

HEPALIFE TECHNOLOGIES INC  
Form 10-Q  
August 14, 2008

---

**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For quarterly period ended **June 30, 2008**

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**000-29819**

(Commission File Number)

**HEPALIFE TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

**Florida**

(State or other jurisdiction of incorporation)

**58-2349413**

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

**60 State Street, Suite 700, Boston, MA 02109**

(Address of principal executive offices)

**(800) 518-4879**

(Registrant's telephone number, including area code)

---

Indicate by check mark whether the registrant (1) has filed all reports required 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 is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.

Large Accelerated Filer	<input type="checkbox"/>
Accelerated Filer	<input type="checkbox"/>
Non-accelerated Filer	<input type="checkbox"/>
Smaller Reporting Company	<input checked="" type="checkbox"/>

# Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

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: 91,596,829 shares of Common Stock, par value \$0.001, were outstanding on August 11, 2008.

---

## TABLE OF CONTENTS

### HEPALIFE TECHNOLOGIES, INC.

### FORM 10-Q, QUARTER ENDED JUNE 30, 2008

#### PART I FINANCIAL INFORMATION

Item 1. Financial Statements	
Interim Unaudited Consolidated Balance Sheets	3
Interim Unaudited Consolidated Statements of Operations	4
Interim Unaudited Consolidated Statement of Stockholders' Equity (Deficiency)	5
Interim Unaudited Consolidated Statements of Cash Flows	8
Notes to Interim Consolidated Financial Statements	9
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3. Quantitative and Qualitative Disclosures About Market Risk	22
Item 4. Controls and Procedures	22

#### PART II OTHER INFORMATION

Item 1. Legal Proceedings	24
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	24
Item 3. Defaults Upon Senior Securities	24
Item 4. Submission of Matters to a Vote of Security Holders	24
Item 5. Other Information	24
Item 6. Exhibits and Reports on Form 8-K	24
Signatures	25

---

#### Item 1. Financial Statements

#### HEPALIFE TECHNOLOGIES, INC.

(A Development Stage Company)

#### CONSOLIDATED BALANCE SHEETS

June 30, 2008 and December 31, 2007  
(Unaudited)

(Expressed in U.S. Dollars)	June 30, 2008	December 31, 2007
<b>ASSETS</b>		
<b>Current assets</b>		
Cash	\$ 4,064,454	\$ 534,113
Prepaid expenses and other receivables	6,895	4,338
<b>Total current assets</b>	<b>4,071,349</b>	<b>538,451</b>
<b>Equipment, net (Note 7)</b>	<b>5,667</b>	<b>10,882</b>
<b>Licence fee (Note 6)</b>	<b>75,000</b>	<b>75,000</b>
<b>Deferred financing costs (Note 9)</b>	<b>-</b>	<b>210,728</b>

Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

<b>Total assets</b>	\$ 4,152,016	\$ 835,061
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 42,263	\$ 4,800
Accounts payable - related parties (Note 4)	-	208,330
Notes payable - related party (Note 4)	-	877,800
<b>Total current liabilities</b>	42,263	1,090,930
<b>Convertible promissory note, at face value (Note 9)</b>	-	755,000
Discount on convertible promissory notes (Note 9)	-	(468,343)
	-	286,657
<b>Total liabilities</b>	42,263	1,377,587
<b>Commitments and Contingencies (Note 5, 6)</b>		
<b>STOCKHOLDERS' EQUITY (DEFICIENCY)</b>		
<b>Stockholders' Equity (Deficiency)</b>		
Preferred stock: \$0.10 par value; Authorized: 1,000,000		
Issued and outstanding: none	-	-
Common stock: \$0.001 par value; Authorized: 300,000,000		
Issued and outstanding: 91,596,829 (2007: 76,264,584)	91,598	76,265
Additional paid-in capital	21,600,658	15,039,050
Accumulated other comprehensive income (loss)	453	(3,772)
Loss accumulated during the development stage	(17,582,956)	(15,654,069)
<b>Total stockholders' equity (deficiency)</b>	4,109,753	(542,526)
<b>Total liabilities and stockholders' equity</b>	\$ 4,152,016	\$ 835,061

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

**HEPALIFE TECHNOLOGIES, INC.**  
(A Development Stage Company)

**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the three months and six months ended June 30, 2008 and 2007**  
**and from inception (October 21, 1997) to June 30, 2008**

	Three months ended June 30,		Six months ended June 30,		From inception (October 21, 1997)
(Expressed in U.S. Dollars)	2008	2007	2008	2007	to June 30, 2008
<b>Revenue</b>	\$ -	\$ -	\$ -	\$ -	\$ -

# Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

## Expenses

Administrative and general	32,387	60,381	71,369	102,515	712,717
Depreciation	2,607	4,090	5,214	7,901	32,803
Professional fees- accounting and legal	66,260	65,762	88,805	75,465	596,326
Management and consulting fees (Note 4)	750	11,355	1,500	23,442	1,003,837
Research and development (Notes 5 and 6)	81,742	34,969	209,205	64,590	1,230,493
Salary and benefits	310,667	314,882	642,750	908,079	5,119,720
Shareholder and investor relations	166,170	201,976	169,470	211,381	3,953,859
Stock offering costs	-	-	-	-	1,926,713
Transfer agent and filing	590	4,008	1,245	4,468	17,262
Travel	12,324	21,532	20,936	38,177	314,535
	673,497	718,955	1,210,494	1,436,018	14,908,265

**Operating Loss** (673,497) (718,955) (1,210,494) (1,436,018) (14,908,265)

## Other income (expense)

Interest on promissory note	(18,685)	(21,649)	(41,615)	(42,818)	(355,112)
Interest, bank charges and foreign exchange loss	4	(2,851)	(9,173)	(5,143)	(33,719)
Interest income	8,569	12,685	11,466	14,229	100,754
Amortization of discount on issuance of convertible promissory notes (Note 9)	-	(62,793)	(468,343)	(62,793)	(2,093,099)
Amortization of deferred financing costs (Note 9)	-	(8,805)	(210,728)	(8,805)	(293,515)
	(10,112)	(83,413)	(718,393)	(105,330)	(2,674,691)

**Net loss available to common shareholders** \$ (683,609) \$ (802,368) \$ (1,928,887) \$ (1,541,348) \$ (17,582,956)

**Loss per share - basic and diluted** \$ (0.01) \$ (0.01) \$ (0.02) \$ (0.02)

## Weighted average number of common shares

**outstanding - basic and diluted** 81,604,652 73,563,727 79,974,458 73,225,292

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

## HEPALIFE TECHNOLOGIES, INC.

(A Development Stage Company)

## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIENCY)

From inception (October 31, 1997) to June 30, 2008

	Common Stock		Additional	Accumulated	Loss accumulated	Comprehensive	Total
(Expressed in U.S. Dollars)	Shares	Amount	paid-in capital	other comprehensive income	during development stage	income (loss)	stockholders' equity (deficiency)
Common stock issued for service rendered at \$0.00025 per share, October 21, 1997	12,000,000	\$ 12,000	\$ (9,000)		\$ -	\$ -	\$ -
Common stock issued for cash at \$0.0625 per share during 1997	1,200,000	1,200	73,800		-	-	
Comprehensive income							
Income from inception							

# Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

(October 21, 1997) to December 31, 1997	-	-	-	-	42	42	42
Total comprehensive income						42	
Balance, December 31, 1997	13,200,000	13,200	64,800	-	42		78,042
Common stock issued for service rendered at \$0.025 per share, December 15, 1998	16,000,000	16,000	384,000		-		400,000
Comprehensive income (loss)							
Loss, year ended December 31, 1998	-	-	-		(471,988)	(471,988)	(471,988)
Total comprehensive income						(471,988)	
Balance, December 31, 1998	29,200,000	29,200	448,800	-	(471,946)		6,054
Common stock issued for cash at \$0.025 per share, March 1999	12,000,000	12,000	288,000		-		300,000
Comprehensive income (loss)							
Loss, year ended December 31, 1999	-	-	-		(121,045)	(121,045)	(121,045)
Total comprehensive income						(121,045)	
Balance, December 31, 1999	41,200,000	41,200	736,800	-	(592,991)		185,009
Comprehensive income (loss)							
Loss, year ended December 31, 2000	-	-	-		(80,608)	(80,608)	(80,608)
Total comprehensive income						(80,608)	
Balance, December 31, 2000	41,200,000	41,200	736,800		(673,599)		104,401
Conversion of debt to equity at \$0.015 per share, July 31, 2001	8,933,332	8,933	125,067		-		134,000
Comprehensive income (loss)							
Loss, year ended December 31, 2001	-	-	-		(160,364)	(160,364)	(160,364)
Total comprehensive income						(160,364)	
Balance, December 31, 2001	50,133,332	50,133	861,867	-	(833,963)		78,037
Common stock issued for services at \$0.06 per share, April 23, 2002	10,000	10	590		-		600
Conversion of debt to equity at \$0.05 per share, April 26, 2002	2,160,000	2,160	105,840		-		108,000
Common stock issued for investor relations services at \$0.05 per share, July 25, 2002	2,390,000	2,390	117,110		-		119,500
Conversion of debt to equity at \$0.05 per share, December 18, 2002	1,920,000	1,920	94,080		-		96,000
Comprehensive income (loss)							
Loss, year ended December 31, 2002	-	-	-		(375,472)	(375,472)	(375,472)

5

---

Total comprehensive income					(375,472)	
Balance, December 31, 2002	56,613,332	56,613	1,179,487	- (1,209,435)		26,665
Common stock issued pursuant to exercise of stock options during the year at between \$0.07 to \$2.11 per share	282,500	283	398,317	-		398,600
Common stock issued pursuant to exercise of share purchase warrants in November 2003 at \$0.025 per share	7,300,000	7,300	175,200	-		182,500

# Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

Comprehensive income (loss)						
Loss, year ended December 31, 2003	-	-	-	(1,102,723)	(1,102,723)	(1,102,723)
Total comprehensive income					(1,102,723)	
Balance, December 31, 2003	64,195,832	64,196	1,753,004	- (2,312,158)		(494,958)
Common stock issued pursuant to exercise of stock options during the year between \$0.07 to \$2.11 per share	1,622,000	1,622	1,339,998	-		1,341,620
Common stock issued pursuant to exercise of share purchase warrants in December 2004 at \$0.025 per share	2,000,000	2,000	48,000	-		50,000
Comprehensive income (loss)						
Loss, year ended December 31, 2004	-	-	-	(1,435,613)	(1,435,613)	(1,435,613)
Total comprehensive income					(1,435,613)	
Balance, December 31, 2004	67,817,832	67,818	3,141,002	- (3,747,771)		(538,951)
Common stock issued pursuant to exercise of stock options in March 2005 at \$3.10 per share	50,000	50	154,950	-		155,000
Common stock issued pursuant to exercise of stock options in May 2005 at \$2.11 per share	45,000	45	94,905	-		94,950
Common stock issued pursuant to exercise of stock options in June 2005 at \$2.11 per share	100,000	100	210,900	-		211,000
Common stock issued pursuant to exercise of stock options in October 2005 at \$2.11 per share	40,000	40	84,360	-		84,400
Common stock issued pursuant to exercise of stock options in March 2005 at \$2.11 per share	50,000	50	105,450	-		105,500
Common stock issued pursuant to exercise of share purchase warrants in March 2005 at \$0.025 per share	1,250,000	1,250	30,000	-		31,250
Restricted common stock issued in June 2005 pursuant to share purchase agreement	20,000	20	37,580	-		37,600
Restricted common stock issued in July 2005						

# Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

pursuant to share purchase agreement	691,598	692	1,382,504	-		1,383,196
Comprehensive income (loss)						
Loss, year ended December 31, 2005				(2,813,602)	(2,813,602)	(2,813,602)

## 6

Total comprehensive income					(2,813,602)	
Balance, December 31, 2005	70,064,430	70,065	5,241,651	-	(6,561,373)	(1,249,657)
Restricted common stock issued in January 2006 pursuant to share purchase agreement	374,753	375	505,542	-	-	505,917
Common stock issued in the first quarter of 2006 to Fusion Capital for cash	431,381	431	449,569	-	-	450,000
Common stock issued in the second quarter of 2006 to Fusion Capital for cash	416,303	416	329,584	-	-	330,000
Common stock issued in the third quarter of 2006 to Fusion Capital for cash	758,606	759	584,234	-	-	584,993
Common stock issued in the fourth quarter of 2006 to Fusion Capital for cash	548,371	548	354,455	-	-	355,003
Exercise of stock options	175,000	175	12,075	-	-	12,250
Stock based compensation expenses	-	-	2,607,302	-	-	2,607,302
Comprehensive income (loss)						
Loss, year ended December 31, 2006				(4,654,499)	(4,654,499)	(4,654,499)
Total comprehensive income					(4,654,499)	
Balance, December 31, 2006	72,768,844	72,769	10,084,412	-	(11,215,872)	(1,058,691)
Common stock issued in the first quarter of 2007 to Fusion Capital for cash	382,000	382	204,619			205,001
Common stock issued in the second quarter of 2007 to Fusion Capital for cash	509,019	509	289,491			290,000
Common stock converted from convertible promissory notes during August - December 2007	2,604,721	2,605	1,742,395			1,745,000
Stock based compensation expenses			935,044			935,044
Proceeds allocated to the warrants issued with the convertible notes			497,689			497,689
Warrants issued for the payment of broker's fees			64,990			64,990
Intrinsic value of the beneficial conversion feature of the notes			1,220,410			1,220,410
Comprehensive income (loss)						
Foreign currency translation adjustment				(3,772)	(3,772)	(3,772)
Loss, year ended December 31, 2007				(4,438,197)	(4,438,197)	(4,438,197)
Total comprehensive income					(4,441,969)	
Balance, December 31, 2007	76,264,584	76,265	15,039,050	(3,772)	(15,654,069)	(542,526)
Common stock issued for convertible promissory notes during January 2008	2,342,415	2,343	752,657			755,000
Common stock and warrants issued for related party notes	2,065,412	2,065	975,680			977,745
Common stock and warrants issued for cash and placement fees at \$0.425 per share in May 2008	10,924,418	10,925	4,519,875			4,530,800
Stock based compensation expenses			313,396			313,396
Comprehensive income (loss)						

# Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

Foreign currency translation adjustment				4,225		4,225	4,225
Loss, six months ended June 30, 2008					(1,928,887)	(1,928,887)	(1,928,887)
Total comprehensive income (loss)						\$ (1,924,662)	
Balance, June 30, 2008	91,596,829 \$	91,598 \$	21,600,658 \$	453 \$	(17,582,956)		\$ 4,109,753

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

7

## HEPALIFE TECHNOLOGIES, INC. (A Development Stage Company)

### CONSOLIDATED STATEMENTS OF CASH FLOWS For the six months ended June 30, 2008 and 2007 and from inception (October 21, 1997) to June 30, 2008

(Expressed in U.S. Dollars)	June 30, 2008	June 30, 2007	From inception (October 21, 1997) to June 30, 2008
<b>Cash flows from operating activities</b>			
Net Loss	\$ (1,928,887)	\$ (1,541,348)	\$ (17,582,956)
Adjustments to reconcile net loss to net cash from operating activities:			
Depreciation	5,214	7,901	32,803
Common stock issued for services	-	-	861,100
Common stock issued as stock offering costs	-	-	1,926,713
Stock based compensation expenses	313,396	641,365	3,855,742
Interest payable written off	(99,945)	-	(99,945)
Amortization of discount on issuance of convertible promissory notes	468,343	62,793	2,093,099
Amortization of deferred financing costs	210,728	8,805	293,515
Change in assets and liabilities:			
Decrease (Increase) in prepaid expenses	(2,557)	1,471	(6,895)
Increase (Decrease) in accounts payable	37,464	(62,407)	42,264
Increase (Decrease) in accounts payable - related party	(108,385)	12,182	99,945
Net cash used in operating activities	(1,104,629)	(869,238)	(8,484,615)
<b>Cash flows from investing activities</b>			
Purchase of property and equipment	-	(3,878)	(38,471)
Increase in licence fees	-	-	(75,000)
Net cash used in investing activities	-	(3,878)	(113,471)
<b>Cash flows from financing activities</b>			
Proceeds from issuance of common stock and warrants	4,530,800	495,001	9,787,867
Proceeds from issuance of convertible notes	-	2,125,000	2,125,000
Repayment of promissory notes	-	(132,200)	877,800
Cash paid for finders fee	-	(228,525)	(228,525)
Net cash provided by financing activities	4,530,800	2,259,276	12,562,142
<b>Increase in cash and cash equivalents</b>	3,426,171	1,386,160	3,964,056



## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

Effect of foreign exchange rate	4,225	(3)	453
<b>Cash and cash equivalents</b> , beginning of period	534,113	252,887	-
<b>Cash and cash equivalents</b> , end of period	\$ 3,964,509	\$ 1,639,044	\$ 3,964,509

### Supplemental disclosure of cash flow information:

Interest paid in cash	\$ 150,000	\$ 25,930	\$ 247,575
Income tax paid in cash	\$ -	\$ -	\$ -

### Non-cash Investing and Financing Activities:

Common stock and warrants issued for private placement fees	\$ 112,078	\$ -	\$ 973,078
Issuance of common stock as stock offering costs	\$ -	\$ -	\$ 1,926,713
Issuance of warrants for deferred financing costs	\$ -	\$ 64,990	\$ 64,990
Conversion of related party note payable and interest to equity	\$ 977,745	\$ -	\$ 977,745
Conversion of debt to equity	\$ 755,000	\$ -	\$ 2,500,000

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

8

## HEPALIFE TECHNOLOGIES, INC. AND SUBSIDIARIES

(A Development Stage Company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2008 (Expressed in US Dollars)**

### NOTE 1 - BASIS OF PRESENTATION - GOING CONCERN UNCERTAINTIES

HepaLife Technologies, Inc. (the Company) was incorporated in the State of Florida on October 21, 1997, with an authorized capital of 100,000,000 shares of common stock, par value of \$0.001 per share, and 1,000,000 shares of \$0.10 par value preferred stock, which may be divided into series with the rights and preferences of the preferred stock to be determined by the Board of Directors. On August 10, 2001, Articles of Amendment to the Articles of Incorporation were filed to increase the authorized capital stock of the Company to 300,000,000 shares of \$0.001 par value common stock.

The Company is a development stage biotechnology company focused on the identification, development and eventual commercialization of cell-based technologies and products.

The Company has incurred net operating losses since inception. The Company faces all the risks common to companies in their early stages of development, including under capitalization and uncertainty of funding sources, high initial expenditure levels, uncertain revenue streams, and difficulties in managing growth. The Company's recurring losses raise substantial doubt about its ability to continue as a going concern and may cause it to cease operations. The Company's financial statements do not reflect any adjustments that might result from the outcome of this uncertainty. The Company expects to incur losses from its business operations and will require additional funding during 2008. The future of the Company hereafter will depend in large part on the Company's ability to successfully raise capital from external sources to pay for planned expenditures and to fund operations.

To meet these objectives, the Company issued common stock and warrants for net proceeds of \$4,530,800 on May 23, 2008 (Note 9). Management believes that its current and future plans enable it to continue operations through June 30, 2009. These financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying financial statements.

### Principles of Consolidation

## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

The accompanying consolidated financial statements have been prepared on the accrual basis in accordance with accounting principles generally accepted in the United States, and include the accounts of HepaLife Technologies, Inc. and its subsidiaries, Phoenix BioSystems, Inc., HepaLife Technologies Ltd. and HepaLife Biosystems Inc.. Phoenix BioSystems, Inc. was incorporated under the laws of the State of Nevada on June 6, 2006. HepaLife Technologies Ltd. was incorporated on April 11, 2007 in British Columbia, Canada, for the purpose of streamlining business operations in Canada. HepaLife Biosystems Inc., was incorporated in State of Nevada on April 17, 2007 for the purpose of categorizing operations and accounting associated with the Company's ongoing research and development efforts associated with its patented PICM-19 cell line, artificial liver technologies, and in vitro toxicology testing systems. All significant inter-company transactions and accounts have been eliminated in consolidation.

### NOTE 2 STATEMENT OF INFORMATION FURNISHED AND ACCOUNTING POLICIES

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with Form 10-Q instructions and in the opinion of management contains all adjustments (which are of a normal recurring nature) necessary to present fairly the financial position as of June 30, 2008 and December 31, 2007, and the results of operations for three and six months ended June 30, 2008 and 2007 and cash flows for the six months ended June 30, 2008 and 2007. These results have been determined on the basis of generally accepted accounting principles and practices in the United States and applied consistently with those used in the preparation of the Company's 2007 Annual Report on Form 10-K.

