting of one share of our common stock and one Series C warrant, at a conversion price of \$0.425 per Unit and (ii) agreed to accept \$150,000 in full payment and satisfaction of the accrued and unpaid interest on the loan in the amount of \$249,945.

Warrants

As of March 31, 2010, we had Warrant shares outstanding that we issued May 11, 2007 with an original exercise price of \$1.50 and original warrant shares of 737,000 convertible into common stock until May 11, 2012. The Warrant Agreement provides for an adjustment to the exercise price and number of shares if we issue shares of common stock or common stock equivalents for consideration less than the then market price at the date of issuance subject to a 1% adjustment floor. As a result of this provision, the total number of Warrant shares outstanding as of March 31, 2010 was 825,000 with an exercise price of \$1.34.

Warrant Exchange/Exercise Agreement

On October 27, 2009, we consummated the transactions contemplated by the Warrant Exchange/Exercise Agreement between us and each of the holders of the Series C warrants. Pursuant to the terms of the Warrant Exchange/Exercise Agreement we issued 3,492,505 shares of restricted stock in exchange for 6,985,010 Series C warrants and issued an aggregate of 6,004,824 shares of common stock in connection with the exercise of the balance of the Series C warrants a price of \$0.10 per share. As of December 31, 2009, there are no Series C warrants outstanding.

The fair value of the Series C warrant liability at October 27, 2009, the effective date of the Warrant Exchange/Exercise Agreement, using the Black-Scholes pricing-model was \$581,559, of which \$268,838 was allocated to the 6,004,824 warrant shares exercised and \$312,721 was allocated to the 6,985,010 warrant shares exchanged.

We received total cash proceeds of \$600,483 from the 6,004,824 warrant shares exercised at \$0.10 per warrant share as part of the Warrant Exchange/Exercise Agreement. The fair value of the Series C warrant liability attributable to the Warrants exercised was \$268,838, prior to the impact of the reduction in exercise price. The fair value of the warrant liability increased by \$691,934 and resulted in a carrying value of \$960,772 from the reduction in exercise price. The increase in the fair value of the warrant liability of \$691,934 was recorded as a component of the loss on extinguishment of warrant liability in 2009.

The fair value of the 3,492,505 shares of common stock issued to settle the exchange for 6,985,010 warrant shares was \$908,952 based on the closing price of the Company's common stock of \$0.26 per share on October 27, 2009 as quoted on the Over the Counter Bulletin Board. The Company recorded a loss on extinguishment of warrant liability on the shares exchanged for common stock in the amount of \$595,330 on October 27, 2009 as a result of the excess of the consideration provided in the form of common stock over the fair value of the Series C warrant liability.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses and related disclosures. We review our estimates on an ongoing basis.

We consider an accounting estimate to be critical if it requires assumptions to be made that were uncertain at the time the estimate was made; and changes in the estimate or different estimates that could have been made could have a material impact on our results of operations or financial condition. We believe the following accounting policies to be critical to the judgments and estimates used in the preparation of our financial statements:

Research and Development Expenses

Research and development expenses represent costs incurred to develop our technology, as well as purchased in-process research and development programs. We charge all research and development expenses to operations as they are incurred.

General and Administrative Expenses

Our general and administrative expenses consist primarily of personnel related costs, legal costs, including intellectual property that is expensed when incurred, investor relations costs, stock-based compensation costs, accounting costs, and other professional and administrative costs.

Stock-Based Compensation

We measure all stock-based compensation awards at fair value on the date of grant and recognize such expense in our consolidated financial statements over the requisite service period for awards expected to vest. We use the Black-Scholes pricing model to determine the fair value of stock-based compensation awards on the date of grant. The Black-Scholes pricing model requires management to make assumptions regarding the option lives, expected volatility, and risk free interest rates. See Note 9. Stock Options in the Notes to Consolidated Financial Statements for additional information on our stock-based compensation plans.

