

ADVANCED CELL TECHNOLOGY, INC.  
Form 10-Q  
August 08, 2012

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON D.C. 20549**

**FORM 10-Q**

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

FOR THE QUARTERLY PERIOD ENDED June 30, 2012

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: 0-50295**

**ADVANCED CELL TECHNOLOGY, INC.**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	87-0656515
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

**33 LOCKE DRIVE, MARLBOROUGH, MASSACHUSETTS 01752**

(ADDRESS, INCLUDING ZIP CODE, OF PRINCIPAL EXECUTIVE OFFICES)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: **(508) 756-1212**

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 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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐  
(Do not check if a 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.

Class:	Outstanding at August 1, 2012:
Common Stock, \$0.001 par value per share	2,112,215,484 shares



**ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY**

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**Part I – FINANCIAL INFORMATION****Item 1. Financial Statements****ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS****AS OF JUNE 30, 2012 AND DECEMBER 31, 2011**

	June 30, 2012 (unaudited)	December 31, 2011
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$9,862,536	\$13,103,007
Deferred royalty fees, current portion	62,435	62,435
Prepaid expenses	122,712	241,248
Total current assets	10,047,683	13,406,690
Property and equipment, net	153,600	154,771
Deferred royalty fees, less current portion	201,434	232,652
Deposits	14,766	14,766
Deferred costs, net of amortization of \$5,756,342 and \$4,854,556, respectively	974,661	1,376,447
<b>TOTAL ASSETS</b>	<b>\$11,392,144</b>	<b>\$15,185,326</b>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$1,839,515	\$2,128,562
Accrued expenses	1,825,684	2,538,545
Accrued settlement	–	34,155,552
Convertible promissory notes, net of discounts of \$94,887 and \$0, respectively	192,898	–
Embedded conversion option liabilities, current portion	186,484	–
Loss contingency accrual	15,347,341	16,704,169
Deferred revenue, current portion	338,617	222,739
Total current liabilities	19,730,539	55,749,567
Convertible promissory notes, net of discounts of \$0 and \$158,142, respectively	–	129,643
Embedded conversion option liabilities, less current portion	5,286	253,530
Warrant and option derivative liabilities	1,178,897	1,671,047
Deferred revenue, less current portion	1,986,510	2,076,257
Total liabilities	22,901,232	59,880,044

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Series A-1 redeemable preferred stock, \$0.001 par value; 50,000,000 shares authorized, 113 shares issued and outstanding; aggregate liquidation value, net of discounts: \$1,537,846 and \$1,472,262, respectively	1,511,701	1,429,126
Commitments and contingencies		
<b>STOCKHOLDERS' DEFICIT:</b>		
Preferred stock, Series B; \$0.001 par value; 50,000,000 shares authorized, 1,000 shares issued and outstanding	1	1
Preferred stock, Series C; \$0.001 par value; 50,000,000 shares authorized, 1,600 and 1,150 shares issued and outstanding	2	1
Common stock, \$0.001 par value; 2,750,000,000 shares authorized, 2,112,215,484 and 1,743,569,255 shares issued and outstanding	2,112,215	1,743,569
Additional paid-in capital	277,304,154	229,319,208
Promissory notes receivable, net of discount of \$4,338,390 and \$4,278,016, respectively	(28,966,005 )	(23,381,185 )
Accumulated deficit	(263,471,156)	(253,805,438)
Total stockholders' deficit	(13,020,789 )	(46,123,844 )
<b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT</b>	<b>\$11,392,144</b>	<b>\$15,185,326</b>

The accompanying notes are an integral part of these consolidated financial statements.

**ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF OPERATIONS****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2012 AND 2011**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Revenue</b> (License fees and royalties)	\$218,184	\$153,688	\$273,869	\$307,376
Cost of Revenue	15,609	281,500	31,218	304,400
Gross profit (loss)	202,575	(127,812)	) 242,651	2,976
Operating expenses:				
Research and development	2,068,098	1,532,271	4,508,640	3,007,044
General and administrative expenses	2,612,471	1,951,728	5,631,476	5,149,254
Loss on settlement of litigation	—	—	—	294,144
Total operating expenses	4,680,569	3,483,999	10,140,116	8,450,442
Loss from operations	(4,477,994)	) (3,611,811)	) (9,897,465)	) (8,447,466)
Non-operating income (expense):				
Interest income	4,508	10,765	9,585	22,549
Interest expense and late fees	(275,292)	) (272,171)	) (547,616)	) (953,881)
Finance cost	3,555,254	(245,734)	) 3,671,081	(2,871,609)
Fines and penalties	(3,500,000)	) —	(3,500,000)	) —
Adjustments to fair value of derivatives	734,081	(701,198)	) 592,482	4,088,221
Total non-operating income (expense)	518,551	(1,208,338)	) 225,532	285,280
Loss before provision for income tax	(3,959,443)	) (4,820,149)	) (9,671,933)	) (8,162,186)
Provision for income tax	—	—	—	—
Net loss	\$(3,959,443)	) \$(4,820,149)	) \$(9,671,933)	) \$(8,162,186)
Weighted average shares outstanding :				
Basic and diluted	2,076,212,012	1,543,519,167	2,010,442,657	1,510,945,682
Loss per share:				
Basic and diluted	\$(0.00)	) \$(0.00)	) \$(0.00)	) \$(0.01)

The accompanying notes are an integral part of these consolidated financial statements.





**ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT****FOR THE SIX MONTHS ENDED JUNE 30, 2012**

	Series B Preferred Stock		Series C Preferred Stock		Common Stock		Additional Paid-in	Pr No Re ne
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	
Balance December 31, 2011	1,000	\$ 1	1,150	\$ 1	1,743,569,255	\$ 1,743,569	\$ 229,319,208	\$ (2
Shares issued for settlements	—	—	—	—	296,405,268	296,405	35,044,893	—
Shares issued for services	—	—	—	—	6,473,980	6,474	833,559	—
Accrued dividends on Series B and C Preferred Stock	—	—	—	—	—	—	948,712	—
Accretion of note receivable discount on Series B and C Preferred Stock	—	—	—	—	—	—	—	(9
Option compensation charges	—	—	—	—	—	—	2,093,657	—
Issuance of Series C preferred stock	—	—	450	1	—	—	4,499,999	—
Issuance of Common Stock to Series C	—	—	—	—	54,805,817	54,806	3,803,438	(

Preferred  
Stock holder  
for note  
receivable

Common  
stock issued  
upon exercise  
of Series C  
Preferred  
Stock  
warrants and  
issuance of  
note  
receivable

Net loss for  
the six months  
ended June  
30, 2012

Balance June  
30, 2012  
(unaudited)

—	—	—	—	10,961,164	10,961	760,688	(7
—	—	—	—	—	—	—	—
1,000	\$ 1	1,600	\$ 2	2,112,215,484	\$ 2,112,215	\$ 277,304,154	\$ (2

The accompanying notes are an integral part of these consolidated financial statements

**ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE SIX MONTHS ENDED JUNE 30, 2012 AND 2011**

	2012 (unaudited)	2011 (unaudited)
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(9,671,933 )	\$(8,162,186 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	25,440	38,394
Amortization of deferred charges	31,218	45,800
Amortization of deferred revenue	(273,869 )	(307,376 )
Redeemable preferred stock dividend accrual	65,583	59,301
Stock based compensation	2,093,657	741,946
Amortization of deferred issuance costs	401,786	795,540
Amortization of discounts	80,247	94,022
Adjustments to fair value of derivatives	(592,481 )	(4,088,221 )
Shares of common stock issued for services	—	475,900
Shares of common stock issued for compensation	840,032	423,138
Non-cash financing costs	(3,671,081 )	2,871,609
Loss on settlement of litigation	—	294,144
Warrant and options issued for consulting services	38,571	769,347
Changes in operating assets and liabilities		
Prepaid expenses	118,536	(344,497 )
Accounts payable and other current liabilities	2,798,092	(396,056 )
Net cash used in operating activities	(7,716,202 )	(6,689,195 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of property and equipment	(24,269 )	(36,830 )
Net cash used in investing activities	(24,269 )	(36,830 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from exercise of warrants and options	—	2,950,940
Proceeds from issuance of Series B preferred stock, net	4,500,000	4,000,000
Net cash provided by financing activities	4,500,000	6,950,940
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(3,240,471 )	224,915
<b>CASH AND CASH EQUIVALENTS, BEGINNING BALANCE</b>	13,103,007	15,889,409
<b>CASH AND CASH EQUIVALENTS, ENDING BALANCE</b>	\$9,862,536	\$16,114,324

CASH PAID FOR:

Interest	\$—	\$—
Income taxes	\$—	\$—

SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES:

Issuance of 0 and 1,519,077 shares of common stock in redemption of debt	\$—	\$ 151,909
Issuance of note receivable on issuance of shares and exercise of warrants for 65,766,981 and 52,335,115 shares of common stock	\$5,400,000	\$9,600,000
Record note receivable discount related to Series C preferred stock	\$(770,107 )	\$(1,369,078 )
Accrued dividends on Series B and C Preferred Stock	\$948,712	\$638,202
Accretion of note receivable discount on Series B and C Preferred Stock	\$954,927	\$570,565
Issuance of 0 and 5,239,895 shares of common stock for cashless exercise of warrants	\$—	\$1,268,936
Issuance of 0 and 1,386,126 shares of common stock for exercise of options	\$—	\$197,663
Issuance of 0 and 30,618,895 shares of common stock for accrued liabilities	\$—	\$6,227,755
Issuance of 296,405,268 and 7,413,000 shares of common stock for accrued settlement	\$35,341,298	\$3,500,000

The accompanying notes are an integral part of these consolidated financial statements.

ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012 and 2011

(Unaudited)

1.ORGANIZATIONAL MATTERS

The unaudited consolidated financial statements have been prepared by Advanced Cell Technology, Inc., pursuant to the rules and regulations of the Securities and Exchange Commission. The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments) which are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and footnote disclosures normally present in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in the Company's Annual Report on Form 10-K. The results for the six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year ending December 31, 2012.

**Organization and Nature of Business**

Advanced Cell Technology, Inc. (the "Company") is a biotechnology company, incorporated in the state of Delaware, focused on developing and commercializing human embryonic and adult stem cell technology in the emerging fields of regenerative medicine. Principal activities to date have included obtaining financing, securing operating facilities, and conducting research and development. The Company has no therapeutic products currently available for sale and does not expect to have any therapeutic products commercially available for sale for a period of years, if at all. These factors indicate that the Company's ability to continue its research and development activities is dependent upon the ability of management to obtain additional financing as required.

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation** —The Company follows accounting standards set by the Financial Accounting Standards Board ("FASB"). The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). References to GAAP issued by the FASB in these footnotes are to the FASB Accounting Standards Codification,<sup>TM</sup> sometimes referred to as the Codification or ASC.

**Principles of Consolidation** — The accounts of the Company and its wholly-owned subsidiary Mytogen, Inc. (“Mytogen”) are included in the accompanying consolidated financial statements. All intercompany balances and transactions were eliminated in consolidation.

**Segment Reporting** — ASC 280, “*Segment Reporting*” requires use of the “management approach” model for segment reporting. The management approach model is based on the way a company’s management organizes segments within the company for making operating decisions and assessing performance. The Company determined it has one operating segment. Disaggregation of the Company’s operating results is impracticable, because the Company’s research and development activities and its assets overlap, and management reviews its business as a single operating segment. Thus, discrete financial information is not available by more than one operating segment.

**Use of Estimates** — These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and, accordingly, require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Specifically, the Company’s management has estimated loss contingencies related to outstanding litigation. In addition, Management has estimated variables used to calculate the Black-Scholes option pricing model used to value derivative instruments as discussed below under “Fair Value Measurements”. Also, management has estimated the expected economic life and value of the Company’s licensed technology, the Company’s net operating loss for tax purposes, share-based payments for compensation to employees, directors, consultants and investment banks, and the useful lives of the Company’s fixed assets and its accounts receivable allowance. Actual results could differ from those estimates.

**Reclassifications** — Certain prior period financial statement balances have been reclassified to conform to the current period presentation.

ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012 and 2011

(Unaudited)

**Cash and Cash Equivalents** — Cash equivalents are comprised of certain highly liquid investments with maturities of three months or less when purchased. The Company maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Company has not experienced any losses related to this concentration of risk. As of June 30, 2012 and December 31, 2011, the Company had deposits in excess of federally-insured limits totaling \$9,362,536 and \$12,037,949, respectively.