9

---

#### Recent Accounting Pronouncements

In December 2007, the FASB ratified EITF No. 07-1, *Accounting for Collaborative Arrangements*, that discusses how parties to a collaborative arrangement (which does not establish a legal entity within such arrangement) should account for various activities. The consensus indicates that costs incurred and revenues generated from transactions with third parties (i.e. parties outside of the collaborative arrangement) should be reported by the collaborators on the respective line items in their income statements pursuant to EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*. Additionally, the consensus provides that income statement characterization of payments between the participants in a collaborative arrangement should be based upon existing authoritative pronouncements; analogy to such pronouncements if not within their scope; or a reasonable, rational, and consistently applied accounting policy election. EITF Issue No. 07-1 is effective for financial statements beginning after December 15, 2008 and is to be applied retrospectively to all periods presented for collaborative arrangements existing as of the date of adoption. The Company is evaluating the impact, if any, the adoption of this consensus will have on the results of operations, financial position or cash flows.

In December 2007, the FASB issued SFAS No. 141 (R), *Business Combinations*, and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. SFAS No. 141 (R) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. SFAS No. 141 (R) and SFAS No. 160 are effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. The Company has not yet determined the effect on the consolidated financial statements, if any, upon adoption of SFAS No. 141 (R) or SFAS No. 160.

In May 2008, the FASB issued Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. This Statement identifies the sources for generally accepted accounting principles (GAAP) in the U.S. and lists the categories in descending order. An entity should follow the highest category of GAAP applicable for each of its accounting transactions. The adoption will not have a material effect on the Company's consolidated financial statements.

In May 2008, the FASB issued FASB Staff Position (FSP) No. APB 14-1 *Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlements)* (previously FSP APB 14-a), which will change the accounting treatment for convertible securities which the issuer may settle fully or partially in cash. Under the final FSP, cash settled convertible securities will be separated into their debt and equity components. The value assigned to the debt component will be the estimated fair value, as of the issuance date, of a similar debt instrument without the conversion feature, and the difference between the proceeds for the convertible debt and the amount reflected as a debt liability will be recorded as additional paid-in capital. As a result, the debt will be recorded at a discount reflecting its below market coupon interest rate. The debt will subsequently be accreted to its par value over its expected life, with the rate of interest that reflects the market rate at issuance being reflected on the income statement. This change in methodology will affect the calculations of net income and earnings per share for many issuers of cash settled convertible securities. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of FSP No. APB 14-1 on the Company's consolidated financial statements.

Research and Development

Research and development costs are expensed as incurred.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management makes its best estimate of the ultimate outcome for these items based on historical trends and other information available when the financial statements are prepared. Changes in estimates are recognized in accordance with the accounting rules for the estimate, which is typically in the period when new information becomes available to management. Actual results could differ from those estimates.

NOTE 3 - LOSS PER SHARE

Basic earnings or loss per share is based on the weighted average number of common shares outstanding. Diluted earnings or loss per share is based on the weighted average number of common shares outstanding and dilutive common stock equivalents. The computation of earnings (loss) per share is net loss available to common stockholders (numerator) divided by the weighted average number of common shares outstanding (denominator) during the periods presented. All earnings or loss per share amounts in the financial statements are basic earnings or loss per share, as defined by SFAS No. 128, Earnings Per Share. Diluted loss per share does not differ materially from basic loss per share for all periods presented. Convertible securities that could potentially dilute basic loss per share in the future are not included in the computation of diluted loss per share because to do so would be anti-dilutive. All per share and per share information are adjusted retroactively to reflect stock splits and changes in par value, when applicable.

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Numerator - net loss available to common stockholders	\$ (683,609)	\$ (802,368)	\$ (1,928,887)	\$ (1,541,348)
Denominator - weighted average number of common shares outstanding	81,604,652	73,563,727	79,974,458	73,225,292
Basic and diluted loss per common share	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.02)

NOTE 4 - RELATED PARTY TRANSACTIONS

Management Fees: During the three months and six months ended June 30, 2008, the Company paid management fees of \$750 (2007: \$nil) and \$1,500 (2007: \$3,465) to the directors respectively. There is no management or consulting agreement in effect nor is there an agreement in place to convert debt to equity.

On May 23, 2008, the Company reached an agreement with Mr. Rayat to which Mr. Rayat (i) converted the entire outstanding principal amount (\$877,800) of his loan (the "Loan") to the Company into an aggregate of 2,065,412 Units, each Unit consisting of one share of the Company's common stock and one Series C Warrant, at a conversion price of \$0.425 per Unit and (ii) agreed to accept \$150,000 in payment and satisfaction of the accrued and unpaid interest on the Loan in the amount of \$249,945. The securities issued to Mr. Rayat are restricted securities as that term is defined in Regulation D, as promulgated pursuant to the Securities Act of 1933, as amended.

Rent: The Company's administrative office is located at 1628 West 1st Avenue, Suite 216, Vancouver, British Columbia, Canada, V6J 1G1. These premises are owned by a private corporation controlled by a director and majority shareholder. The Company paid rent of \$9,644 (2007: \$8,190) and \$19,070 (2007: \$16,855) for the three months and six months ended June 30, 2008.

## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

Mr. Harmel S. Rayat is an officer, director and stockholder of the Company. He is also an officer, director and stockholder of each of PhytoMedical Technologies, Inc., Entheos Technologies, Inc., Octillion Corp., MicroChannel Technologies Corporation and International Energy, Inc.

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

### NOTE 5 - COOPERATIVE AGREEMENTS

#### (i) Cooperative Research and Development Agreement

On November 1, 2002, the Company entered into a Cooperative Research and Development Agreement (the "CRADA") with the United States Department of Agriculture ("USDA") Agricultural Research Service ("ARS"), and committed a total payment of \$292,727 to ARS over the two year period, ending February 19, 2005.

On May 24, 2004, the CRADA was extended to September 30, 2007 and later to December 1, 2007 and the required total payments to ARS were amended to \$807,828; of which the entire amount was paid as of December 31, 2007.

11

---

As amended, the Company, instead of ARS as in the original agreement, has the first option to prepare and prosecute patent or Plant Variety Protection Certificate applications, foreign and domestic, on subject invention owned or co-owned by the U.S Government, subject to certain conditions.

The CRADA is for the purpose of funding salaries, equipment, travel and other indirect costs of one post-doctoral researcher, one support scientist, and one technician. The terms of the agreement require the interaction of the Company with ARS personnel on the technical details involved with pig liver cell culture development, providing the necessary funds for the purpose above, preparing and filing any patent applications, and reviewing reports and implementing procedures for the development of an artificial liver device utilizing the pig liver cell line. ARS's responsibilities include hiring the postdoctoral research associate for a two-year period, providing laboratory and office space for the research associate, providing experimental animals (pigs) and slaughter facilities, conducting the research, preparing progress reports on project objectives, and preparing and submitting technical reports for publication.