Fair Value

We measure fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. We utilize a three-tier hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1. Valuations based on quoted prices in active markets for identical assets or liabilities that an entity has the ability to access. We have no assets or liabilities valued with Level 1 inputs.

Level 2. Valuations based on quoted prices for similar assets or liabilities, quoted prices for identical assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable data for substantially the full term of the assets or liabilities. We have no assets or liabilities valued with Level 2 inputs.

Level 3. Valuations based on inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Liabilities valued with Level 3 inputs are described in Note 8. Warrants in the Notes to

Consolidated Financial Statements.

Warrant Liability Derivative

We evaluate financial instruments for freestanding or embedded derivatives. The warrant liability derivative is recorded at fair value with changes in value recognized as other income (expense) in the consolidated statements of operations in the period of change.

Results of Operations

We have yet to establish any history of profitable operations and our accumulated deficit from inception through March 31, 2010 is \$20,509,850. We have not generated any revenues from operations and do not expect to generate any revenues for the foreseeable future. We expect that any future revenues will not be sufficient to sustain our operations for the foreseeable future. Our profitability will require the successful completion of our research and development programs, and the subsequent commercialization of the results or of products derived from such research and development efforts. No assurances can be given when this will occur or that we will ever be profitable.

We expect to continue to incur losses from business operations and we believe our cash and cash equivalents balances, anticipated cash flows from operations, and other external sources of credit will be sufficient to meet our cash requirements through March 2012. Our future after March 2012 will depend in large part on our ability to successfully raise capital from external sources to pay for planned expenditures and to fund operations.

Operating Expenses

The following is a summary of operating expenses for the three-month periods ended March 31, 2010 and 2009:

	March 31, 2010	March 31, 2009	Increase (Decrease)	% Change
Expenses				
Salary and benefits	\$ 68,909	\$ 200,048	\$ (131,139)	(65.6%)
Research and development	-	51,075	(51,075)	(100.0%)

Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

Shareholder relations and name branding	7,316	2,280	5,036	220.9%
Administrative and general	56,383	53,966	2,417	4.5%
Professional fees- accounting and legal	103,219	104,254	(1,035)	(1.0%)
Director, management and consulting fees	38,740	41,708	(2,968)	(7.1%)
	\$ 274,567	\$ 453,331	\$ (178,764)	(39.4%)

Salaries and benefits: We incurred salaries and benefits expense of \$68,909 for the three-month period ended March 31, 2010 which represents a decrease of \$131,139 or 65.6% compared to the same period in 2009. The decrease is due primarily to a decrease in stock option compensation expense resulting from the acceleration of vesting of certain options based upon performance during the three-month period ended March 31, 2009.

Research and development: Our research and development expenses were significantly reduced during the three-month period ended March 31, 2010 as a result of lower regulatory consulting fees and associated expenses. During this period, the Company did not feel further expense for regulatory consulting was required or warranted, since we have received, we believe, the necessary regulatory guidance in order to best determine the Company's near-term product development and clinical trials strategy.

Shareholder relations and name branding: We incurred \$7,316 of shareholder relations expense and name branding which represents an increase of \$5,036 compared to the same period in 2009. Investor relations costs represent fees paid to publicize our technology within the industry and investor community with the purpose of increasing company recognition. The increase in investor relations expense is due to the Company entering into a Shareholder Communications Agreement as described below.

Effective April 15, 2009, the Company entered into a one-year Shareholder Communication Services Agreement (the Shareholder Communications Agreement) with a third party consultant to provide shareholder communication and related administrative services. In accordance with the terms of the Shareholder Communications Agreement, the Company pays the third party consultant \$1,250 per month.

Administrative and general: We incurred \$56,383 in administrative and general expenses for the three-month period ended March 31, 2010 which represents an increase of \$2,417 or 4.5% compared to the same period in 2009.

Professional fees: We incurred a total of \$103,219 in professional fees for the three-month period ended March 31, 2010 which represents a decrease of \$1,035 or 1.0% compared to the same period in 2009. Professional fees primarily consist of accounting, audit, tax, and legal fees. These expenses were flat for these two quarters comparatively as there have been no changes in our staffing and recurring nature of their responsibilities.

