



**STEM CELL**  

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**THERAPEUTICS**

**Stem Cell Therapeutics Corp.**

Management Discussion and Analysis  
Third Quarter Ended September 30, 2006

Dated: November 29, 2006

Dated November 29, 2006

The following information should be read in conjunction with the Corporation's unaudited financial statements as at and for the three and nine months ended September 30, 2006 and 2005, and should also be read in conjunction with the audited financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") contained in the Corporation's annual report for the year ended December 31, 2005.

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

Where "we", "us", "our", "SCT", the "Company" or the "Corporation" is used, it is referring to Stem Cell Therapeutics Corp. unless otherwise indicated.

All amounts are in Canadian dollars, unless otherwise indicated.

Additional information relating to the Corporation including the Corporation's most recently filed Annual Information Form, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

## **FORWARD-LOOKING STATEMENTS**

Certain information contained in management's discussion and analysis of our financial condition and results of our operations constitute forward-looking statements. **Forward-looking statements are identified by words such as "expect", "believe", "intend", "anticipate", "will", "may", or other similar expressions.** These statements relate to future events or to our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such risks and uncertainties include, **but are not limited to, uncertainties related to the research and development of pharmaceuticals, the difficulty of predicting regulatory approvals, acceptance and demand for new pharmaceutical products, the impact of competitive products and pricing, the Company's ability to finance, manufacture and commercialize its products, the protection of intellectual property and any other similar or related risks and uncertainties.**

### **Overview**

Stem Cell Therapeutics Corp. is a biotechnology company focused on the development of a technology platform and intellectual property to selectively induce a patient's own stem cells to proliferate in the brain. Our core technology has been demonstrated to increase the replication of innate adult stem cells when our therapeutic approach is applied to test animals. This fundamental technology will be further developed to create specific disease treatments for stroke and potentially, Huntington's disease, Alzheimer's disease and other neurodegenerative conditions. Our collaborators and researchers have used animals to demonstrate re-growth of brain cells from existing stem cells and functional improvement using our therapeutic approach. Since these tests were completed, we have identified additional agents that may be used for neurogenesis-promoting and from which we have created the NTx™-265 regimen of agents for the treatment of stroke.

Concurrently with these advanced pre-clinical studies, a Phase IIa clinical safety study with NTx™-265 in human stroke patients was initiated at the end of April, 2006, with an anticipated completion date in mid-2007.

As a development stage company, the continuation of SCT's research and development activity and the commercialization of its stem cell related technologies are dependent on the Corporation's ability to complete its research and development programs and finance its cash requirements. The Corporation currently believes that it has adequate financial resources for anticipated expenditures until the end of 1Q07 (please see Note 1, 3Q06 Financial Statements). This has been reduced from previous estimates due to cash payments made to Transition Therapeutics Inc., as well as Stem Cells Inc. Management is undertaking a cash preservation strategy in order to extend the cash resources of the Corporation beyond 1Q07. However, there is doubt as to the Corporation's ability to continue operations on a long term basis. Additionally, the Corporation is actively seeking additional financing but there is no certainty that management will be successful in this regard. The value of our intangible assets could become impaired should our research and development activities decrease significantly or cease.

### **Review of Operations**

Net loss for the nine month period ended September 30, 2006 was \$3,644,393 or \$0.07 per common share while losses for the three month period ended September 30, 2006 were \$1,298,475 or \$0.02 per common share (compared to \$2,186,543 or \$0.04 and \$865,011 or \$0.02 for the nine and three month periods respectively, ended September 30, 2005). The increase in the Corporation's net loss of \$1,457,850 mainly reflects the increase in research and development costs (increased by \$1,201,143 accounting for 82% of the total increase in net loss) as well as other cost items as detailed below.

### **Research and Development**

The Corporation's research and development expenses consist primarily of fees paid to external service providers. We expect our research and development expenses to increase significantly over the next few years as clinical trials progress for our products and we continue to advance other research and development programs. As a result of the risks and uncertainties that are discussed in the "Risk and Uncertainties" section, we are unable to estimate the specific timing and future costs of our research and development programs.