All rights, title, and interest in any subject invention made solely by ARS employees are owned by ARS, solely by the Company are owned by the Company, and owned jointly between the Company and ARS if made jointly by ARS and the Company. The Company is granted an option to negotiate an exclusive license in each subject invention owned or co-owned by ARS for one or more field (s) of use encompassed by the CRADA. The option terminates when the Company fails to (1) submit a complete application for an exclusive license within sixty days of being notified by ARS of an invention availability for licensing or (2) submit a good faith written response to a written proposal of licensing terms within forty five days of such proposal.

The CRADA, or parts thereof, is subject to termination at any time by mutual consent. Either party may unilaterally terminate the entire CRADA at any time by giving the other party written notice not less than sixty calendar days prior to the desired termination date.

#### (ii) New Cooperative Research and Development Agreement

On November 20, 2007, HepaLife Technologies, Inc. entered into a new Cooperative Research and Development Agreement with the U.S. Department of Agriculture, Agricultural Research Service pertaining to the continued development and use of patented liver cell lines in artificial liver devices and in-vitro toxicological testing platforms, and committed a total payment of \$519,130 to USDA-ARS over the two year period, ending November 19, 2009.

As of June 30, 2008, total payments of \$338,272 have been paid.

### NOTE 6 - LICENSE AGREEMENT

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

## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

The license agreement gives the Company exclusive rights to five issued patents. Under the terms of the license agreement, the Company agreed to pay MSU an initial fee of \$1,000 (paid) upon execution of the license agreement. A 2.5% annual royalty based on future sales is payable, with an annual minimum payment of \$10,000 from 2010 to 2014 and \$20,000 from 2015 until the expiration of the last to expire of the patents, or until fifteen (15) years after the effective date of June 15, 2006, whichever is longer.

The Company also has to make milestone payments of \$1,000, \$2,000, \$2,000 and \$10,000 to MSU when MSU achieves each of the 4 different developmental steps, respectively.

As part of the license agreement, the Company issued 17,650 common shares or 15% of the total issued and outstanding shares of PBS, to Dr. Paul Coussens at par value on October 2, 2006. After issuance of the shares, the Company holds 85% of the total issued and outstanding shares of PBS. The Company recorded the fair value of the shares of PBS issued to Dr. Paul Coussens at a nominal value. As PBS had no assets or liabilities no value was allocated to the minority interest.

The termination date of the sponsored research agreement was July 14, 2007.

### 12

---

On February 2, 2008, the Company, through its subsidiary, Phoenix BioSystems, Inc., entered into an amendment of the above mentioned exclusive worldwide license agreement with Michigan State University for the development of new cell-culture based flu vaccines to protect against the spread of influenza viruses among humans, including potentially the high pathogenicity H5N1 virus.

As of June 30, 2008, total payment of \$73,352 has been paid in relation to the project, including the reimbursement of research expenses of \$68,353 to MSU.

On November 2, 2007, HepaLife Technologies, Inc. entered into an exclusive license agreement with the U.S. Department of Agriculture, Agricultural Research Service for the use of patented liver cell lines in bioartificial liver devices and in-vitro toxicological testing platforms.

#### NOTE 7 - EQUIPMENT

	June 30, 2008	December 31, 2007
Computer equipment	\$ 37,382	\$ 37,382
furniture and fixtures	1,089	1,089
	38,471	38,471
Less: accumulated depreciation	(32,804)	(27,589)
	\$ 5,667	\$ 10,882

Depreciation expenses charged to operations for the three months and six months ended June 30, 2008 were \$2,607 (2007: \$4,090) and \$5,214 (2007: \$7,901) respectively.

#### NOTE 8 - SHARE CAPITAL

##### Fusion Capital

Under the New Purchase Agreement with Fusion Capital Fund II ( Fusion Capital ) dated January 20, 2006, Fusion Capital had agreed to purchase from the Company up to \$15,000,000 of the Company's share of common stock over a thirty month period. On May 11, 2007, the Company and Fusion Capital mutually terminated the Common Stock Purchase Agreement. The Company did not incur any termination costs as a result of mutually terminating this agreement.

During the year ended December 31, 2007, Fusion Capital has purchased 891,019 shares of common stock of the Company for total proceeds of \$495,001.

##### Private Placement

## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

On May 23, 2008, the Company completed a private placement (the "Private Placement") of 10,660,705 units (the "Units") at a price of \$0.425 per Unit or \$4,530,800 in the aggregate. Each Unit consisted of one share (collectively, the "Unit Shares") of the Company's common stock and one Series C Stock Purchase Warrant to purchase a share of common stock at \$0.55 per share for a period of two years from the date of issuance (the "Series C Warrants"). In connection with the Private Placement the Company agreed to file a registration statement for the purpose of registering the Unit Shares and the shares issuable upon the exercise of the Series C Warrants, for resale by the Investors.

The Units were offered and sold to 12 accredited investors (the "Investors") as defined in Regulation D as promulgated under the Securities Act of 1933, as amended.

Pursuant to the Subscription Agreement and the Registration Rights Agreement, the Company and the investor parties have made other covenants and representations and warranties regarding matters that are customarily included in financings of this nature. In the event that during the twelve month period following the Closing Date, the Company issues shares at a price per share which is less than \$0.425 per share (the "Base Share Price") then the Company is required to issue to the investors the number of shares equal to (1) the quotient of the aggregate purchase price payable under the Securities Purchase Agreement

13

---

divided by Base Share Price less (2) the quotient of the aggregate purchase price divided by the per share purchase price under the Securities Purchase Agreement.

In connection with the private placement, the agent was due a sales commission equal to \$90,828 or two (2%) percent of the gross proceeds, which it elected to receive in the form of 213,713 Units. In addition, the Company issued an aggregate of 50,000 Units, in payment of legal fees in the amount of \$21,250. These Units were otherwise issued on the same terms and conditions as the Units sold in the Private Placement.

See also Note 4.

### NOTE 9 - CONVERTIBLE PROMISSORY NOTE

On May 11, 2007, the Company entered into a Securities Purchase Agreement (the "Agreement") with GCA Strategic Investment Limited (the "Purchaser"). The Agreement provided for the sale of \$2,500,000 aggregate principal amount of Company's Convertible Note due May 11, 2009 (the "Convertible Note"). The Convertible Note was issued on May 11, 2007 and the purchase price of the Convertible Note was \$2,125,000 (eighty-five per cent of the principal amount of the Convertible Note). The Convertible Note does not bear interest except upon an event of default, at which time interest shall accrue at the rate of 18% per annum. Under the terms of the Agreement, the Purchaser agreed not to effect, or cause any affiliate or associate to effect a short sale of Company's common stock.

In connection therewith, the Company also issued to the Purchaser warrants to purchase up to an aggregate of 670,000 shares of the Company's common stock at a price of \$1.50 per share (the "Warrants"). The Warrants have a term of five years.