Director, management and consulting fees: We incurred \$38,740 in director, management and consulting expenses for the three-month period ended March 31, 2010 which representing a decrease of \$2,968 or 7.1% compare to the same period in 2009. The decrease is due primarily to lower board fees as one member of our Board resigned effective October 2009.

Other Income and (Expense)

The following is a summary of other income and (expense) for the three-month periods ended March 31, 2010 and 2009:

	March 31, 2010	March 31, 2009	Increase (Decrease)	% Change
Other income and (expenses)				
Bank charges and foreign exchange loss	\$ (950)	\$ (590)	360	61.0%
Interest income	4,885	10,540	(5,655)	(53.7%)
Amortization of discount on notes	-	(2,349)	(2,349)	(100.0%)
Change in fair value of warrant liability	(2,102)	(420,891)	418,789	(99.5%)

Interest income: Interest income for the three-month period ended March 31, 2010 and 2009, represents interest earned on cash and cash equivalents.

Amortization of discount on notes: This account decreased due to the payment-in-full in April 2009 of the note related to the Arbios asset acquisition.

Change in fair value of warrant liability: Our Warrants are considered derivative liabilities and are therefore required to be adjusted to fair value each quarter. We value our warrant liability using the Black-Scholes model. Our stock price, remaining term of the warrants and the volatility of our stock all impact the fair value of the warrants.

The amount recorded to adjust the Warrants to fair value resulted in a net non-cash loss of \$2,102 for the three-month period ended March 31, 2010. The decrease from the quarter ended March 31, 2009, is due to fewer warrants accounted for as derivatives during 2010 compared to 2009.

Liquidity and Capital Resources

We had cash and cash equivalents of \$2,077,362 and \$2,310,200 as of March 31, 2010 and December 31, 2009, respectively. We had no financing activities during the three-month periods ended March 31, 2010 and 2009.

Net cash flow used in operating activities was \$232,838 and \$306,875 for the three-month periods ended March 31, 2010 and 2009, respectively. We have financed operations primarily from cash on hand and through private placement of securities, as well as through the exercise of Series C Warrants. The accompanying financial statements have been prepared assuming we will continue as a going concern. We incurred cumulative losses of \$20,509,850 from inception through March 31, 2010. Additionally, we have expended a significant amount of cash in developing our technology. We expect to continue to incur losses from business operations and we believe our cash and cash equivalents balances, anticipated cash flows from operations, and other external sources of credit will be sufficient to meet our cash requirements through March 2012. Our future after March 2012 will depend in large part on our ability to successfully raise capital from external sources to pay for planned expenditures and to fund operations.

Related Party Transactions

Executive Management: For the three-month periods ended March 31, 2010 and 2009, we incurred \$21,000 and \$0 in fees paid to Mr. Amit Dang the President, Chief Executive Officer, Chief Financial Officer and Secretary of the Company. In addition, for the three-month periods ended March 31, 2010 and 2009, we recorded \$7,834 and \$0 as stock compensation expense for

stock option awards granted to Mr. Dang in October 2009 upon his appointment to the Company.

Director Fees: For the three-month periods ended March 31, 2010 and 2009, we incurred \$7,500 and \$10,000, respectively, in board fees for non-employee directors of the Company. In addition, for the three-month periods ended March 31, 2010 and 2009, we recorded \$2,406 and \$6,508, respectively, as stock compensation expense relating to initial stock option awards granted to non-employee directors for 50,000 shares each (refer to Note 9. Stock Options in the Notes to Consolidated Financial Statements in this Form 10-Q).

Our Board of Directors recently approved a change of control Severance Plan (the Severance Plan) that affects the Company's Board of Directors. Pursuant to the Severance Plan, if a Director resigns or is removed following a change in control, the Director will be entitled to receive a cash severance payment equal to \$1,200 per month served as a Director, up to a maximum amount of \$24,000.