The Corporation has contracts with several research organizations in Canada, the United States of America and in Europe to further develop stem cell related therapies. For the nine months ended September 30, 2006, the total research and development charge was \$1,778,190 (\$693,630 for the three month period ended September 30, 2006) compared to \$577,047 for the nine month period ended September 30, 2005 (\$346,152 for the three month period ended September 30, 2005). The increase between the two periods is mainly a function of the increased research and development activities of the Corporation, most notably the initiation of the Phase IIa clinical safety trial with NTx™-265. The following analysis details costs for the two periods:

|                                   | Three Month<br>Period Ended<br>September 30,<br>2006<br>\$ | Three<br>Month<br>Period<br>Ended<br>September<br>30, 2005<br>\$ | Nine<br>Month<br>Period<br>Ended<br>September<br>30, 2006<br>\$ | Nine<br>Month<br>Period<br>Ended<br>September<br>30, 2005<br>\$ | Cumulative<br>from Inception<br>on March 31,<br>2004 to<br>September 30,<br>2006<br>\$ |
|-----------------------------------|--|--|---|---|--|
| Clinical development              | 85,780   | -  | 407,101   | -   | 621,684  |
| Preclinical development           | 119,561  | 205,907  | 416,930   | 281,923   | 814,871  |
| Research                          | 43,187   | 78,174   | 186,000   | 127,174   | 535,174  |
| Salaries and bonuses              | 49,930   | 38,071   | 158,065   | 96,213  | 369,276  |
| Consulting fees                   | 61,256   | 24,000   | 206,924   | 71,737  | 283,123  |
| Other costs <sup>(1)</sup>        | 333,916  | 0  | 403,170   | -   | 401,504  |
| Research and development<br>costs | 693,630  | 346,152  | 1,778,190   | 577,047   | 3,025,632  |

(1) Other costs includes payment related to the cross licensing agreement with Stem Cells Inc.

Regarding NTx<sup>TM</sup>-265, our lead product candidate, a Phase IIa clinical safety study with NTx<sup>TM</sup>-265 in stroke patients was initiated at the end of April, 2006. Currently, this study is actively screening and enrolling eligible patients. It is expected that this study will be complete in mid-2007.

We currently estimate that cumulative (since inception of the Corporation) research and development expenditures will increase to \$3.4 million by the end of 2006, reflecting a \$0.3 million increase from previous estimates, due to a cash payment to Stem Cells Inc. for the cross-license agreement dated August 29<sup>th</sup>, 2006.

### Professional Fees

Professional fees reflect charges for intellectual property development (i.e. patents), general corporate legal fees with regards to ongoing corporate matters, as well as accounting and audit services. Professional fees for the nine months ended September 30, 2006 amounted to \$269,928 (\$138,308 for the 3 month period ended September 30, 2006) compared to \$272,122 for the nine months ended September 30, 2005 (\$42,695 for the 3 month period ended September 30, 2005). Total costs remained virtually unchanged for the two nine month periods.

### Management and Consulting Fees

Management and consulting fees for the nine months ended September 30, 2006 totaled \$257,619 (\$79,720 for the 3 month period ended September 30, 2006) compared to \$194,936 for the nine months ended September 30, 2005 (\$60,458 for the 3 month period ended September 30, 2005). The increase is mainly due to an increase in management compensation between the two periods.

### General and Administration (G&A)

G&A expenses for the nine months ended September 30, 2006 was \$743,557 (\$199,427 for the 3 month period ended September 30, 2006) compared to \$562,962 for the nine months ended September 30, 2005 (\$185,713 for the 3 month period ended September 30, 2005) representing a

total increase of \$180,595 for the nine month period. This increase is mainly due to an increase in the number of administrative staff and salary increases, additional printing costs mainly as a result of printing the annual report for 2005, and an increase in lease charges for the office space.

### **Stock options**

Stock option expense for the nine month period ended September 30, 2006 amounted to \$237,867 (\$66,252 for the 3 month period ended September 30, 2006) compared to \$245,241 for the nine month period ended September 30, 2005 (\$112,099 for the 3 month period ended September 30, 2005). The increase in the total for the nine month period is mainly a result of stock options granted to new directors of the Corporation during 2006 which vested at the grant date as well as other stock options granted after September, 2005 for which costs are spread into 2006.

### **Intellectual Property**

The value of the intellectual property purchased from Transition Therapeutics Inc. on October 4, 2004 was recorded based on the present value of the purchase price amortized over a 10 year period at 15% as an intellectual property asset. The current and long term portions of the corresponding purchase liability as well as the deemed interest expense were recorded appropriately at the end of September 30, 2006.

Change in net intellectual property balance from the December 31, 2005 balance is limited to the effect of amortization calculated for the first, second and third quarters of 2006.