**Accounts Receivable** — The Company periodically assesses its accounts receivable for collectability on a specific identification basis. If collectability of an account becomes unlikely, the Company records an allowance for that doubtful account. Once the Company has exhausted efforts to collect, management writes off the account receivable against the allowance it has already created. The Company does not require collateral for its trade accounts receivable.

**Property and Equipment** — The Company records its property and equipment at historical cost. The Company expenses maintenance and repairs as incurred. Upon disposition of property and equipment, the gross cost and accumulated depreciation are written off and the difference between the proceeds and the net book value is recorded as a gain or loss on sale of assets. In the case of certain assets acquired under capital leases, the assets are recorded net of imputed interest, based upon the net present value of future payments. Assets under capital lease are pledged as collateral for the related lease.

The Company provides for depreciation over the assets' estimated useful lives as follows:

Machinery & equipment	4 years
Computer equipment	3 years
Office furniture	4 years
Leasehold improvements	Lesser of lease life or economic life
Capital leases	Lesser of lease life or economic life

**Equity Method Investment** — The Company follows ASC 323 “*Investments-Equity Method and Joint Ventures*” in accounting for its investment in the joint venture. In the event the Company's share of the joint venture's net losses reduces the Company's investment to zero, the Company will discontinue applying the equity method and will not provide for additional losses unless the Company has guaranteed obligations of the joint venture or is otherwise committed to provide further financial support for the joint venture. If the joint venture subsequently reports net

income, the Company will resume applying the equity method only after its share of that net income equals the share of net losses not recognized during the period the equity method was suspended.

***Deferred Costs*** — Consist of the following:

- (a) Payments, either in cash or share-based, made in connection with the sale of debentures which are amortized using the effective interest method over the lives of the related debentures. These deferred issuance costs are charged to financing costs when and if the related debt instrument is retired or converted early. The weighted average amortization period for deferred debt issuance costs is 48 months.
- (b) Payments made to secure commitments under certain financing arrangements. These amounts are recognized in financing costs ratably over the period of the financing arrangements, and are recognized in financing costs immediately if the arrangement is cancelled, forfeited or the utility of the arrangement to the company is otherwise compromised.
- (c) Payments made to financial institutions and consulting firms in order to provide financing related services. These costs are being amortized over the terms of the related agreements.

***Long-Lived Assets***— The Company follows ASC 360-10, “*Property, Plant, and Equipment*,” which established a “primary asset” approach to determine the cash flow estimation period for a group of assets and liabilities that represents the unit of accounting for a long-lived asset to be held and used. Long-lived assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell. Through June 30, 2012, the Company had not experienced impairment losses on its long-lived assets.



ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012 and 2011

(Unaudited)

***Fair Value of Financial Instruments*** — For certain financial instruments, including cash and cash equivalents, prepaid expenses, accounts payable and accrued expenses, the carrying amounts approximate fair value due to their relatively short maturities.

***Fair Value Measurements*** — The Company applies the provisions of ASC 820-10, “*Fair Value Measurements and Disclosures*.” ASC 820-10 defines fair value, and establishes a three-level valuation hierarchy for disclosures of fair value measurement that enhances disclosure requirements for fair value measures. The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents and current liabilities each qualify as financial instruments and are a reasonable estimate of their fair values because of the short period of time between the origination of such instruments and their expected realization and their current market rate of interest. The three levels of valuation hierarchy are defined as follows:

~~—~~Level 1 inputs to the valuation methodology are quoted prices for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, ~~and~~ inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

—Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The Company analyzes all financial instruments with features of both liabilities and equity under ASC 480, “*Distinguishing Liabilities From Equity*” and ASC 815, “*Derivatives and Hedging*.” Derivative liabilities are adjusted to reflect fair value at each period end, with any increase or decrease in the fair value being recorded in results of operations as adjustments to fair value of derivatives. The effects of interactions between embedded derivatives are calculated and accounted for in arriving at the overall fair value of the financial instruments. In addition, the fair values of freestanding derivative instruments such as warrant and option derivatives are valued using the Black-Scholes model.

The Company uses Level 2 inputs for its valuation methodology for the warrant derivative liabilities and embedded conversion option liabilities as their fair values were determined by using the Black-Scholes option pricing model based on various assumptions. The Company’s derivative liabilities are adjusted to reflect fair value at each period end,

with any increase or decrease in the fair value being recorded in results of operations as adjustments to fair value of derivatives.

At June 30, 2012, the Company identified the following assets and liabilities that are required to be presented on the balance sheet at fair value:

	Fair Value As of	Fair Value Measurements at June 30, 2012 Using Fair Value Hierarchy		
		June 30, 2012	Level 1      Level 2	Level 3
Derivative Liabilities				
Warrant derivative liabilities	\$1,178,897	\$—	1,178,897	—
Embedded conversion option liabilities	191,770	—	191,770	—
	\$1,370,667	\$—	1,370,667	—

For the three and six months ended June 30, 2012, the Company recognized a gain of \$734,081 and a loss of \$592,482, respectively, for the changes in the valuation of derivative liabilities. For the three and six months ended June 30, 2011, the Company recognized a loss of \$701,198 and a gain of \$4,088,221, respectively, for the changes in the valuation of derivative liabilities.

The Company did not identify any non-recurring assets and liabilities that were recorded at fair value during the periods presented.

ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012 and 2011

(Unaudited)

***Revenue Recognition and Deferred Revenue*** — The Company's revenues are primarily generated from license and research agreements with collaborators. Licensing revenue is recognized on a straight-line basis over the shorter of the life of the license or the estimated economic life of the patents related to the license.

License fee revenue begins to be recognized in the first full month following the effective date of the license agreement. Deferred revenue represents the portion of the license and other payments received that has not been earned. Costs associated with the license revenue are deferred and recognized over the same term as the revenue. Reimbursements of research expense pursuant to grants are recorded in the period during which collection of the reimbursement becomes assured, because the reimbursements are subject to approval.

In some cases, the Company is entitled to receive royalty payments from licensees. In such cases, the Company recognizes the royalties when they are earned and collectability of those royalty payments is reasonably assured.

In connection with its license agreements, the Company recorded \$218,184 and \$273,869 in license fee revenue for the three and six months ended June 30, 2012, respectively. In connection with its license agreements, the Company recorded \$153,688 and \$307,376 in license fee revenue for the three and six months ended June 30, 2011, respectively, in its consolidated statements of operations, and the remainder of the license fees have been accrued in deferred revenue at June 30, 2012 and 2011, respectively.

***Research and Development Costs*** — Research and development costs consist of expenditures for the research and development of patents and technology, which cannot be capitalized. The Company's research and development costs consist mainly of payroll and payroll related expenses, research supplies and research grants. Reimbursements of research expense pursuant to grants are recorded in the period during which collection of the reimbursement becomes assured, because the reimbursements are subject to approval. Research and development costs are expensed as incurred.

***Share-Based Compensation*** — The Company records stock-based compensation in accordance with ASC 718, "Compensation – Stock Compensation." ASC 718 requires companies to measure compensation cost for stock-based employee compensation at fair value at the grant date and recognize the expense over the employee's requisite service period. The Company recognizes in the statement of operations the grant-date fair value of stock options and other

equity-based compensation issued to employees and non-employees. There were 100,672,803 options outstanding as of June 30, 2012.

**Income Taxes** — Deferred income taxes are provided using the liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of the changes in tax laws and rates of the date of enactment.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Applicable interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statements of operations.

ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012 and 2011

(Unaudited)

**Net Loss Per Share** — Earnings per share is calculated in accordance with the ASC 260-10, “*Earnings Per Share*.” Basic earnings-per-share is based upon the weighted average number of common shares outstanding. Diluted earnings-per-share is based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period.

At June 30, 2012 and 2011, approximately 98,333,965 and 132,371,922 potentially dilutive shares, respectively, were excluded from the shares used to calculate diluted earnings per share as their inclusion would be anti-dilutive.

**Concentrations and Other Risks** — Currently, the Company’s revenues are concentrated on a small number of customers. The following table shows the Company’s concentrations of its revenue for those customers comprising greater than 10% of total license revenue for the six months ended June 30, 2012 and 2011.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Exeter Life Sciences, Inc.	*	20%	*	20%
START Licensing, Inc.	*	16%	*	16%
International Stem Cell Corporation	74%	24%	59%	24%
CHA Biotech and SCRMI	15%	21%	24%	21%
Lifeline	*	11%	12%	11%

\*License revenue earned during the period was less than 10% of total license revenue.

Other risks include the uncertainty of the regulatory environment and the effect of future regulations on the Company’s business activities. As the Company is a biotechnology research and development company, there is also the attendant risk that someone could commence legal proceedings over the Company’s discoveries. Acts of God could also adversely affect the Company’s business.

***Recent Accounting Pronouncements***

In May 2011, the FASB issued ASU 2011-04 which was issued to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and IFRS. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. This guidance is effective for the Company beginning on January 1, 2012. The adoption of this ASU did not have an impact on the Company's consolidated financial statements.

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, *Presentation of Comprehensive Income*. ASU 2011-05 revises the manner in which entities present comprehensive income in their financial statements. The new guidance removes the presentation options in Accounting Standards Codification (ASC) 220, *Comprehensive Income*, and requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The ASU does not change the items that must be reported in other comprehensive income. In December 2011, the FASB issued ASU 2011-12 which defers the requirement in ASU 2011-05 that companies present reclassification adjustments for each component of accumulated other comprehensive income in both net income and other comprehensive income on the face of the financial statements. ASU 2011-05 is effective for fiscal years and interim reporting periods within those years beginning after December 15, 2011, with early adoption permitted. The adoption of ASU 2011-05, as amended by ASU 2011-12, did not significantly impact the Company's consolidated financial statements as the Company does not have any comprehensive income at June 30, 2012.

ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY

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In September 2011, the FASB issued ASU 2011-08 which provides an entity the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test for goodwill impairment. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The revised standard is effective for the Company for its annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of ASU 2011-08 did not significantly impact the Company's consolidated financial statements.

### 3.SETTLEMENT AND CANCELANATION OF LICENSE AGREEMENT

On December 18, 2008, the Company entered into a license agreement with Transition Holdings, Inc. for certain of the Company's non-core technology. Under the agreement, the Company received \$2,000,000, less wire fees. The Company further received \$1,500,000 in 2009. The Company had initially recorded the transactions as deferred revenue and was amortizing the revenue over its 17-year patent useful life. In December 2010, the Company received notice that Transition Holdings, Inc. was disputing the nature of the arrangement, and subsequently entered into a settlement arrangement with Transition Holdings, Inc. As a result of this settlement, the Company reclassified the unamortized license fee in the amount of \$3,205,856 from deferred revenue to accrued settlement. On February 15, 2011, the Company issued 7,413,000 shares as payment in full and recorded a loss on settlement of \$294,144.

### 4.INVESTMENT IN JOINT VENTURE

On December 1, 2008, the Company and CHA Bio & Diostech Co., Ltd. formed an international joint venture. The new company, Stem Cell & Regenerative Medicine International, Inc. ("SCRMI"), will develop human blood cells and other clinical therapies based on the Company's hemangioblast program, one of the Company's core technologies. Under the terms of the agreement, the Company purchased upfront a 33% interest in the joint venture, and will receive another 7% interest upon fulfilling certain obligations under the agreement over a period of 3 years. The Company's contribution includes (a) the uninterrupted use of a portion of its leased facility at the Company's expense, (b) the uninterrupted use of certain equipment in the leased facility, and (c) the release of certain of the Company's research and science personnel to be employed by the joint venture. In return, for a 60% interest, CHA has agreed to contribute \$150,000 cash and to fund all operational costs in order to conduct the hemangioblast program. Effective May 1, 2010, the Company was no longer obligated to provide laboratory space to SCRMI, and the Company holds a 40% interest in the joint venture and CHA Bio & Diostech, Ltd. owns a 60% interest. The two partners to the joint venture are in negotiations on further funding of the joint venture, but there can be no assurances that an agreement will be reached. Any financial statement impact at this time is unclear should an agreement not be reached.

The Company has agreed to collaborate with the joint venture in securing grants to further research and development of its technology. Additionally, SCRMI has agreed to pay the Company a fee of \$500,000 for an exclusive, worldwide license to the Hemangioblast Program. The Company recorded \$7,353 and \$14,706 in license fee revenue for the three and six months ended June 30, 2012, respectively, and \$7,353 and \$14,706 in license fee revenue for the three and six months ended June 30, 2011, respectively, in its consolidated statements of operations, and the balance of unamortized license fee of \$395,833 and \$410,539 is included in deferred revenue in the consolidated balance sheets at June 30, 2012 and December 31, 2011, respectively.