Legal Fees: Legal fees expensed for the three-month periods ended March 31, 2010 and 2009 that were paid or are due to our attorney who also serves as a board member totaled \$56,143 and \$35,988, respectively.

All related party transactions are recorded at the exchange amount established and agreed to between related parties and are in the normal course of business.

Off Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Recent Accounting Pronouncements

See Note 2. Significant Accounting Policies in the Notes to Consolidated Financial Statements in this Form 10-Q.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk is confined to our cash equivalents and short-term investments. We invest in high-quality financial instruments; primarily money market funds, federal agency notes, and US Treasury obligations, with the effective duration of the portfolio within one year which we believe are subject to limited credit risk. We currently do not hedge interest rate exposure. Due to the short-term nature of our investments, we do not believe that we have any material exposure to interest rate risk arising from our investments.

ITEM 4T. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), as of the end of the period covered by this quarterly report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of March 31, 2010 that our disclosure controls and procedures were effective such that the information required to be disclosed in our United States Securities and Exchange Commission (SEC) reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Internal Control Over Financial Reporting.

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

PART II OTHER INFORMATION

Item 1. Legal Proceedings

None

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

None

Item 3. Defaults Upon Senior Securities

None

Item 5. Other Information

None

Item 6. Exhibits

Exhibit Number	Exhibit Description	Form	Incorporated by Reference		Exhibit Number	Filed Herewith
			File No.	Date of First Filing		
3.1	Articles of Incorporation of	10-SB12G	000-29819	3/7/2000	3(i)	

	HepaLife Technologies, Inc.				
3.2	Amended Bylaws of HepaLife Technologies, Inc.	10-K	000-29819	12/31/09	3.2
10.1	2001 Incentive Stock Purchase Plan	S-8	333-105083	5/8/03	10.2
10.2	Common Stock Purchase Agreement (Exhibit 10.) and Registration Rights Agreement (Exhibit 10.2) with Fusion Capital Fund II, LLC	8-K	000-29819	7/13/05	
10.3	Securities Purchase Agreement with GCA Strategic Investment Limited	8-K	000-29819	5/16/07	
10.4	Subscription Agreement (Exhibit 10.1), Registration Rights Agreement (Exhibit 10.2) and Series C Warrant Agreement (Exhibit 10.3), relating to the Private Placement of 10,660,705 units on May 23, 2008	8-K	000-29819	5/28/08	10.1 10.2
10.5	Interim Executive Services Agreement, dated October 13, 2009, with Amit S. Dang	8-K	000-20819	10/19/09	
10.6	Warrant Exercise or Exchange Agreement with the holders of its Series C Warrants (Exhibit 10.1)	8-K	000-29819	10/28/09	10.1

Exhibit Number	Exhibit Description	Form	Incorporated by Reference Date of First Filing	File No.	Exhibit Number	Filed Herewith
31.1	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					*
32.1	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 USC. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					*

SIGNATURES

Pursuant to the requirements of Sections 13 or 15 (d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report on Form 10-Q for the quarter ended March 31, 2010, to be signed on its behalf by the undersigned, thereunto duly authorized on this 4th day of May, 2010.

HepaLife Technologies, Inc.

/s/ Amit Dang

Amit Dang

President, Chief Executive Officer,

Principal Executive Officer, Secretary

Chief Financial Officer, Principal

Financial Officer and Principal Accounting Officer

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

Signature

Title

Date

/s/ Amit Dang

President, Chief Executive Officer,

May 4, 2010

Amit Dang

Principal Executive Officer, Secretary,

Chief Financial Officer, Principal Financial
Officer, and Principal Accounting Officer

/s/ Jatinder S. Bhogal

Director

May 4, 2010

Jatinder S. Bhogal

/s/ Javier Jimenez

Director

May 4, 2010

Javier Jimenez

/s/ Joseph Sierchio

Director

May 4, 2010

Joseph Sierchio