The Company also agreed to pay:

Global Capital Advisors, LLC ( "Adviser"), the Purchaser's adviser, out of pocket fees of \$15,000; and

Equinox Securities, Inc., 10% of the amount funded (\$212,500) plus a warrant to purchase a number of shares of the Company's common stock equal to 10% (in this case, 67,000 shares) of the number of shares subject to the Warrants at the same exercise price as set forth in the Warrants (\$1.50 per share) in consideration of its efforts in securing, on behalf of the Company, the financing with the Purchaser.

During the six months ended June 30, 2008, Notes in the amount of \$755,000 were converted into 2,342,415 shares.

During the six months ended June 30, 2008, \$468,343 of the discount on issuance of Note was recorded in the Statement of Operations. At June 30, 2008, all discounts on issuance of Note were amortized.

### NOTE 10 - WARRANTS

As of June 30, 2008, there were 737,000 warrants outstanding (Note 9) and 12,989,830 Series C Warrants outstanding (Note 4 and 8). Each warrant entitles the holder to purchase one share of the common stock of the Company at an exercise price of \$1.50 per share until May 11, 2012 and each Series C Warrant entitles the holder to purchase one share of the common stock of the Company at an exercise price of \$0.55 per share until May 23, 2010.

## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

The fair value of the 737,000 warrants issued on May 11, 2007 was \$714,890 and was estimated using the Black-Scholes option pricing model with assumptions as follows:

Risk free interest rate	4.58%
Expected life of the conversion feature in years	5.0 years
Expected volatility	96.2%
Dividend per share	\$0.00

The fair value of the 12,989,830 Series C Warrants issued on May 23, 2008 and was estimated using the Black-Scholes option pricing model with assumptions as follows:

14

---

Risk free interest rate	2.46%
Expected life of the conversion feature in years	2.0 years
Expected volatility	94.1%
Dividend per share	\$0.00

The fair value of the warrants was calculated at \$4,018,132 and the allocated proceeds was \$1,898,867.

### NOTE 11 - STOCK OPTIONS

As of June 30, 2008, the Company had an active stock option plan that provides shares available for options granted to employees, directors and others. Options granted to employees under the Company's option plans generally vest over two to five years or as otherwise determined by the plan administrator. Options to purchase shares expire no later than ten years after the date of grant.

The movement of stock options can be summarized as follows:

	Number of options	Weighted average exercise price	Remaining contractual term (years)	Aggregate intrinsic value
Outstanding at December 31, 2006	10,350,000	\$ 0.67		
Granted	2,026,750	0.52		
Cancelled	(10,350,000)	0.67		
Outstanding at December 31, 2007	2,026,750	0.52		
Granted	675,000	0.58		
Outstanding at June 30, 2008	2,701,750	0.54	8.92	\$ -
Exercisable at June 30, 2008	-	\$ 0.54		
Available for grant at June 30, 2008	35,096,250			

The aggregate intrinsic value in the table above represents the total pretax intrinsic value for all in-the-money options (i.e. the difference between the Company's closing stock price on the last trading day of the period ended June 30, 2008 and the exercise price, multiplied by the number of shares) that would have been received by the option holders had all option holders exercised their options on June 30, 2008. This amount change is based on the fair market value of the Company's stock. Total intrinsic value of options exercised was \$nil (2007: \$nil) for the six months ended June 30, 2008. Weighted average fair value of options granted during the six months ended June 30, 2008 was \$0.39 (2007: \$0.52) per share.

A summary of the Company's unvested stock options and changes during the periods is as follows:

# Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

	Number of options	Fair value per share
Unvested, December 31, 2006	4,650,000	\$ 0.51
Granted during 2007	2,026,750	0.43
Cancelled during 2007	(4,650,000)	0.51
Unvested, December 31, 2007	2,026,750	0.43
Granted during 2008	675,000	0.39
Unvested, June 30, 2008	2,701,750	0.42

On March 3, 2007, the Company cancelled 8,100,000 stock options previously granted to employees, comprising of 2,100,000 and 6,000,000 options at an exercise price of \$0.07 and \$0.85 each, respectively.

The 2,250,000 employee stock options issued on October 1, 2006 were cancelled effective January 25, 2007 and simultaneously, the Company granted options to purchase up to 2,000,000 shares of the Company's common stock at an exercise price of \$0.52. The options vest as follows: (a) 1,500,000 options shall vest if and when the Company or a wholly owned subsidiary, or any one current or future medical device or other technology, approved by the Board of Directors is

## 15

acquired, in whole or in part, or when either the Company or a subsidiary, enters into a strategic collaborative agreement for any one current or future medical device or other technology, approved by the Board of Directors, provided that the Company's Board of Directors has approved, by written resolution, any such acquisition, sale or agreement; (b) 250,000 stock options shall vest upon the filing of human safety trials for the Company's artificial liver device (or such other Board approved medical device or other technology) in Europe or the equivalent filing in the US; and (c) 250,000 stock options shall vest upon the successful completion of human safety trials for the Company's artificial liver device (or such other Board approved medical device or other technology) in Europe or the equivalent safety trial approval in the US (completion of phase 1).

The fair value of the 2,000,000 options granted was estimated at \$0.38 each, for a total of amount of \$760,000, by using the Black-Scholes Option Pricing Model with the following weighted average assumptions: dividend yield of 0%, expected volatility of 93.95%, risk-free interest rates of 4.85%, and expected lives of 4.7 years.

Additional stock-based compensation expense of \$58,337 will be recognized over the remaining requisite service period as a result of the cancellation and re-issuance of stock options.

On December 1, 2007, the Company granted options to two employees to purchase up to 17,000 shares of the Company's common stock at an exercise price of \$0.58. The options are vested in 4,250 options each upon achieving each of the four goals set by the Company. The four goals are expected to be achieved on or before March 31, 2008, June 30, 2008, September 30, 2008 and December 31, 2008 respectively.

On December 1, 2007, the Company granted options to an employee to purchase up to 9,750 shares of the Company's common stock at an exercise price of \$0.58. Of the total options, 750 options vest upon achieving the first goal of the Company. The remaining options are vested in 2,250 options each upon achieving each of the four goals set by the Company. The four goals are expected to be achieved on or before March 31, 2008, June 30, 2008, September 30, 2008 and December 31, 2008 respectively.

The fair value of the 26,750 options granted was estimated at \$0.25 each, for a total of amount of \$6,688, by using the Black-Scholes Option Pricing Model with the following weighted average assumptions: dividend yield of 0%, expected volatility of 94.73%, risk-free interest rates of 3.41%, and expected lives of 5 years.

On February 1, 2008, the Company granted options to an employee to purchase up to 75,000 shares of the Company's common stock at an exercise price of \$0.37 each. Of the total options, 25,000 options vest upon achieving the first goal of the Company. The remaining options are vested in another 25,000 options each upon achieving each of the three goals set by the Company. The three goals are expected to be achieved on or before July 31, 2009, January 31, 2010 and January 31, 2011 respectively.