SCT had its second and third patents issued in the second quarter of 2006. The second patent (US patent 7,033,995) covers the production of radial glial cells in the brain of a patient suffering from a central nervous system (CNS) disease and has the potential to be a fundamental technology in the field, key to the successful development of neural stem cell based approaches for the treatment of many CNS diseases. The third patent (US patent 7,048,934) protects novel methods of treating patients suffering from a variety of CNS disorders including through the combined regulation method of neural cell production.

The Corporation continues to file patents on all new intellectual property that is developed under the research contract with an Alberta-based university as well as that developed through our contracts with independent contract research organizations.

### **Amortization**

Amortization of property and equipment over the nine months ended September 30, 2006 was \$32,536 (\$11,095 for the 3 month period ended September 30, 2006) compared to \$21,304 for the nine month period ended September 30, 2005 (\$9,047 for the 3 month period ended September 30, 2005). This increase was primarily due to new assets added and amortized over the period. All amortization was calculated on a straight line basis over the estimated useful lives of the assets.

Intellectual property assets, such as the intellectual property purchased via the Stem Cell Therapeutics Inc. agreement are amortized over a 10 year period using a straight line basis. The amortization charge related to intellectual property amounted to \$182,342 for the nine months ended September 30, 2006 (\$60,786 for the 3 month period ended September 30, 2006).

## Revenue

As an early development stage company developing biotechnology related products for the treatment of disease, we have not generated any revenues from product sales to date and do not expect to do so for a number of years. This is primarily due to the long time line that is required to develop drugs that are proven in a clinical setting in humans to be safe and useful for treating a particular disease state. Revenues to date include only interest income generated on our cash balances. For the nine months ended September 30, 2006, interest income accrued and received amounted to \$75,900 (\$25,866 for the 3 month period ended September 30, 2006) compared to \$106,086 for the nine months ended September 30, 2005 (\$34,247 for the 3 month period ended September 30, 2005). The decrease is due to lower cash balances invested in interest bearing accounts or guaranteed investment certificates.

## Summary of Quarterly Results

The following table is a summary of selected quarterly financial information (in dollars) of the Corporation for each of the 8 most recently completed quarters.

|   | <u>As at, and for the three months ended</u> |             |              |                 |                  |             |              |                 |
|---|--|-------------|--------------|-----------------|------------------|-------------|--------------|-----------------|
|   | <u>2006</u>                                  |             |              | <u>2005</u>     |                  |             |              | <u>2004</u>     |
|   | <u>September</u>                             | <u>June</u> | <u>March</u> | <u>December</u> | <u>September</u> | <u>June</u> | <u>March</u> | <u>December</u> |
| Revenue(1)                              | 25,866                                       | 21,303      | 28,732       | 29,990          | 34,247           | 35,917      | 35,922       | 1,889           |
| Net loss                                | 1,298,475                                    | 1,167,304   | 1,178,614    | 1,083,608       | 865,011          | 725,848     | 595,685      | 681,500         |
| Basic and diluted loss per common share | 0.02   | 0.02        | 0.02         | 0.02            | 0.02             | 0.01        | 0.01         | 0.01            |
| Total assets                            | 4,061,031                                    | 5,766,306   | 6,934,528    | 7,929,121       | 8,473,903        | 9,511,232   | 10,081,738   | 2,972,645       |
| Cash balance                            | 1,600,612                                    | 3,045,722   | 4,623,813    | 5,551,187       | 6,084,348        | 7,061,821   | 7,599,790    | 422,899         |
| Total long-term debt(2)                 | 1,438,535                                    | 1,818,391   | 1,820,175    | 1,821,914       | 1,824,110        | 1,937,903   | 1,925,876    | 1,926,564       |

(1) Interest income on cash balances

(2) Includes capital lease obligations and obligation under share purchase agreement

(3) The Corporation has not declared or paid any dividends since incorporation.

The quarterly results of the Corporation reflect the increase in net losses and decrease in cash balances between the periods as the company continues its preclinical and clinical development activities and incur administrative costs to sustain activities.

## Liquidity and Capital Resources

The Corporation's primary capital needs are for funds to support our scientific research and development activities including pre-clinical and clinical trials and for working capital.