On July 15, 2011, the Company and CHA Biotech entered into a binding term sheet, with the expectation of entering into a future definitive agreement, in which the joint venture was realigned around both product development rights and research responsibilities. Under the terms of the binding term sheet, SCRMI exclusively licensed the rights to the Hemangioblast Program to the Company for United States and Canada and expanded the jurisdictional scope of the license to CHA Biotech to include Japan (in addition to South Korea, which was already exclusively licensed to CHA Biotech). As part of the agreement, the scientists at SCRMI involved in the Hemangioblast Program were transferred to the Company, and SCRMI discontinued its research activity and became solely a licensing entity. The Company is obligated to meet a minimal research spending requirement of \$6.75 million by July 31, 2014 in order to maintain its exclusive license, up to the point of filing an investigational new drug for a therapeutic product. Intellectual property rights created by the Company in the course of our research are subject to a non-exclusive license to CHA Biotech for Japan and South Korea, and to SCRMI to be sub-licensable under certain circumstances for countries other than the United States, Canada, Japan and South Korea. Pursuant to the agreement, the Company paid \$820,000 to SCRMI in July 2011. As of June 30, 2012, no further payments have been made. The joint venture's accumulated losses exceed the Company's investment at June 30, 2012.



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The following table is a summary of key financial data for the joint venture as of and for the six months ended June 30, 2012 and 2011:

	June 30, 2012	2011
Current assets	\$183,644	\$578,142
Noncurrent assets	\$1,046,328	\$119,468
Current liabilities	\$292,117	\$1,447,504
Noncurrent liabilities	\$2,313,727	\$2,265,463
Net revenue	\$149,903	\$38,336
Net income (loss)	\$101,255	\$(839,237 )

5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30, 2012 and December 31, 2011:

	June 30, 2012	December 31, 2011
Machinery & equipment	\$1,497,703	\$1,488,527
Computer equipment	458,470	449,893
Office furniture	82,822	82,822
Leasehold improvements	318,108	311,592
Capital leases	51,235	51,235
	2,408,338	2,384,069
Accumulated depreciation	(2,254,738)	(2,229,298)
Property and equipment, net	\$153,600	\$154,771

Depreciation expense for the three and six months ended June 30, 2012 amounted to \$13,349 and \$25,440, respectively. Depreciation expense for the three and six months ended June 30, 2011 amounted to \$17,109 and \$38,394, respectively.

## 6. ACCRUED SETTLEMENT

### Midsummer Investment, Ltd

On August 9, 2011, the Company entered into a Settlement Agreement and Mutual Release ("Settlement Agreement") with Midsummer Investment, Ltd and Midsummer Small Cap Master, Ltd. (collectively, "Midsummer"). Pursuant to the Settlement Agreement, upon tender by Midsummer to the Company of warrants held by Midsummer to purchase a total of 20,319,730 shares of the Company's common stock (the "Warrants"), and duly executed notices of exercise (deemed to occur upon execution of the Settlement Agreement), the Company, to settle errors involving warrant issuances to Midsummer, agreed to (i) deliver to Midsummer an aggregate of 36,000,000 shares of the Company's common stock (the "Current Shares"), as an exercise of the Warrants in respect of a partial exercise of Warrants, (ii) undertake to issue 30,585,774 additional shares of the Company's common stock (the "Future Shares"), as an exercise of the remainder of the Warrants within ten days of the date that the Company shall have sufficient authorized and unissued shares of Common Stock ("Authorized Share Increase") which are not otherwise reserved for issuance for other purposes to enable the Company to issue all of the Future Shares and (iii) issue 3,058,577 shares of the Company's common stock (the "Additional Future Shares") for every calendar month elapsed between the date of delivery of the Current Shares and the date following delivery of the Future Shares. The Company and Midsummer provided mutual general releases.

The shares were valued at \$0.17 which is the share price on the date of the agreement. Per the Settlement Agreement, the Company issued 36,000,000 shares on August 12, 2011 and issued the Future Shares of 30,585,774 and the Additional Future Shares of 15,292,885 on January 31, 2012.

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Alpha Capital

On October 14, 2011, the United States District Court for the Southern District of New York entered an order granting plaintiff Alpha Capital Anstalt's ("Alpha Capital") motion for a preliminary injunction and preliminary declaratory relief in the lawsuit entitled *Alpha Capital Anstalt v. Advanced Cell Technology, Inc.*, Case No. 11 CIV 6458 (S.D.N.Y. filed Sept. 16, 2011). The lawsuit is described in the current report on Form 8-K filed by the Company with the Securities and Exchange Commission on September 22, 2011. In its motion, Alpha Capital sought an order directing the Company to deliver to it at least 39,514,859 shares of its common stock in accordance with the terms of its warrants and convertible promissory notes. The court's October 14, 2011 order directed the Company to hold in escrow 39,514,859 shares of its common stock pending the entry of a preliminary injunction, and directed Alpha Capital to submit a proposed form of order to the court by October 27, 2011.

On November 1, 2011, the Company issued the 39,514,859 shares to Alpha Capital. On November 23, 2011, the Company answered Alpha Capital's Complaint and asserted affirmative defenses. On December 12, 2011, the Company and Alpha submitted a Civil Case Management Plan and Scheduling Order and discovery has since commenced. Despite receiving the 39,514,859 shares on November 1, 2011 as a result of its preliminary injunction, Alpha Capital continues to seek damages against the Company. The Company has evaluated Alpha Capital's complaint in the frame work of ASC 450 and believes that the consolidated financial statements as of June 30, 2012 properly reflect management's consideration of ASC 450. The Company's Management intends to contest this case vigorously.

Black Mountain Equities

On November 9, 2011, the United States District Court for the Southern District of New York entered an order granting plaintiff Black Mountain Equities, Inc. ("Black Mountain") motion for a preliminary injunction and preliminary declaratory relief in the lawsuit entitled *Black Mountain Equities, Inc. v. Advanced Cell Technology, Inc.*, Case No. 11 CIV 7305, filed on October 17, 2011. In its motion, Black Mountain sought an order directing the Company to deliver to it at least 18,000,000 shares of its common stock in accordance with the terms of its warrants and convertible promissory notes. The court's November 9, 2011 order directed the Company to hold in escrow 18,000,000 shares of its common stock pending the entry of a preliminary injunction.

On November 15, 2011, the Company issued and held in escrow the 18,000,000 shares. On December 15, 2011, the Company answered BME's initial Complaint and asserted counterclaims, disputing BME's contention that it was owed 18,000,000 shares. On December 29, 2011, BME filed an Amended Complaint. On January 17, 2012, the Company answered the Amended Complaint and asserted revised counterclaims. On April 9, 2012, the Company settled by agreeing to release 18,000,000 shares of common stock held in escrow and issuing an additional 800,000 shares of common stock, which were issued on May 8, 2012.

#### Cranshire Master Fund

On December 15, 2011, the United States District Court for the Southern District of New York entered an order granting plaintiff Cranshire Capital Master Fund, Ltd.'s ("Cranshire") motion for a preliminary injunction in the lawsuit entitled *Cranshire Capital Master Fund, Ltd. v. Advanced Cell Technology, Inc.*, Case No. 11 CIV 8755 (S.D.N.Y. filed December 1, 2011). Cranshire asserts that as a result of the transactions between the Company and MJJ, the exercise price of its warrants should have been decreased to \$.0353 and the total number of warrant shares issuable upon exercise should have been increased from 6,918,197 to 19,598,292. Based upon these figures, Cranshire asserted that its December 2010 warrant exercise should have resulted in an additional 12,680,094 shares. Cranshire asserts claims for damages, in an amount to be determined at trial, for the Company's alleged failure to deliver the shares and to provide proper notice of reduction in exercise price and conversion price. On December 2, 2011, Cranshire moved for preliminary declaratory relief and for a preliminary injunction directing the Company to deliver immediately at least 12,680,094 shares of its common stock to Cranshire. At the hearing on December 15, 2011, Cranshire changed its argument, contending that the exercise price should have been decreased to \$.027 (as opposed to \$.0353) and that, consequently, it was entitled to 18,000,000 shares (as opposed to 12,660,094 shares). On December 15, 2011, the court granted a preliminary injunction and directed the Company to deliver to Cranshire 10,730,265 shares of the Company's common stock.

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The Company issued the 10,730,265 shares to Cranshire on December 16, 2011. On February 24, 2012, the Company entered into an agreement with Cranshire to settle all outstanding claims against the Company. Pursuant to the agreement, the Company issued to Cranshire (1) an additional 1,949,735 of common stock, (2) plus the quotient of (x) \$276,000 divided by (y) 90% of the closing price of common stock on the trading day immediately preceding the entry of the court order. The number of shares of common stock issued based on a \$0.11 share price at February 24, 2011 was 4,737,614.

Global Settlement

On December 7, 2011, the Company entered into settlement agreements with 40 holders of convertible promissory notes and warrants that were issued between 2005 and 2010. The settlement agreements relate to claims that the holders may have against the Company regarding the assertion that the conversion price of the notes and the exercise price of the warrants should have been adjusted as a result of certain transactions between the Company and JMJ Financial, Inc. during 2010. Pursuant to the settlement agreements, the Company agreed to issue an aggregate of 239,601,630 shares of common stock to the settling holders.

At the time of settlement, the Company did not have a sufficient number of authorized but unissued shares of common stock to issue all of the shares of common stock that the Company agreed to issue to settling holders pursuant to the settlement agreements. On January 24, 2012, the Company's shareholders approved the increase in authorized shares to 2,750,000,000. The Company issued 238,237,459 shares on January 31, 2012 and 1,364,171 shares on February 7, 2012.

7. LOSS CONTINGENCY ACCRUAL

The Company was not able to reach a settlement agreement with all of holders of convertible promissory notes and warrants that were issued between 2005 and 2010. The Company will continue to negotiate with the holders and anticipates that the number of shares to be issued will be similar to the settlements that have already been finalized as of June 30, 2012. The loss contingency accrual was \$15,347,341 and \$16,704,169 at June 30, 2012 and December 31, 2011, respectively.

## 8. CONVERTIBLE PROMISSORY NOTES

### *2010 JMJ Convertible Promissory Notes*

During 2010, the Company issued three convertible promissory notes to JMJ Financial, for a total of \$3,000,000 available to receive in cash, for a principal sum of \$3,850,000, which included an original issue discount of \$850,000. The notes bear a one-time interest charge of 10% on the principal sum. The holder may at its election convert all or part of these notes into shares of the Company's common stock at the conversion rate of the lesser of: (a) \$0.10 per share, or (b) 85% of the average of the three lowest trade prices in the 20 trading days prior to the conversion. During 2010, the Company received the entire \$3,000,000 on these notes. Of the \$3,850,000 borrowed, the Company converted \$3,562,215 into 76,465,706 shares of common stock during 2010. The notes mature on March 30, 2013.

As of June 30, 2012 and December 31, 2011, the convertible promissory notes were convertible at the option of the holders into a total of 5,642,843 and 4,303,863 shares, respectively, subject to anti-dilution and other customary adjustments. The fair value of the embedded conversion option was \$186,484 and \$227,547 as of June 30, 2012 and December 31, 2011, respectively. The decrease in the fair value of this liability was \$19,615 and \$41,063 during the three and six months ended June 30, 2012, respectively, and \$178,538 and \$19,552 during the three and six months ended June 30, 2011, respectively, which was recorded through the statements of operations as an adjustment to fair value of derivatives. The assumptions used in the Black-Scholes option pricing model at June 30, 2012 are as follows: (1) dividend yield of 0%; (2) expected volatility of 160%, (3) risk-free interest rate of 0.21%, and (4) expected life of 0.75 years.

Interest expense from amortization of debt discounts related to the JMJ Convertible Promissory Notes for the three and six months ended June 30, 2012 was \$31,628 and \$63,255, respectively. Interest expense from amortization of debt discounts related to the JMJ Convertible Promissory Notes for the three and six months ended June 30, 2011 was \$31,629 and \$62,910, respectively.

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9. SERIES A-1 REDEEMABLE CONVERTIBLE PREFERRED STOCK

On March 3, 2009, the Company entered into a \$5 million credit facility ("Facility") with a life sciences fund. Under the terms of the agreement, the Company may draw down funds, as needed, from the investor through the issuance of Series A-1 redeemable convertible preferred stock, par value \$.001, at a basis of 1 share of Series A-1 redeemable convertible preferred stock for every \$10,000 invested. The preferred stock pays dividends, in kind of preferred stock, at an annual rate of 10%, matures in four years from the initial drawdown date, and is convertible into common stock at \$0.75 per share at the option of the holder.

However, in the event the closing price of the common stock during the 5 trading days following the notice to convert falls below 75% of the average of the closing bid price in the 5 trading days prior to the closing date, the investor may, at its option, and without penalty, decline to purchase the applicable put shares on the closing date.