The fair value of the 75,000 options granted was estimated at \$0.27 each, for a total of amount of \$20,250, by using the Black-Scholes Option Pricing Model with the following weighted average assumptions: dividend yield of 0%, expected volatility of 90.53%, risk-free interest rates of 2.75%, and expected lives of 5 years.



## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

On June 11, 2008, the Company granted options to two directors to purchase up to 550,000 shares of the Company's common stock at an exercise price of \$0.61 each. Every 100,000 of the first 500,000 options vest annually starting from October 1, 2008 and every 10,000 of the remaining 50,000 options vest annually starting from June 11, 2009.

The fair value of the 550,000 options granted was estimated at \$0.41 each, for a total of amount of \$225,500, by using the Black-Scholes Option Pricing Model with the following weighted average assumptions: dividend yield of 0%, expected volatility of 83.39%, risk-free interest rates of 3.49%, and expected lives of 5 years.

On June 18, 2008, the Company granted options to a director to purchase up to 50,000 shares of the Company's common stock at an exercise price of \$0.57 each. Every 10,000 of the 50,000 options vest annually starting from June 18, 2009.

The fair value of the 50,000 options granted was estimated at \$0.39 each, for a total of amount of \$19,500, by using the Black-Scholes Option Pricing Model with the following weighted average assumptions: dividend yield of 0%, expected volatility of 83.32%, risk-free interest rates of 3.57%, and expected lives of 5 years.

16

During the six months ended June 30, 2008, compensation expense of \$313,396 (2007: \$641,365) was recognized for options previously granted and vesting over time and is recorded in Salaries and Benefits on the Consolidated Statements of Operations. As of June 30, 2008, the Company had \$532,033 of total unrecognized compensation cost related to unvested stock options.

The options outstanding and exercisable as of June 30, 2008 can be summarized as follows:

Range of Exercise Prices	Number Outstanding at June 30, 2008	Outstanding Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Exercisable	
				Number Exercisable at June 30, 2008	Weighted Average Exercise Price
\$ 0.52	2,000,000	8.58	\$ 0.52	-	\$ -
0.58	26,750	9.43	0.58	-	-
0.37	75,000	9.60	0.37	-	-
0.61	550,000	9.95	0.61	-	-
0.57	50,000	9.97	0.57	-	-
0.54	2,701,750	8.92	0.54	-	-

The Company does not repurchase shares to fulfill the requirements of options that are exercised. Further, the Company issues new shares when options are exercised.

17

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

#### **Forward-Looking Statements**

Except for the historical information presented in this document, the matters discussed in this Form 10-Q for the three and six months ending June 30, 2008, this report contains forward-looking statements. Such forward-looking statements include statements regarding, among other things, (a) our projected sales and profitability, (b) our growth strategies, (c) anticipated trends in our industry, (d) our future financing plans, and (e) our anticipated needs for working capital. Forward-looking statements, which involve assumptions and describe our future plans, strategies, and expectations, are generally identifiable by use of the words may, will, should, expect, anticipate, estimate, believe, intend, project or the negative of these words or other variations on these words or comparable terminology. This information may involve known and

## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from the future results, performance, or achievements expressed or implied by any forward-looking statements. These statements may be found under Management's Discussion and Analysis of Financial Condition and Results of Operations, Business, Properties, as well as in this report generally. Actual events or results may differ materially from those discussed in forward-looking statements as a result of various factors, including, without limitation, the risks outlined under Risk Factors and matters described in this report generally. In light of these risks and uncertainties, there can be no assurance that the forward-looking statements contained in this filing will in fact occur.

### **Overview**

We are a development stage biotechnology company focused on the identification and development of cell-based technologies and products. We currently do not directly conduct any of our research and development activities. Rather, once a technology has been identified, we fund the research and development activities relating to the technology with the intention of ultimately, if warranted, licensing, commercializing and marketing the subject technology.

Our sponsored research is being conducted pursuant to a Cooperative Research and Development Agreement ( CRADA ) with the United States Department of Agriculture ( USDA ) Agricultural Research Service ( ARS ) and a sponsored research agreement with Michigan State University ( MSU ). Currently, we are concentrating our sponsored research and development efforts on developing a cell-supported artificial liver device, in-vitro toxicology and pre-clinical drug testing platforms, and a cell-based vaccine production system.

### **Artificial Liver Device**

We are working towards optimizing the hepatic (liver) functionality of a porcine cell line, and subclones thereof, which we refer to as the PICM-19 Cell Line. The PICM-19 Cell Line was developed and patented by USDA Agricultural Research Service scientists.

The hepatic characteristics of the PICM-19 Cell Line have been demonstrated to have potential application in the production of an artificial liver device, which application was also developed and patented by USDA Agricultural Research Service scientists for potential use by human patients with liver failure.

### **In-Vitro Toxicology Testing**

The PICM-19 Cell Line, grown in-vitro, can synthesize liver specific proteins such as albumin and transferrin, and display enhanced liver-specific functions, such as ureagenesis (conversion of ammonia to urea) and cytochrome P450 (a family of over 60 enzymes the body uses to break down toxins and make blood) activity. The P-450 enzyme systems are key components in the overall hepatic detoxification pathway of drugs and other xenobiotics (toxic foreign chemicals which can be both man-made and natural chemicals, such as pesticides and pollutants). Likewise, ureagenesis is another important hepatic function since urea production is required for the detoxification of ammonia derived from the catabolism (breakdown of complex organic molecules into simpler components) of a number of nitrogen-containing compounds. As a result, we believe the PICM-19 Cell Line could be an important element in developing in-vitro toxicological and pre-clinical drug testing platforms that could more accurately determine the potential toxicity and metabolism of new pharmacological compounds in the liver.

### **Cell Based Vaccine Production**

We are working towards commercializing a chicken cell line, and subclones thereof, which we refer to as the PBS-1 Cell Line. The PBS-1 Cell Line was developed for use in cell-based vaccine production and was exclusively licensed from

Michigan State University in June 2006. Successful cell-culture based vaccine production has the potential to reduce manufacturing time compared to traditional influenza vaccine manufacturing methods and could allow for rapid expansion of vaccine production in the face of an influenza pandemic.

Currently, vaccine production involves injecting a small amount of a targeted virus into fertilized chicken eggs. Over time, the virus is harvested from the eggs, eventually inactivated and purified, and finally blended into a vaccine and bottled in vials. This egg-based production method takes at least six months, and in the event of a flu pandemic, it is unlikely to produce vaccines fast enough to meet expected demand.

Third-party analysis has confirmed that PBS-1 cells are free from exogenous (from outside the system) agents, fungi, bacteria, diseases, and potentially harmful viruses. In addition, PBS-1 cells have grown and replicated several human influenza virus types, including H1N1, H3N2 and

## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

type B. The most important step towards the production of a cell-culture based vaccine against a targeted virus is the ability to efficiently grow the same virus in a cell substrate.