As of September 30, 2006 the working capital (current assets minus current liabilities) for the Corporation was \$1,337,009 (\$4,868,735 as of December 31, 2005). This working capital position reflects full payment of the Phase IIa clinical safety trial, as represented in the prepaid

balance of the Corporation's financial statements. The continuation of the company is dependent upon the Corporation's ability to finance its cash requirements, which will allow it to continue its research and development activity and the commercialization of its stem cell related technologies. The Corporation currently believes that it has adequate financial resources for anticipated expenditures until end of 1Q07 (please see Note 1, 3Q06 Financial Statements). This has been reduced from previous estimates due to cash payments made to Transition Therapeutics Inc., as well as Stem Cells Inc. Management is undertaking a cash preservation strategy in order to extend the cash resources of the Corporation beyond 1Q07. However, there is doubt as to the Corporation's ability to continue operations on a long term basis. Additionally, the Corporation is actively seeking additional financing but there is no certainty that management will be successful in this regard.

The Corporation's specific commitments include the lease for its office space which covers a three year period effective from January 1, 2006. Annual costs under this contract are limited to an annual rent charge of \$38,780 and annual operating costs estimated to be \$34,154, with a total expected cost of \$164,102 over the remainder of the contract life. Also, expected charges for the remainder of 2006 under a research contract with an Alberta-based university amount \$42,000.

Outstanding shares as of September 30, 2006 totaled 53,801,364 Common shares and 6,360,000 Class B shares. Outstanding shares as of November 29, 2006 are 53,801,364 Common and 6,360,000 Class B shares. Outstanding and exercisable options as at September 30, 2006 total 4,800,000 and 2,627,778 respectively.

### **Financing Activities**

As of November 29, 2006 the gross proceeds raised since inception by the Corporation totaled \$10,097,510.

At the time of our Initial Public Offering we expected that approximately \$4.7 million of the proceeds would be used over 2005 and 2006 for research and development focusing on our lead product and out of the remaining \$1.8 million to \$2.8 million will be used for general and administrative expenses including working capital and possible acquisitions of additional technology. Up to September 30, 2006 cumulative (since inception of the Company) research and development costs totaled \$3,025,632 not including payments associated with the acquisition of Stem Cell Therapeutics Inc. amounting \$1,200,000 to-date. We currently estimate that cumulative research and development expenditures will increase to \$3.4 million by the end of 2006, reflecting a \$0.3 million increase from previous estimates.

The Corporation's ability to continue operations in the long term is contingent upon its ability to obtain additional sources of funding to finance future operations. The Corporation is actively seeking additional financing but there is no certainty that management will be successful in this regard.

### **Investing Activities**

The Corporation has invested capital into intellectual property development and patent filing activities and basic corporate office infrastructure. Cash is currently in interest bearing Guaranteed Investment Certificates, interest-bearing and non interest-bearing bank accounts.

## **Risks and Uncertainties**

Prospects for companies in the biotechnology industry may generally be regarded as uncertain given the nature of the industry. Accordingly, investments in biotechnology companies should be regarded as highly speculative. The realization of our long-term potential will be dependent upon the successful development and commercialization of products and product candidates currently under development. We can make no assurance that these products and product candidates will be developed or that they will receive regulatory approval. Our new products and product candidates are currently in the research and development stages, the highest risk stages for a company in the biotechnology industry.

We can make no assurance that our research and development programs will result in commercially viable products and product candidates. To achieve profitable operations, we, alone or with others, must successfully develop, launch and market our products and product candidates. To obtain regulatory approvals for the products and product candidates being developed and to achieve commercial success, clinical trials must demonstrate that the products and product candidates are safe for human and/or animal use and that they demonstrate efficacy. Unsatisfactory results obtained from a particular study relating to a research and development program may cause the Corporation or its collaborators to abandon their commitments to that program. We can make no assurance that any future tests, if undertaken, will yield favorable results.

The Corporation has several patent filings in progress that have been filed, as well as others acquired from Stem Cell Therapeutics Inc., including three patents that have been issued. The Corporation's success is dependent upon its ability to obtain these patents; however, there is no guarantee that they will be obtained, and, if obtained, the Corporation may not be able to successfully defend any subsequent infringements to these patents. The Corporation is currently unaware that it has infringed any existing patents issued to third parties and the Corporation's success will, in part, depend on operating without such infringement. The presence of such patents could severely limit the Corporation's ability to conduct its existing research and/or require financial resources to defend litigation, which may be in excess of the Corporation's ability to raise such funds. Additionally, the Corporation relies on trade secrets, know-how and other proprietary information as well as requiring its employees, consultants, advisors and collaborators to sign confidentiality agreements.

The Corporation's ability to continue operations in the long term is contingent upon its ability to obtain additional sources of funding to finance future operations. The Corporation is actively seeking additional financing but there is no certainty that management will be successful in this regard. As such, there is doubt as to the Corporation's ability to continue operations on a long term basis.