The Company is required to keep available out of its authorized but unissued shares of common stock, such number of shares sufficient to effect a conversion of all then outstanding shares of the Series A-1 redeemable convertible preferred stock.

The Series A-1 redeemable preferred stock has been classified within the mezzanine section between liabilities and equity in the consolidated balance sheets because it is considered conditionally redeemable. The embedded conversion option has been recorded as a derivative liability in the Company's consolidated balance sheets, and changes in the fair value each reporting period are reported in adjustments to fair value of derivatives in the consolidated statements of operations.

The outstanding balance at June 30, 2012 and December 31, 2011 was \$1,130,165, and is convertible into 1,506,887 shares of the Company's common stock. The Company values the conversion option initially when each draw takes place (see section entitled "Conversion Option" in this footnote below). As of June 30, 2012, the Company has drawn \$3,418,166 of the \$5,000,000 commitment.

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The following table summarizes the Series A-1 redeemable convertible preferred stock outstanding at June 30, 2012 and December 31, 2011:

	June 30, 2012	December 31, 2011
Principal due	\$1,130,166	\$1,130,166
Accrued dividend	407,680	342,097
Debt discount	(26,144 )	(43,137 )
	1,511,702	1,429,126
Non-current portion	\$1,511,702	\$1,429,126

Aggregate liquidation value\* \$1,537,846 \$1,472,263

\* Represents the sum of principal due and accrued dividends.

The dividends are accrued at a rate of 10% per annum, and the Company records the accrual as interest expense in its consolidated statements of operations in the period incurred. The Company recorded accrued dividends on the Series A-1 redeemable convertible preferred stock of \$34,275 and \$65,583 for the three and six months ended June 30, 2012, respectively, and \$31,152 and \$59,302 for the three and six months ended June 30, 2011, respectively, which is recorded as interest expense in the consolidated statements of operations.

#### *Redemption Rights*

Upon the earlier of (i) the fourth anniversary of the issuance date, and (ii) the occurrence of a major transaction, each holder shall have the right, to require the Company to redeem all or a portion of such holder's share of Series A-1 preferred stock, at a price per share equal to the Series A-1 liquidation value. The Company has the option to pay the redemption price in cash or in shares of its common stock. The Company shall have the right to redeem all or a portion of the shares of Series A-1 redeemable preferred stock, at any time at a price per share of Series A-1 redeemable preferred stock equal to 100% of the Series A-1 liquidation value.



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*Termination and Liquidation Rights*

The Company may terminate this agreement and its right to initiate future draw-downs by providing 30 days advanced written notice to the investor, subject to certain limitations.

Upon any liquidation, dissolution or winding up of the Company, the holders of the Series A-1 redeemable convertible preferred stock shall first be entitled to be paid out of the assets of the Company available for distribution (subject to certain limitations) to its stockholders an amount with respect to each share of Series A-1 redeemable convertible preferred stock equal to \$10,000, plus any accrued by unpaid dividends.

*Conversion Option:*

The embedded conversion option was valued at \$5,286 and \$25,983 at June 30, 2012 and December 31, 2011, respectively, at fair value using the Black-Scholes model. The decrease in the fair value of the embedded conversion option liability of \$17,050 and \$20,697 for the three and six months ended June 30, 2012, respectively, and \$10,461 and \$64,599 for the three and six months ended June 30, 2011, respectively, was recorded through the statements of operations as an adjustment to fair value of derivatives.

The assumptions used in the Black-Scholes model to value the embedded conversion option at June 30, 2012 were as follows: (1) dividend yield of 0%; (2) expected volatility of 160%, (3) risk-free interest rate of 0.21%, and (4) expected life of 0.77 years.

*Commitment fee and expenses*

For providing investor relations services in connection with the Series A-1 redeemable convertible preferred stock credit facility, the Company issued a consultant 24,900,000 shares of its common stock on February 9, 2009. The Company valued the issuance of these shares at \$4,731,000 based on a closing price of \$0.19 on February 9, 2009 and recorded the value of the shares as deferred financing costs on the date they were issued. Beginning on the date of the first draw-down on April 6, 2009 (the loan maturity date is 4 years after the initial draw-down), the Company amortizes these fees over the term of the Series A-1 redeemable convertible preferred stock facility which represents the implied term of the investor relations contract.

The Company also incurred a non-refundable commitment fee to the holder of this convertible preferred stock facility in the amount of \$250,000. The initial fee went into delinquency and was modified on October 19, 2009. (See modification section in the footnote below.)

Beginning on the date of the first draw-down on April 6, 2009 (the loan maturity date is 4 years after the initial draw-down), the Company amortizes the deferred issuance costs ratably over the term of the Series A-1 redeemable convertible preferred stock facility.

Interest expense from amortization of the debt discount and deferred costs for the three and six months ended June 30, 2012 was \$111,074 and \$222,149, respectively and for the three and six months ended June 30, 2011 was \$111,075 and \$220,930, respectively.

*Modification of Series A-1 Convertible Redeemable Preferred Stock:*

On October 19, 2009, the Company entered into two letter agreements with Volation, pursuant to which (i) the Company reduced the conversion price of its existing outstanding Series A-1 convertible preferred stock issued to Volation to \$.10 per share resulting in 22,880,000 shares of Common Stock upon conversion, (ii) the Company issued Volation 2,500,000 shares of its Common Stock at \$0.10 per share in payment of an outstanding commitment fee, and (iii) Volation waived the delinquency in non-payment of the \$250,000 commitment fee required pursuant to the preferred stock purchase agreement between the Company and Volation. The commitment fee was paid during the year ended December 31, 2010 by reducing the proceeds paid by the Series A-1 Preferred Stock investors by the amount of the commitment fee.

## 10. SERIES B PREFERRED STOCK

On November 2, 2009 ("Effective Date"), the Company entered into a preferred stock purchase agreement with Optimus Life Sciences Capital Partners, LLC ("Investor" or "Optimus"). Pursuant to the purchase agreement, the Company agreed to sell, and the Investor agreed to purchase, in one or more purchases from time to time at the Company's sole discretion, (i) up to 1,000 shares of Series B preferred stock at a purchase price of \$10,000 per share, for an aggregate purchase price of up to \$10,000,000, and (ii) five-year warrants to purchase shares of the Company's common stock with an aggregate exercise price equal to 135% of the purchase price paid by the Investor, at an exercise price per share as follows:

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On the sixth (6th) Trading Day following the Tranche Notice Date, the Exercise Price of the Optimus Warrant shall be adjusted to equal the VWAP for the 5 trading days beginning on and including the Tranche Notice Date (as so adjusted, the “Adjusted Exercise Price”); and

If the Adjusted Exercise Price results in additional Warrant Shares being issuable to the Holder, such additional shares shall be delivered to the Holder within one Trading Day following the Adjustment Date. If the Adjusted Exercise Price results in less Warrant Shares being issuable to the Holder, the excess Warrant Shares shall be returned by the Holder to the Company within one Trading Day following on the Adjustment Date.

The Company agreed to pay to the Investor a commitment fee of \$500,000, at the earlier of the closing of the first Tranche or the six month anniversary of the effective date, payable at the Company’s election in cash or common stock valued at 90% of the volume weighted average price of the Company’s common stock on the five trading days preceding the payment date. The \$500,000 commitment fee was outstanding and was recorded in accrued expenses in the Company’s consolidated balance sheet at December 31, 2009. During 2010, the Company issued 50 shares of preferred stock as payment for the commitment fee.

During 2010, the Company delivered tranche notices to Optimus Life Sciences Capital Partners, LLC for delivery of a total of 1,000 shares under the Series B preferred stock for funding in the amount of \$10,000,000 (\$9,485,000 in cash proceeds, \$500,000 of commitment fee applied, and \$15,000 in legal fees).

During 2010, in connection with the funding, the Company issued 95,870,362 shares of its common stock upon exercise of the same number of warrants, which were granted simultaneously with the Company’s tranche notices. During 2010, the Company received secured promissory notes in the amount of \$13,500,000 to settle the warrant exercise.

*Dividends*

Commencing on the date of the issuance of any shares of Series B preferred stock, Holders of Series B preferred stock will be entitled to receive dividends on each outstanding share of Series B preferred stock, which will accrue in shares of Series B preferred stock at a rate equal to 10% per annum from the issuance date compounded annually. Accrued dividends will be payable upon redemption of the Series B preferred stock. Accrued dividends were \$1,778,954 and \$1,229,538 at June 30, 2012 and December 31 2011, respectively.

*Redemption Rights*

Upon or after the fourth anniversary of the initial issuance date, the Company will have the right, at the Company's option, to redeem all or a portion of the shares of the Series B preferred stock, at a price per share equal to 100% of the Series B liquidation value. The preferred stock may be redeemed at the Company's option, commencing 4 years from the issuance date at a price per share of (a) \$10,000 per share plus accrued but unpaid dividends (the "Series B Liquidation Value"), or, at a price per share of : (x) 127% of the Series B Liquidation Value if redeemed on or after the first anniversary but prior to the second anniversary of the initial issuance date, (y) 118% of the Series B Liquidation Value if redeemed on or after the second anniversary but prior to the third anniversary of the initial issuance date, and (z) 109% of the Series B Liquidation Value if redeemed on or after the third anniversary but prior to the fourth anniversary of the initial issuance date.

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*Liquidation Rights*

The preferred shares shall, with respect to dividend, rights upon liquidation, winding-up or dissolution, rank: (i) senior to the Company's common stock, and any other class or series of preferred stock of the Company, except Series A-1 Convertible Preferred Stock which shall rank senior in right of liquidation and *pari passu* with respect to dividends; and (ii) junior to all existing and future indebtedness of the Company.

If the Company determines to liquidate, dissolve or wind-up its business, it must redeem the Series B preferred stock at the prices set forth above. Upon any liquidation, dissolution or winding up of the Company the Holders of Series B preferred stock shall be first entitled to be paid out of the assets of the Company available for distribution to its stockholders an amount with respect to each share of Series B preferred stock equal to \$10,000, plus any accrued and unpaid dividends.

The Company has classified the Series B redeemable preferred stock in the equity section in its consolidated balance sheets.

*Related Secured Promissory Notes Receivable:*

In accordance with the terms of the Series B preferred stock agreement, Optimus issued to the Company a secured promissory note in consideration for receiving warrants under each tranche. The value of each secured promissory note equals the value of the warrants that Optimus received. Interest on the notes accrues at 2% per year, compounding annually if the interest remains unpaid at the end of each year. The note is secured by freely tradable marketable securities belonging to Optimus. Each promissory note matures on the fourth anniversary of its issuance.

In the event the Company redeems all or a portion of any shares of Series B preferred stock held by Optimus, the Company will be permitted to offset the full amount of such proceeds against amounts outstanding under the promissory notes. Accordingly, the Company included the discounted value of the secured promissory notes as a separate component of stockholders' deficit at June 30, 2012 and 2011.

The value of the secured promissory notes in the consolidated balance sheet was \$11,756,294, net of discounts of \$2,098,812 and accrued interest of \$355,106 at June 30, 2012, reflecting a face value of \$13,500,000. The value of the secured promissory notes in the consolidated balance sheet was \$11,207,935, net of discounts of \$2,537,499 and accrued interest of \$245,434 at December 31, 2011, reflecting a face value of \$13,500,000. The Company determined that a 10% discount is appropriate, in order to consistently reflect the Company's cost of borrowing under the terms of the underlying Series B preferred stock that permits offset. The Company recorded an initial discount on the promissory notes in the amount of \$3,519,238 during the year ended December 31, 2010. The Company accretes interest at 10% over the respective four-year terms of the promissory notes.

During the three and six months ended June 30, 2012, the Company accreted interest on the promissory notes in the amount of \$283,022 and \$548,359, respectively, and during the three and six months ended June 30, 2011, the Company accreted interest on the promissory notes in the amount of \$257,947 and \$509,002, respectively, which was recorded in accumulated deficit during the periods then ended. The Company recorded dividends on its Series B preferred stock during the three and six months ended June 30, 2012 of \$283,567 and \$549,416, respectively and during the three and six months ended June 30, 2011 of \$258,444 and \$509,983, respectively. The accrued dividends are offset by the accretion of the note receivable discount.

As of June 30, 2012 and December 31, 2011, 1,000 shares of Series B preferred stock were outstanding. As of June 30, 2012, the Company has drawn the entire commitment of \$10,000,000.

## 11. SERIES C PREFERRED STOCK

On December 30, 2010 (the "Series C Effective Date"), the Company entered into a securities purchase agreement (the "Series C Purchase Agreement") with Socius CG II, Ltd., a Bermuda exempted company ("Socius"). Pursuant to the Series C Purchase Agreement:

The Company agreed to sell, and Socius agreed to purchase, in one or more purchases from time to time (each such purchase, a "Series C Tranche") in the Company's sole discretion (subject to the conditions set forth therein), (i) up to 2,500 shares of Series C Preferred Stock (the "Series C Preferred Shares") at a purchase price of \$10,000 per share, for an aggregate purchase price of up to \$25,000,000, and (ii) a two-year warrant (the "Socius Warrant") obligating Socius to purchase shares of the Company's common stock (the "Common Stock") with an aggregate exercise price equal to 20% of the purchase price paid by Socius for the Series C Preferred Shares sold in each Series C Tranche, at an exercise price per share equal to the closing bid price of the Company's Common Stock on the date the Company provides notice of such Series C Tranche (the "Series C Tranche Notice"). On each date that the Company delivers a Series C Tranche Notice to Socius, Socius shall also become obligated, pursuant to a right automatically vesting on such Series C Tranche Notice date, to purchase that number of shares of Common Stock (such shares of Common Stock the "Additional Investment Shares") equal in dollar amount to 100% of the Series C Tranche amount set forth in the Series C Tranche Notice at a price per share equal to the closing bid price of the Common Stock on the Series C Tranche Notice date.



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The Series C Purchase Agreement requires that, when the Company requests Socius to purchase a tranche of Series C Preferred Shares, the mandatory purchase by Socius of the related Additional Investment Shares must occur no later than sixty (60) calendar days following the Series C Tranche Notice date.

The Socius Warrant was issued to Socius on December 30, 2010 (the "Closing Date") simultaneous with entering into the Series C Purchase Agreement. The Socius Warrant was issued with an initial exercise price per warrant is of \$0.16 per share and for a total of up to 31,250,000 shares, subject to adjustment as described therein. On January 10, 2011, Socius and the Company entered into a letter agreement in which the parties agreed that, following arms-length negotiations and notwithstanding anything to the contrary in the Socius Warrant, that the initial number of shares issuable under the Socius Warrant, subject to the adjustment mechanism set forth therein, was equal to 30,000,000.

As required by the Purchase Agreement, the Socius Warrant must be exercised for such number of shares of Common Stock equal in amount to 20% of the cumulative purchase price paid by Socius for the Series C Preferred Shares. The maximum amount of Series C Preferred Stock that Socius may become obligated to purchase under all Series C Tranches is \$25,000,000. Assuming the maximum drawdown of \$25,000,000 by the Company under the Series C Purchase Agreement, Socius would be required to exercise the Socius Warrant to purchase 20% of this total dollar amount, or \$5,000,000 worth of shares of Common Stock.

The Letter Agreement modified the Socius Warrant only with respect to the initial number of underlying shares and expressly provides that, except as so modified, the Socius Warrant shall remain unchanged and shall continue in full force and effect.

At the initial closing pursuant to the Series C Purchase Agreement, which occurred on the Closing Date, (i) Socius purchased 400 Preferred Shares and the Company received gross proceeds of \$4,000,000 (ii) the Company delivered to Socius an initial warrant (the "Initial Warrant") obligating Socius to purchase shares of Common Stock with an aggregate purchase price of \$800,000, which shall be automatically exercisable on the date a registration statement for the resale of all shares of Common Stock issuable pursuant to the Series C Purchase Agreement is declared effective (which effectiveness occurred on April 13, 2011), with delivery of such shares made to Socius on the trading day immediately following the exercise date at a per-share price equal to the closing bid price of the Common Stock on the delivery date, and (iii) Socius became obligated to purchase additional shares of Common Stock equal in aggregate dollar amount to \$4,000,000 (such shares of Common Stock the "Initial Investment Shares"), with delivery of such shares made to Socius on the trading day immediately following the date the registration statement is declared effective at a price per share equal to the closing bid price of Common Stock on the delivery date.



The Company agreed to pay to Socius a commitment fee of \$1,250,000 (the “Commitment Fee”), at the earlier of the closing of the first Series C Tranche or the six month anniversary of the Series C Effective Date. This Commitment Fee is payable solely at the Company’s election, in cash or in the alternative, in shares of common stock valued at 88% of the volume weighted average price of the Company’s Common Stock on the five trading days preceding the payment date. If the Company elects to pay the Commitment Fee in shares of Common Stock, no cash payment would be due as the issuance of shares would satisfy the Commitment Fee obligation in full. The Company issued 7,562,008 shares of common stock on June 30, 2011 as full payment of the commitment fee.

The Company agreed to use its best efforts to file within 60 days of the Series C Effective Date, and cause to become effective as soon as possible thereafter, a registration statement with the Securities and Exchange Commission for the resale of all shares of Common Stock issuable pursuant to the Series C Purchase Agreement, including the shares of Common Stock underlying the Socius Warrant, shares of the Common Stock issuable upon exercise of the Initial Warrant, shares of Common Stock issuable as Initial Investment Shares, shares of Common Stock issuable as Additional Investment Shares, and shares of Common Stock issuable in payment of the Commitment Fee.

In the event that Socius does not comply with its obligations under the Series C Purchase Agreement (including its obligations to exercise the Socius Warrant), the Series C Purchase Agreement provides that, in addition to being entitled to exercise all rights provided therein or granted by law, the Company would be entitled to seek specific performance by Socius under the Series C Purchase Agreement and the Socius Warrant.

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On December 30, 2010, in accordance with the purchase agreement, the Company filed a certificate of designations for the Series C preferred stock with the Secretary of State of the state of Delaware. As previously reported, pursuant to the Certificate of Designations, the preferred shares shall, with respect to dividend, rights upon liquidation, winding-up or dissolution, rank: (i) senior to the Company's common stock, and any other class or series of preferred stock of the Company (collectively, with any warrants, rights, calls or options exercisable for or convertible into such preferred stock, the "Junior Securities"); provided, however, the Series A-1 convertible preferred stock and Series B preferred stock (together, the "Senior Securities") shall rank senior in right of redemption, liquidation, and dividends; and (ii) junior to all existing and future indebtedness of the Company.

On June 16, 2011, the Company delivered the second Series C Tranche notice to Socius for delivery of a total of 400 shares under the Series C preferred stock for funding in the amount of \$4,000,000.

On September 22, 2011, the Company delivered the third Series C Tranche notice to Socius for delivery of a total of 150 shares under the Series C preferred stock for funding in the amount of \$1,500,000.

On December 15, 2011, the Company delivered the fourth Series C Tranche notice to Socius for delivery of a total of 200 shares under the Series C preferred stock for funding in the amount of \$2,000,000.

On March 16, 2012, the Company delivered the fifth Series C Tranche notice to Socius for delivery of a total of 250 shares under the Series C preferred stock for funding in the amount of \$2,500,000.

On June 18, 2012, the Company delivered the sixth Series C Tranche notice to Socius for delivery of a total of 200 shares under the Series C preferred stock for funding in the amount of \$2,000,000.

As of June 30, 2012, the Company has drawn \$16,000,000 of the \$25,000,000 commitment.

### *Dividends*

Commencing on the date of the issuance of any shares of Series C preferred stock, holders of Series C preferred stock will be entitled to receive dividends on each outstanding share of Series C preferred stock, which will accrue in shares of Series C preferred stock at a rate equal to 6% per annum from the issuance date compounded annually. Accrued dividends will be payable upon redemption of the Series C preferred stock. Accrued dividends were \$799,405 and \$400,110 at June 30, 2012 and December 31, 2011, respectively.

### *Redemption Rights*

Upon or after the fourth anniversary of the initial issuance date, the Company will have the right, at the Company's option, to redeem all or a portion of the shares of the Series C preferred stock, at a price per share equal to 100% of the Series C liquidation value. The preferred stock may be redeemed at the Company's option, commencing 4 years from the issuance date at a price per share of (a) \$10,000 per share plus accrued but unpaid dividends (the "Series C Liquidation Value"), or, at a price per share of : (x) 136% of the Series C Liquidation Value if redeemed prior to the first anniversary of the initial issuance date, (y) 127% of the Series C Liquidation Value if redeemed on or after the second anniversary but prior to the third anniversary of the initial issuance date, and (z) 109% of the Series C Liquidation Value if redeemed on or after the third anniversary but prior to the fourth anniversary of the initial issuance date.

### *Termination and Liquidation Rights*

If the Company determines to liquidate, dissolve or wind-up its business, it must redeem the Series C preferred stock at the prices set forth above. Upon any liquidation, dissolution or winding up of the Company, the Holders of Series C preferred stock shall be first entitled to be paid out of the assets of the Company available for distribution to its stockholders an amount with respect to each share of Series C preferred stock equal to \$10,000, plus any accrued and unpaid dividends.

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*Related Secured Promissory Notes Receivable:*

In accordance with the terms of the Series C preferred stock agreement, the Company issued the following notes receivable:

On April 14, 2011 and associated with the first Series C Tranche notice which occurred on December 31, 2010, Socius issued to the Company a secured promissory note of \$4,000,000 for 22,222,222 shares of common stock and issued a secured promissory note of \$800,000 for the exercise of warrants for 4,444,444 shares of common stock. On June 16, 2011 and associated with the second Series C Tranche notice, Socius issued to the Company a secured promissory note of \$4,000,000 for 21,390,374 shares of common stock and issued a secured promissory note of \$800,000 for the exercise of warrants for 4,278,075 shares of common stock.

On September 22, 2011 and associated with the third Series C Tranche notice, Socius issued to the Company a secured promissory note of \$1,500,000 for 9,671,180 shares of common stock and issued a secured promissory note of \$300,000 for the exercise of warrants for 1,934,236 shares of common stock.

On December 15, 2011 and associated with the fourth Series C Tranche notice, Socius issued to the Company a secured promissory note of \$2,000,000 for 20,512,821 shares of common stock and issued a secured promissory note of \$400,000 for the exercise of warrants for 4,102,564 shares of common stock.

On March 16, 2012 and associated with the fifth Series C Tranche notice, Socius issued to the Company a secured promissory note of \$2,500,000 for 26,315,789 shares of common stock and issued a secured promissory note of \$500,000 for the exercise of warrants for 5,263,158 shares of common stock.

On June 18, 2012 and associated with the sixth Series C Tranche notice, Socius issued to the Company a secured promissory note of \$2,000,000 for 28,490,028 shares of common stock and issued a secured promissory note of \$400,000 for the exercise of warrants for 5,698,006 shares of common stock.

Interest on the notes accrues at 2% per year, compounding annually if the interest remains unpaid at the end of each year. The note is secured by freely tradable marketable securities belonging to Socius. Each promissory note matures on the fourth anniversary of its issuance.

In the event the Company redeems all or a portion of any shares of Series C preferred stock held by Socius, the Company will be permitted to offset the full amount of such proceeds against amounts outstanding under the promissory notes. Accordingly, the Company included the discounted value of the secured promissory notes as a separate component of stockholders' deficit at June 30, 2012 and 2011.

The value of the secured promissory notes in the consolidated balance sheet was \$17,209,711, net of discounts of \$2,239,579 and accrued interest of \$249,290 at June 30, 2012, reflecting a face value of \$19,200,000. The value of the secured promissory notes as of December 31, 2011 was \$12,173,251, net of discounts of \$1,740,516 and accrued interest of \$113,767, reflecting a face value of \$13,800,000. The Company determined that a 6% discount is appropriate, in order to consistently reflect the Company's cost of borrowing under the terms of the underlying Series C preferred stock that permits offset. The Company recorded an initial discount on the promissory notes in the amount of \$1,968,050 during the year ended December 31, 2011 and an additional \$770,107 of debt discounts during the six months ended June 30, 2012 related to the fifth and sixth tranche notice. The Company accretes interest at 6% over the respective four-year terms of the promissory notes.

During the three and six months ended June 30, 2012, the Company accreted interest on the promissory note in the amount of \$223,233 and \$406,567, respectively, and during the three and six months ended June 30, 2011, the Company accreted interest on the promissory note in the amount of \$61,563 and \$61,563, respectively, which was recorded in accumulated deficit during the periods then ended. The Company recorded dividends on its Series C preferred stock during the three and six months ended June 30, 2012 of \$217,514 and \$399,296, respectively, and recorded dividends of \$69,041 and \$128,219 for the three and six months ended June 30, 2011, respectively. The accrued dividends are offset by the accretion of the note receivable discount.

The Company has classified the Series C redeemable preferred stock in the equity section in its consolidated balance sheets. As of June 30, 2012 and December 31, 2011, 1,600 and 1,150 shares of Series C preferred stock were outstanding, respectively.

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(Unaudited)

12. WARRANT SUMMARY

*Warrant Activity*

A summary of warrant activity for the six months ended June 30, 2012 is presented below:

	Number of Warrants	Weighted Average Exercise Price \$	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (000) \$
Outstanding, December 31, 2011	21,757,421	0.18	2.88	—
Granted	10,961,164	0.082		
Exercised	(10,961,164)	0.082		
Forfeited/Canceled	—	—		
Outstanding, June 30, 2012	21,757,421	0.18	2.38	—
Exercisable, June 30, 2012	21,757,421	0.18	2.38	—

The aggregate intrinsic value in the table above is before applicable income taxes and is calculated based on the difference between the exercise price of the warrants and the quoted price of the Company's common stock as of the reporting date.

The following table summarizes information about warrants outstanding and exercisable at June 30, 2012:

**Warrants Outstanding and Exercisable**

Exercise Price \$	Number of Shares	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price \$
.10 - .11	15,916,785	2.09	0.10
.20 - .30	1,630,000	3.50	0.25
.38-.39	1,330,636	5.07	0.39
.40-.45	2,065,000	1.56	0.42
0.70	815,000	3.50	0.70
	21,757,421		

During the six months ended June 30, 2012, the Company issued to Socius 10,961,164 warrants which were exercised immediately through Socius issuing the Company a note receivable as discussed in Note 11.

### 13.STOCKHOLDERS' EQUITY TRANSACTIONS

On April 26, 2012, at the Annual Meeting of the Company's Shareholders, the Company's shareholders approved an amendment to the Certificate of Incorporation of the Company to effect a reverse stock split of the Company's common stock, par value \$0.001 per share, at a ratio not less than one-for-twenty and not greater than one-for-eighty, and reduce the number of authorized shares of the Company's common stock in the same proportion as the reverse split, with the exact ratio to be set within such range in the discretion of the Board of Directors without further approval or authorization of the Company's shareholders, provided that the Board of Directors determines to effect the reverse stock split and proportional reduction in authorized shares of common stock and such amendment is filed with the Secretary of State of Delaware no later than December 31, 2012.

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On March 16, 2012, the Company issued 31,578,947 shares of common shares in exchange for promissory notes of \$2,500,000 and \$500,000 as discussed in Note 11.

On June 18, 2012, the Company issued 34,188,034 shares of common shares in exchange for promissory notes of \$2,000,000 and \$400,000 as discussed in Note 11.

Effective July 1, 2011, the Company entered into an amended and restated employment agreement with Gary Rabin. Per the agreement, the Company agreed to issue 10,000,000 shares of restricted stock which vests in equal installments on the last day of each calendar quarter commencing on July 31, 2011 and ending on December 31, 2013. During the six months ended June 30, 2012, the Company issued 2,000,000 shares of common stock pursuant to the agreement. As of June 30, 2012, 4,000,000 shares have been issued. The Company valued the 10,000,000 shares at \$0.185 per share for a value of \$1,850,000 which will be amortized over 30 months. During the three and six months ended June 30, 2012, the Company recorded \$185,000 and \$370,000 as payroll expense in the consolidated statements of operations.

On August 8, 2011, the Company entered into a new employment agreement with Robert Lanza. Per the agreement, the Company agreed to issue 15,000,000 shares of restricted stock with 6,000,000 shares vesting immediately and the remaining 9,000,000 shares vesting over a 21 months period beginning on January 31, 2012. During the six months ended June 30, 2012, the Company issued 2,571,428 shares of common stock pursuant to the agreement. As of June 30, 2012, 8,571,428 shares have been issued. The Company valued the 15,000,000 shares at \$0.1571 per share for a value of \$2,356,500 which will be amortized through September 30, 2013. During the three and six months ended June 30, 2012, the Company recorded \$163,142 and \$326,284 as payroll expense in the accompanying consolidated statements of operations.

On January 31, 2012, February 7, 2012 and May 8, 2012, the Company issued 238,237,459, 1,364,171 and 800,000 shares, respectively, to various debt and warrant holders as part of the global settlement as discussed in Note 6. The shares were valued at \$26,428,179. The Company reduced the accrued settlement by \$26,356,179 and the loss contingency accrual by \$72,000 with the issuance of the shares.



On January 31, 2012, the Company issued 45,878,659 shares to Midsummer Investment, Ltd. per the settlement agreement as discussed in Note 6. The shares were valued at \$7,799,373. The Company reduced the accrued settlement by \$7,799,373 with the issuance of the shares.

On February 17, 2012, the Company issued 5,183,374 shares to RHP Master Fund, Ltd. as a result of a preliminary injunction from the court as discussed in Note 6. The shares were valued at \$570,171. The Company reduced the loss contingency accrual by \$570,171 for the issuance of the shares.

On March 12, 2012 the Company issued 4,941,605 shares in settlement of litigation with Cranshire Capital Master Fund, Ltd. The shares were recorded as finance costs and valued at \$543,577.

On March 30, 2012, the Company issued various board members 792,832 shares of common stock valued at \$73,500 as compensation for board services.

On June 29, 2012, the Company issued various board members 1,009,720 shares of common stock valued at \$70,250 as compensation for board services.

#### 14. STOCK-BASED COMPENSATION

##### *Stock Plans*

	Options/Shares	Options	Options/Shares Available	Total
Stock Plan	Issued	Outstanding	For Grant	Authorized
2004 Stock Plan	2,492,000	70,000	308,000	2,800,000
2004 Stock Plan II	1,301,161	1,071,161	—	1,301,161
2005 Stock Plan	104,042,168	99,531,642	146,968,865	251,011,033
	107,835,329	100,672,803	147,276,865	255,112,194

## ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(Unaudited)

*Stock Option Activity*

A summary of option activity for the six months ended June 30, 2012 is presented below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding, December 31, 2011	91,800,285	\$ 0.23	8.19	\$
Granted	9,872,518	0.10		
Exercised	—	—		
Forfeited/canceled	(1,000,000 )	0.12		
Outstanding, June 30, 2012	100,672,803	\$ 0.22	7.95	\$ 700
Vested and expected to vest at June 30, 2012	96,610,824	\$ 0.22	7.91	\$ 700
Exercisable, June 30, 2012	68,426,814	\$ 0.23	7.52	\$ 700

The aggregate intrinsic value in the table above is before applicable income taxes and is calculated based on the difference between the exercise price of the options and the quoted price of the Company's common stock as of the reporting date.

The following table summarizes information about stock options outstanding and exercisable at June 30, 2012.

Options Outstanding			Options Exercisable		
Exercise Price	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number of Shares	Weighted Average Exercise Price

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0.05	70,000	\$0.05	2.12	70,000	\$0.05	2.12
0.08 - 0.09	14,252,022	0.09	7.93	9,421,620	0.09	8.09
0.10 - 0.157	42,261,769	0.12	8.52	30,822,732	0.12	8.01
0.185 - 0.21	26,735,835	0.19	8.15	16,759,285	0.20	7.64
0.25 - 0.45	11,071,161	0.36	8.38	5,071,161	0.35	7.63
0.85	5,604,099	0.85	2.59	5,604,099	0.85	2.59
1.35 - 2.48	677,917	\$2.04	3.36	677,917	\$2.04	3.36
	100,672,803			68,426,814		

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The assumptions used in calculating the fair value of options granted using the Black-Scholes option- pricing model for options granted during the six months ended June 30, 2012 are as follows:

	June 30,2012
Risk-free interest rate	1.04%
Expected life of the options	6.26 years
Expected volatility	160%
Expected dividend yield	0%
Expected forfeitures	13%

As of June 30, 2012, total unrecognized stock-based compensation expense related to nonvested stock options was approximately \$4,333,291, which is expected to be recognized over a weighted average period of approximately 2.95 years.

**15. COMMITMENTS AND CONTINGENCIES**

Estate of William Caldwell

The Company has received a copy of a Creditor's Claim (the "Claim") in the amount of \$27,909,706 made with the Estate of William Caldwell ("Decedent"), who at the time of his death was the Chief Executive Officer and Chairman of the Board of Directors of the Company. The Claim states that Decedent's liability arises under a cause of action that the Claimant intends to file in Federal court against the Company for violations of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including Section 10(b) of the Exchange Act and the rules promulgated thereunder. As of the date of the filing of this report, the Company is not aware of any action commenced against it by the Claimant.

In the Claim, the Claimant alleges that in September 2005, he entered into a Settlement Agreement with the Company pursuant to which he received a warrant to purchase shares of the Company's Common Stock. In the Claim, the Claimant makes several allegations against the Company including that in reliance on misinformation provided to him by the Decedent he exercised his warrant to purchase the Company's Common Stock at an inflated price and received

fewer shares than he was owed by the Company under the terms of his warrant, that the Company breached the Claimant's warrant by not timely issuing stock after the warrant was exercised, and that the Company failed to provide proper notice of certain events that allegedly triggered the Claimant's purported rights to additional shares under the warrant. Claimant previously brought an action against the Company, in October 2007, with respect to a dispute over the interpretation of the anti-dilution provisions of the warrant but withdrew this action the day before the trial date.

Pursuant to the employment agreement between the Company and the Decedent, the Company has to indemnify and hold Decedent harmless from costs, expenses or liability arising out of or relating to any acts or decisions made by Decedent in the course of his employment to the same extent that the Company indemnifies and holds harmless other officers and directors of the company in accordance with the Company's established policies. Our directors and officers are indemnified by our bylaws against amounts actually and necessarily incurred by them in connection with the defense of any action, suit or proceeding in which they are a party by reason of being or having been directors or officers of the Company. Our certificate of incorporation provides that none of our directors or officers shall be personally liable for damages for breach of any fiduciary duty as a director or officer involving any act or omission of any such director or officer. Insofar as indemnification for liabilities arising under the Securities Act of 1933, as amended, may be permitted to such directors, officers and controlling persons pursuant to the foregoing provisions, or otherwise, the Company has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

ADVANCED CELL TECHNOLOGY, INC. AND SUBSIDIARY

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(Unaudited)

In the event that a claim for indemnification against such liabilities, other than the payment by the Company of expenses incurred or paid by such director, officer or controlling person in the successful defense of any action, suit or proceeding, is asserted by such director, officer or controlling person in connection with the securities being registered, the Company will, unless in the opinion of counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

The Company determined that an accrual was necessary at June 30, 2012, which is included in the "loss contingency accrual" amount on the consolidated balance sheets. See Note 7.

Camofi Master LOC

Camofi Master LOC and Camzhn Master LOC (the "Camofi Parties") filed their Complaint on October 13, 2011. In their Complaint, the Camofi Parties argue that as a result of the transactions between the Company and JMJ, Gemini Master Fund, Ltd. and Midsummer Investment, Ltd. respectively, the exercise prices in their Warrants and debentures should have been reduced. Consequently, the Camofi Parties argue that they have been denied the right to receive, in total, at least 130,795,594 shares of the Company's common stock, which has allegedly resulted in losses to the Camofi Parties of at least \$22,265,951. The Camofi Parties also seek unspecified damages, in an amount to be proven at trial, based upon the Company's alleged failure to lower the conversion price of the debentures and to provide proper notice of reduction in exercise price and conversion price. On November 18, 2011, the Company answered the Complaint and asserted affirmative defenses. Discovery has commenced in this case. The Company has evaluated this complaint in the frame work of ASC 450 and believes that the consolidated financial statements as of June 30, 2012 properly reflect management's consideration of ASC 450. Management intends to contest this case vigorously if a reasonable settlement cannot be achieved.

Securities and Exchange Commission – Civil Action

In May 2012, the Company was named as a defendant in a civil action brought by the Securities and Exchange Commission related to transactions involving the sale and issuance of the Company's securities. The Securities and Exchange Commission alleges that certain sales of shares to outside organizations, completed in late 2008 and early

2009 under the Company's former management, resulted in \$3.5 million in proceeds to the Company in violation of Section 3(a)(10) of the Securities Act of 1933, as amended. The Company expensed the \$3.5 million as "fines and penalties" in the consolidated statement of operations and recorded the \$3.5 million liability to "loss contingency accrual" in the consolidated balance sheet.

See Note 6 "Accrued Settlement" and Note 7 "Loss Contingency Accrual"

## 16. RELATED PARTY TRANSACTIONS

On January 31, 2012, the Shapiro Family Trust received 5,532,198 shares of the Company's common stock valued at \$608,542 upon cashless exercise of the warrants in connection with the 2005-2008 convertible debentures and in accordance with the December 7, 2011 global settlement agreement. Dr. Shapiro, one of the Company's directors, may be deemed the beneficial owner of the securities owned by the Shapiro Family Trust.

On January 31, 2012, PDPI, LLC received 11,204,101 of the Company's common stock valued at \$1,232,451 upon cashless exercise of warrants in accordance with the December 7, 2011 global settlement agreement. Mr. Rabin, the Company's Chief Executive Officer and Chairman of the Board of Directors, has a 33.33% equity interest in the entity.

## 17. SUBSEQUENT EVENTS

The Company evaluates and discloses subsequent events as required by ASC Topic No. 855, Subsequent Events. The Topic establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. Subsequent events have been evaluated as of the date of this filing and no further disclosures were required.

## **CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q and the materials incorporated herein by reference contain forward-looking statements that involve risks and uncertainties. We use words such as “may,” “assumes,” “forecasts,” “positions,” “predicts,” “strategy,” “will,” “expects,” “estimates,” “anticipates,” “believes,” “projects,” “intends,” “plans,” “budgets,” “potential,” “com” variations thereof, and other statements contained in this quarterly report, and the exhibits hereto, regarding matters that are not historical facts and are forward-looking statements. Because these statements involve risks and uncertainties, as well as certain assumptions, actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to risks inherent in: our early stage of development, including a lack of operating history, lack of profitable operations and the need for additional capital; the development and commercialization of largely novel and unproven technologies and products; our ability to protect, maintain and defend our intellectual property rights; uncertainties regarding our ability to obtain the capital resources needed to continue research and development operations and to conduct research, preclinical development and clinical trials necessary for regulatory approvals; uncertainty regarding the outcome of clinical trials and our overall ability to compete effectively in a highly complex, rapidly developing, capital intensive and competitive industry. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date that they are made. Except as may be required under applicable securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Forward-looking statements include our plans and objectives for future operations, including plans and objectives relating to our products and our future economic performance. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions, future business decisions, and the time and money required to successfully complete development and commercialization of our technologies, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the assumptions underlying the forward-looking statements contained herein are reasonable, any of those assumptions could prove inaccurate and, therefore, we cannot assure you that the results contemplated in any of the forward-looking statements contained herein will be realized. Based on the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of any such statement should not be regarded as a representation by us or any other person that our objectives or plans will be achieved.

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

### **OVERVIEW**

The following discussion should be read in conjunction with the financial statements and notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q.



We are a biotechnology company focused on developing and commercializing human stem cell technology in the emerging fields of regenerative medicine and stem cell therapy. Principal activities to date have included obtaining financing, securing operating facilities, and conducting research and development. We have no therapeutic products currently available for sale and do not expect to have any therapeutic products commercially available for sale for a period of years, if at all. These factors indicate that our ability to continue research and development activities is dependent upon the ability of management to obtain additional financing as required.

## CRITICAL ACCOUNTING POLICIES

***Deferred Issuance Cost***— Payments, either in cash or share-based payments, made in connection with the sale of debentures are recorded as deferred debt issuance costs and amortized using the effective interest method over the lives of the related debentures. The weighted average amortization period for deferred debt issuance costs is 48 months.

***Fair Value Measurements*** — For certain financial instruments, including accounts receivable, accounts payable, accrued expenses, interest payable and notes payable, the carrying amounts approximate fair value due to their relatively short maturities.

On January 1, 2008, we adopted FASB ASC 820-10, “*Fair Value Measurements and Disclosures*.” FASB ASC 820-10 defines fair value, and establishes a three-level valuation hierarchy for disclosures of fair value measurement that enhances disclosure requirements for fair value measures. The carrying amounts reported in the consolidated balance sheets for receivables and current liabilities each qualify as financial instruments and are a reasonable estimate of their fair values because of the short period of time between the origination of such instruments and their expected realization and their current market rate of interest. The three levels of valuation hierarchy are defined as follows:

—Level 1 inputs to the valuation methodology are quoted prices for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

—Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Management analyzes all financial instruments with features of both liabilities and equity under ASC 480, “*Distinguishing Liabilities From Equity*” and ASC 815, “*Derivatives and Hedging*.” Derivative liabilities are adjusted to reflect fair value at each period end, with any increase or decrease in the fair value being recorded in results of operations as adjustments to fair value of derivatives. The effects of interactions between embedded derivatives are calculated and accounted for in arriving at the overall fair value of the financial instruments. In addition, the fair values of freestanding derivative instruments such as warrant and option derivatives are valued using the Black-Scholes model.

**Revenue Recognition—** Our revenue is generated from license and research agreements with collaborators. Licensing revenue is recognized on a straight-line basis over the shorter of the life of the license or the estimated economic life of the patents related to the license. Deferred revenue represents the portion of the license and other payments received that has not been earned. Costs associated with the license revenue are deferred and recognized over the same term as the revenue. Reimbursements of research expense pursuant to grants are recorded in the period during which collection of the reimbursement becomes assured, because the reimbursements are subject to approval.

**Stock Based Compensation—** We record stock-based compensation in accordance with ASC 718, “*Compensation – Stock Compensation*.” ASC 718 requires companies to measure compensation cost for stock-based employee compensation at fair value at the grant date and recognize the expense over the employee’s requisite service period. We recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees and non-employees.

## RESULTS OF OPERATIONS

*Comparison of Three Months Ended June 30, 2012 and 2011*

	Three Months Ended June 30, 2012			Three Months Ended June 30, 2011		
	Amount	% of Revenue		Amount	% of Revenue	
Revenue	\$218,184	100.0 %		\$153,688	100.0 %	
Cost of revenue	15,609	7.2 %		281,500	183.2 %	
Gross profit	202,575	92.8 %		(127,812 )	-83.2 %	
Research and development expenses	2,068,098	947.9 %		1,532,271	997.0 %	
General and administrative expenses	2,612,471	1197.4 %		1,951,728	1269.9 %	
Loss on settlement of litigation	—	0.0 %		—	0.0 %	
Non-operating income (expense)	518,551	237.7 %		(1,208,338)	-786.2 %	
Net loss	\$(3,959,443)	-1814.7 %		\$(4,820,149)	-3136.3 %	

### ***Revenue***

Revenue relates to license fees and royalties collected that are being amortized over the period of the license granted, and are therefore typically consistent between periods. Revenue was \$218,184 for the three months ended June 30, 2012 and increase of \$64,496 or 42% compared to the three months ended June 30, 2011. The increase is due to the receipt of \$150,000 that was recognized as revenue during the current period offset by license agreements that were terminated in 2011.

### ***Research and Development Expenses and Grant Reimbursements***

Research and development expenses ("R&D") consists mainly of facility costs, payroll and payroll related expenses, research supplies and costs incurred in connection with specific research grants, and for scientific research. R&D expenditures for the three months ended June 30, 2012 increased from \$1,532,271 in 2011 to \$2,068,098 for 2012 for an increase of \$535,827 or 35%. The increase in R&D expenditures during 2012 as compared to 2011 was primarily due to compensation increase of approximately \$561,000, legal fees of approximately \$69,000 and other expenses of approximately \$26,000 offset by an increase in grant reimbursements of \$120,000.

Our research and development expenses consist primarily of costs associated with basic and pre-clinical research exclusively in the field of human stem cell therapies and regenerative medicine, with focus on development of our technologies in cellular reprogramming, reduced complexity applications, and stem cell differentiation. These expenses represent both pre-clinical development costs and costs associated with non-clinical support activities such as quality control and regulatory processes. The cost of our research and development personnel is the most significant category of expense; however, we also incur expenses with third parties, including license agreements, sponsored research programs and consulting expenses.

We do not segregate research and development costs by project because our research is focused exclusively on human stem cell therapies as a unitary field of study. Although we have three principal areas of focus for our research, these areas are completely intertwined and have not yet matured to the point where they are separate and distinct projects. The intellectual property, scientists and other resources dedicated to these efforts are not separately allocated to individual projects, since the research is conducted on an integrated basis.

We expect that research and development expenses will increase in the foreseeable future as we add personnel, expand our pre-clinical research, continue clinical trial activities, and increase our regulatory compliance capabilities. The amount of these increases is difficult to predict due to the uncertainty inherent in the timing and extent of progress in our research programs, and initiation of clinical trials. In addition, the results from our basic research and pre-clinical trials, as well as the results of trials of similar therapeutics under development by others, will influence the number, size and duration of planned and unplanned trials. As our research efforts mature, we will continue to review the direction of our research based on an assessment of the value of possible commercial applications emerging from

these efforts. Based on this continuing review, we expect to establish discrete research programs and evaluate the cost and potential for cash inflows from commercializing products, partnering with others in the biotechnology or pharmaceutical industry, or licensing the technologies associated with these programs to third parties.

We believe that it is not possible at this stage to provide a meaningful estimate of the total cost to complete our ongoing projects and bring any proposed products to market. The use of human embryonic stem cells as a therapy is an emerging area of medicine, and it is not known what clinical trials will be required by the FDA in order to gain marketing approval. Costs to complete could vary substantially depending upon the projects selected for development, the number of clinical trials required and the number of patients needed for each study. It is possible that the completion of these studies could be delayed for a variety of reasons, including difficulties in enrolling patients, delays in manufacturing, incomplete or inconsistent data from the pre-clinical or clinical trials, and difficulties evaluating the trial results. Any delay in completion of a trial would increase the cost of that trial, which would harm our results of operations. Due to these uncertainties, we cannot reasonably estimate the size, nature nor timing of the costs to complete, or the amount or timing of the net cash inflows from our current activities. Until we obtain further relevant pre-clinical and clinical data, we will not be able to estimate our future expenses related to these programs or when, if ever, and to what extent we will receive cash inflows from resulting products.

#### ***General and Administrative Expenses***

General and administrative expenses for the three months ended June 30, 2012 compared to the three months ended June 30, 2011 increased by \$660,743 to \$2,612,471 in 2012 compared to \$1,951,728 for the three months ended June 30, 2011. This increase was primarily a result of an increase in option compensation charges of 460,000, legal fees of \$357,000 offset by a decrease in bonuses of approximately \$125,000.

***Other Income (Expense)***

Other income (expense) consisted of the following:

	For the three months ended June 30,			
	2012	2011	\$ Change	% Change
Interest income	4,508	10,765	(6,257 )	-58 %
Interest expense and late fees	(275,292 )	(272,171 )	(3,121 )	1 %
Finance cost	3,555,254	(245,734 )	3,800,988	-1547 %
Fines and penalties	(3,500,000)	—	(3,500,000)	-100 %
Adjustments to fair value of derivatives	734,081	(701,198 )	1,435,279	-205 %
Total non-operating income (expense)	518,551	(1,208,338)	1,726,889	

Interest expense remained consistent for the three months ended June 30, 2011 compared to the three months ended June 30, 2012.

Finance costs decreased by \$3,800,933 due to the change in estimates related to the settlement and warrant related litigation. Our estimates are based on an estimated number of shares to be issued multiplied by the share price at each reporting date. During the three months ended June 30, 2012, we increased the number of possible shares to be issued by approximately 25,543,037 and decreased the share price from \$0.09 to \$0.06. (see footnote 6).

Fines and penalties increased \$3,500,000 during the three months ended June 30, 2012 compared to the three months ended June 30, 2011. We have been named as a defendant in a civil action brought by the Securities and Exchange Commission related to transactions involving the sale and issuance of our securities. The Securities and Exchange Commission alleges that certain sales of shares to outside organizations, completed in late 2008 and early 2009 under the company's former management, resulted in \$3.5 million in proceeds to us in violation of Section 3(a)(10) of the Securities Act of 1933, as amended.

Adjustment to fair value of derivatives changed from a loss of \$701,198 during the three months ended June 30, 2011, to a gain of \$734,081 during the three months ended June 30, 2012. The change of \$1,435,279 is due to the fluctuation in our share price and the reduction in the number of outstanding warrants. Our share price increased from \$0.18 at March 31, 2011 to \$0.19 at June 30, 2011 which resulted in an increase in derivative fair value of approximately \$701,000. Our share price changed from \$0.09 at March 31, 2012 to \$0.06 at June 30, 2012 which resulted in a decrease in derivative fair value of approximately \$734,000. At June 30, 2011 there were approximately 95,311,218 warrants outstanding compared to approximately 21,757,000 at June 30, 2012.

***Comparison of Six Months Ended June 30, 2012 and 2011***

	Six Months Ended June 30, 2012			Six Months Ended June 30, 2011	
	Amount	% of Revenue		Amount	% of Revenue
Revenue	\$273,869	100.0 %		\$307,376	100.0 %
Cost of revenue	31,218	11.4 %		304,400	99.0 %
Gross profit	242,651	88.6 %		2,976	1.0 %
Research and development expenses	4,508,640	1646.3 %		3,007,044	978.3 %
General and administrative expenses	5,631,476	2056.3 %		5,149,254	1675.2 %
Loss on settlement of litigation	—	0.0 %		294,144	95.7 %
Non-operating income (expense)	225,532	82.4 %		285,280	92.8 %
Net loss	\$(9,671,933)	-3531.6 %		\$(8,162,186)	-2655.4 %

### ***Revenue***

Revenue relates to license fees and royalties collected that are being amortized over the period of the license granted, and are therefore typically consistent between periods. The decrease in revenue during the six months ended June 30, 2012, was due to license agreements that were terminated in 2011.

### ***Research and Development Expenses and Grant Reimbursements***

Research and development expenses (“R&D”) consists mainly of facility costs, payroll and payroll related expenses, research supplies and costs incurred in connection with specific research grants, and for scientific research. R&D expenditures increased from \$3,007,044 in 2011 to \$4,508,640 for 2012 for an increase of \$1,501,596 or 50%. The increase in R&D expenditures during 2012 as compared to 2011 was primarily due to compensation increase of approximately \$1,367,000, clinical trials of approximately \$62,000, legal fees of approximately \$146,000 and other expenses of approximately \$47,000 offset by an increase in grant reimbursements of \$120,000..

Our research and development expenses consist primarily of costs associated with basic and pre-clinical research exclusively in the field of human stem cell therapies and regenerative medicine, with focus on development of our technologies in cellular reprogramming, reduced complexity applications, and stem cell differentiation. These expenses represent both pre-clinical development costs and costs associated with non-clinical support activities such as quality control and regulatory processes. The cost of our research and development personnel is the most significant category of expense; however, we also incur expenses with third parties, including license agreements, sponsored research programs and consulting expenses.

We do not segregate research and development costs by project because our research is focused exclusively on human stem cell therapies as a unitary field of study. Although we have three principal areas of focus for our research, these areas are completely intertwined and have not yet matured to the point where they are separate and distinct projects. The intellectual property, scientists and other resources dedicated to these efforts are not separately allocated to individual projects, since the research is conducted on an integrated basis.

We expect that research and development expenses will increase in the foreseeable future as we add personnel, expand our pre-clinical research, continue clinical trial activities, and increase our regulatory compliance capabilities. The amount of these increases is difficult to predict due to the uncertainty inherent in the timing and extent of progress in our research programs, and initiation of clinical trials. In addition, the results from our basic research and pre-clinical trials, as well as the results of trials of similar therapeutics under development by others, will influence the number, size and duration of planned and unplanned trials. As our research efforts mature, we will continue to review the direction of our research based on an assessment of the value of possible commercial applications emerging from these efforts. Based on this continuing review, we expect to establish discrete research programs and evaluate the cost and potential for cash inflows from commercializing products, partnering with others in the biotechnology or



pharmaceutical industry, or licensing the technologies associated with these programs to third parties.

We believe that it is not possible at this stage to provide a meaningful estimate of the total cost to complete our ongoing projects and bring any proposed products to market. The use of human embryonic stem cells as a therapy is an emerging area of medicine, and it is not known what clinical trials will be required by the FDA in order to gain marketing approval. Costs to complete could vary substantially depending upon the projects selected for development, the number of clinical trials required and the number of patients needed for each study. It is possible that the completion of these studies could be delayed for a variety of reasons, including difficulties in enrolling patients, delays in manufacturing, incomplete or inconsistent data from the pre-clinical or clinical trials, and difficulties evaluating the trial results. Any delay in completion of a trial would increase the cost of that trial, which would harm our results of operations. Due to these uncertainties, we cannot reasonably estimate the size, nature nor timing of the costs to complete, or the amount or timing of the net cash inflows from our current activities. Until we obtain further relevant pre-clinical and clinical data, we will not be able to estimate our future expenses related to these programs or when, if ever, and to what extent we will receive cash inflows from resulting products.

#### ***General and Administrative Expenses***

General and administrative expenses for the six months ended June 30, 2012 increased \$482,222 or 9% to \$5,631,476 compared to \$5,149,254 for the six months ended June 30, 2011. This increase was primarily a result of an increase in compensation and stock issued for services of approximately \$995,000 and legal expenses of approximately \$724,000 offset by a decrease in consultant expenses of approximately \$1,218,000.

**Other Income (Expense)**

Other income (expense) consisted of the following:

	For the six months ended June 30,			
	2012	2011	\$ Change	% Change
Interest income	9,585	22,549	(12,964 )	-57%
Interest expense and late fees	(547,616 )	(953,881 )	406,265	-43%
Finance cost	3,671,081	(2,871,609)	6,542,690	-228%
Fines and penalties	(3,500,000)	—	(3,500,000)	-100%
Adjustments to fair value of derivatives	592,482	4,088,221	(3,495,739)	-86%
Total non-operating income (expense)	225,532	285,280	(59,748 )	

Interest expense decreased from \$953,881 for the six months ended June 30, 2011 to \$547,616 for the six months ended June 30, 2012. The decrease was primarily due to the \$365,000 deferred offering costs related to the Series B Preferred Stock which were recorded to interest expense during the six months ended June 30, 2011.

Finance costs decreased by \$6,542,690 for the six months ended June 30, 2012 compared to the six months ended June 30, 2011. During the six months ended June 30, 2011, we incurred approximately \$2,400,000 in financing costs associated with the Gemini Master Fund warrant settlement. During the six months ended June 30, 2012, we had income of \$3,671,081 due to the change in estimates related to the settlement and warrant related litigation. The number of estimated shares to be issued increased during the six months ended June 30, 2012 by approximately 81,099,000 shares, but the estimated share price decreased from \$0.13 to \$0.06 during the same period.

Fines and penalties increased \$3,500,000 during the six months ended June 30, 2012 compared to the six months ended June 30, 2011. We have been named as a defendant in a civil action brought by the Securities and Exchange Commission related to transactions involving the sale and issuance of our securities. The Securities and Exchange Commission alleges that certain sales of shares to outside organizations, completed in late 2008 and early 2009 under the company's former management, resulted in \$3.5 million in proceeds to us in violation of Section 3(a)(10) of the Securities Act of 1933, as amended.

Adjustment to fair value of derivatives changed from a gain of \$4,088,221 during the six months ended June 30, 2011, to a gain of \$592,482 during the six months ended June 30, 2012. The change of \$3,495,739 is due to the fluctuation in our share price and the reduction in the number of outstanding warrants. Our share price changed from \$0.21 at December 31, 2010 to \$0.19 at June 30, 2011 which resulted in a decrease in derivative fair value of approximately \$4,088,000. Our share price changed from \$0.08 at December 31, 2011 to \$0.06 at June 30, 2012 which resulted in a decrease in derivative fair value of approximately \$593,000. At June 30, 2011 there were approximately 95,311,218 warrants outstanding compared to approximately 21,757,000 at June 30, 2012.

## ***LIQUIDITY AND CAPITAL RESOURCES***

### *Cash Flows*

The following table sets forth a summary of our cash flows for the periods indicated below:

	Six Months Ended June 30,	
	2012	2011
Net cash used in operating activities	\$(7,716,202)	\$(6,689,195 )
Net cash used in investing activities	(24,269 )	(36,830 )
Net cash provided by financing activities	4,500,000	6,950,940
Net increase (decrease) in cash and cash equivalents	(3,240,471)	224,915
Cash and cash equivalents at the end of the period	\$9,862,536	\$16,114,324

*Operating Activities*

Our net cash used in operating activities during the six months ended June 30, 2012 and 2011 was \$7,716,202 and \$6,689,195, respectively. Cash used in operating activities increased during the current period primarily due to an increase in operating expenditures.

*Cash Flows from Investing*

Cash used in investing activities during the six months ended June 30, 2012 and 2011 was \$24,269 and \$36,830, respectively. Our cash used in investing activities during the six months ended June 30, 2012 was attributed to the purchase of fixed assets for approximately \$24,269.

*Cash Flows from Financing Activities*

Cash flows provided by financing activities during the six months ended June 30, 2012 and 2011 was \$4,500,000 and \$6,950,940, respectively. During the six months ended June 30, 2012, we received \$4,500,000 from the issuance of 450 shares of Series C Preferred stock.

We plan to fund our operations for the foreseeable future from the following sources:

— As of June 30, 2012, we have approximately \$9,862,536 in cash.  
As of June 30, 2012, approximately \$1,580,000 is available to us upon the sale of our Series A-1 preferred stock for a maximum placement commitment of \$5 million subject to compliance with the transactions agreement.  
As of June 30, 2012, \$9,000,000 is available to us upon the sale of our Series C preferred stock for a maximum placement commitment of \$25,000,000 subject to compliance with the transactions agreement.  
We continue to repay our debt financings in shares of common stock, enabling us to use our cash resources to fund our operations.

On a long term basis, we have no expectation of generating any meaningful revenues from our product candidates for a substantial period of time and will rely on raising funds in capital transactions to finance our research and development programs. Our future cash requirements will depend on many factors, including the pace and scope of our research and development programs, the costs involved in filing, prosecuting and enforcing patents, and other costs associated with commercializing our potential products. We intend to seek additional funding primarily through public or private financing transactions, and, to a lesser degree, new licensing or scientific collaborations, grants from governmental or other institutions, and other related transactions. If we are unable to raise additional funds, we will

be forced to either scale back our business efforts or curtail our business activities entirely. We anticipate that our available cash and expected income will be sufficient to finance most of our current activities for the foreseeable future. We cannot assure you that public or private financing or grants will be available on acceptable terms, if at all. Several factors will affect our ability to raise additional funding, including, but not limited to, the volatility of our common stock.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our exposure to market risk is limited primarily to interest income sensitivity, which is affected by changes in the general level of U.S. interest rates, particularly because a significant portion of our investments are in short-term debt securities issued by the U.S. government and institutional money market funds. The primary objective of our investment activities is to preserve principal. Due to the nature of our marketable securities, we believe that we are not exposed to any material market risk. We do not have any derivative financial instruments or foreign currency instruments. If interest rates had varied by 10% in the quarter ended June 30, 2012, it would not have had a material effect on our results of operations or cash flows for that period.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Disclosure Controls and Procedures**

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in the reports we file pursuant to the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our Chief Executive Officer (“CEO”), who also serves as the Company’s Principal Financial Officer (“PFO”), to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can only provide a reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Management designed the disclosure controls and procedures to provide reasonable assurance of achieving the desired control objectives.

We carried out an evaluation, under the supervision and with the participation of our management, including our CEO and PFO, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report. Based upon that evaluation, the Chief Executive Officer and Principal Financial Officer concluded that the Company’s disclosure controls and procedures are effective.

### **Changes in Internal Control over Financial Reporting**

There have been no changes in our internal controls over financial reporting (as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act) during the quarter ended June 30, 2012 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**

In May 2012, the Company was named as a defendant in a civil action brought by the Securities and Exchange Commission related to transactions involving the sale and issuance of the Company's securities. The Securities and Exchange Commission alleges that certain sales of shares to outside organizations, completed in late 2008 and early 2009 under the company's former management, resulted in \$3.5 million in proceeds to the company in violation of Section 3(a)(10) of the Securities Act of 1933, as amended.

### **ITEM 1A. RISK FACTORS**

**There have been no material changes from the risk factors disclosed in the Company's Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission on March 1, 2012.**

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

On June 29, 2012, we issued various board members 1,109,720 shares of common stock for services.

On June 29, 2012, we issued 1,000,000 shares of common stock to Gary Rabin pursuant to his employment agreement.

On June 29, 2012, we issued 1,285,714 shares of common stock to Robert Lanza pursuant to his employment agreement.

In connection with the foregoing, the Company relied upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended, for transactions not involving a public offering.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable

### **ITEM 5. OTHER INFORMATION**

None.

### **ITEM 6. EXHIBITS**

#### **Exhibit Description**

31.1 Section 302 Certification of Principal Executive Officer and Principal Financial Officer.\*

32.1



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Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C.  
Section 1350.\*

101.INS XBRL Instance Document\*  
101.SCH XBRL Extension Schema\*  
101.CAL XBRL Calculation Linkbase\*  
101.DEF XBRL Definition Linkbase\*  
101.LAB XBRL Label Linkbase\*  
101.PRE XBRL Presentation Linkbase\*

\* Filed herewith

**SIGNATURE**

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

ADVANCED CELL TECHNOLOGY, INC.

By: /s/ Gary Rabin  
Gary Rabin  
Chief Executive Officer and Chairman

(Principal Executive Officer, Principal Financial Officer and Principal Accounting Officer)

Dated: August 8, 2012