### Critical Accounting Policies

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

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

### General and Administrative Expenses

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

### Research and Development Costs

Research and development costs represent costs incurred to develop our technology incurred pursuant to our CRADA with the USDA's Agricultural Research Service and pursuant to our sponsored research agreement with MSU. The agreements include salaries and benefits for research and development personnel, allocated overhead and facility occupancy costs, contract services and other costs. We charge all research and development expenses to operations as they are incurred, except for prepayments, which are capitalized and amortized over the applicable period. We do not track research and development expenses by project. In addition costs for third party laboratory work might occur.

### Sponsored Research Agreements

#### Cooperative Research and Development Agreement

On November 20, 2007, HepaLife Technologies, Inc. entered into a new Cooperative Research and Development Agreement with the U.S. Department of Agriculture, Agricultural Research Service pertaining to the continued development and use of patented liver cell lines in artificial liver devices and in-vitro toxicological testing platforms, and committed to pay a total of \$519,130 to USDA's Agricultural Research Service over a two-year period ending November 19, 2009

As of June 30, 2008, total payments of \$338,272 been paid.

#### Ownership of Developed Technologies under the Sponsored Research Agreement

In consideration for research support and patent expenses received hereunder, the MSU grants HepaLife a right of first refusal applicable to any exclusive option or exclusive license that MSU elects to offer with respect to any University or joint invention, including any patent application and patents resulting from. In addition, any commercial non-exclusive option or license that the MSU elects to offer with respect to such University invention shall be offered to us simultaneously and under identical terms with the offer to any third party.

### License Agreement

#### (i)USDA Agricultural Research Service

On November 2, 2007, HepaLife Technologies, Inc. entered into an exclusive license agreement with the U.S. Department of Agriculture, Agricultural Research Service for the use of patented liver cell lines in bioartificial liver devices and in-vitro toxicological testing platforms.

The terms of the agreement cover specific patents and the PICM-19 hepatocyte cell lines. Financial details were not disclosed.

(ii) Michigan State University

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

The license agreement gives the Company exclusive rights to five issued patents. Under the terms of the license agreement, the Company agreed to pay MSU an initial fee of \$1,000 (paid) upon execution of the license agreement. A 2.5% annual royalty based on future sales is payable, with an annual minimum payment of \$10,000 from 2010 to 2014 and \$20,000 from 2015 until the expiration of the last to expire of the patents, or until fifteen (15) years after the effective date of June 15, 2006, whichever is longer.

The Company also has to make milestone payments of \$1,000, \$2,000, \$2,000 and \$10,000 to MSU when MSU achieves each of the 4 different developmental steps, respectively.

As part of the license agreement, the Company issued 17,650 common shares or 15% of the total issued and outstanding shares of PBS, to Dr. Paul Coussens at par value on October 2, 2006. After issuance of the shares, the Company holds 85% of the total issued and outstanding shares of PBS. The Company recorded the fair value of the shares of PBS issued to Dr. Paul Coussens at a nominal value. As PBS had no assets or liabilities no value was allocated to the minority interest.

On February 2, 2008, the Company, through its subsidiary, Phoenix BioSystems, Inc., entered into an amendment of the above mentioned exclusive worldwide license agreement with Michigan State University for the development of new cell-culture based flu vaccines to protect against the spread of influenza viruses among humans, including potentially the high pathogenicity H5N1 virus.

**Results of Operation**

The Company has yet to generate any revenues or establish any history of profitable operations. The Company has incurred operating losses of \$673,497 and \$718,955 for the three months ended June 30, 2008 and June 30, 2007, respectively. As a result, at June 30, 2008, the Company has an accumulated deficit of \$17,582,956.

We expect that our future revenues will not be sufficient to sustain our operations for the foreseeable future. Our profitability will require the successful completion of our research and development programs, and the subsequent commercialization of the results or of products derived from such research and development efforts. No assurances can be given when this will occur or that we will ever be profitable.

**Three and Six Months Ended June 30, 2008 and 2007**

The Company had no revenues in the three and six months ended June 30, 2008 and June 30, 2007. Our expenses decreased 13% to \$591,755 in the three months ended June 30, 2008, from \$683,986 in the same period in 2007.

Our expenses decreased 27% to \$1,001,289 in the six months ended June 30, 2008, from \$1,371,428 in the same period in 2007. This decrease of \$370,139 for the six months ended June 30, 2008 compared to the same period in 2007 was primarily attributable to a decrease in salary and benefits.

Interest income decreased 32% to \$8,569 in the three months ended June 30, 2008, from \$12,685 during the same period in 2007, reflecting lower than average cash balances maintained during most of the second quarterly period in 2008. For the six months ended June 30, 2008 and in the same period in 2007, interest income has decreased 19% to \$11,466 from \$14,229, reflecting lower than average cash balances maintained during most of the first two fiscal quarterly periods in 2008.

We incurred net losses of \$683,609 and \$802,368 during the three months ended June 30, 2008 and in the same period in 2007, respectively and we also incurred net losses of \$1,928,887 and \$1,541,348 for the six months ended June 30, 2008 and June 30, 2007.

**Liquidity and Capital Resources**

## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

As at June 30, 2008, the Company had a cash balance of \$4,064,454. The Company has financed its operations primarily from cash on hand and funds for private placement during the six month period ending June 30, 2008.

Net cash flows used in operating activities was \$1,004,684 for the six month period ending June 30, 2008, compared to net cash flows used of \$869,238 for the same period in 2007.

Net cash provided by financing activities was \$4,530,800 for the six months period ending June 30, 2008 compared to \$2,259,276 for the same period in 2007. The Company has financed its operations primarily from cash on hand and through a private placement.

At this time, we have no agreements or understandings with any third party regarding any financings.

### **Related Party Transactions**

**Management Fees:** During the three months and six months ended June 30, 2008, the Company paid management fees of \$750 (2007: \$nil) and \$1,500 (2007: \$3,465) to the directors respectively. There is no management or consulting agreement in effect nor is there an agreement in place to convert debt to equity.

On May 23, 2008, the Company reached an agreement with Mr. Rayat to which Mr. Rayat (i) converted the entire outstanding principal amount (\$877,800) of his loan (the "Loan") to the Company into an aggregate of 2,065,412 Units, each Unit consisting of one share of the Company's common stock and one Series C Warrant, at a conversion price of \$0.425 per Unit and (ii) agreed to accept \$150,000 in full payment and satisfaction of the accrued and unpaid interest on the Loan in the amount of \$249,945. The securities issued to Mr. Rayat are restricted securities as that term is defined in Regulation D, as promulgated pursuant to the Securities Act of 1933, as amended.

**Rent:** The Company's administrative office is located at 1628 West 1st Avenue, Suite 216, Vancouver, British Columbia, Canada, V6J 1G1. These premises are owned by a private corporation controlled by a director and shareholder. The Company paid rent of \$9,644 (2007: \$8,190) and \$19,070 (2007: \$16,855) for the three months and six months ended June 30, 2008.

Mr. Harmel S. Rayat is an officer, director and majority stockholder of the Company. He is also an officer, director and stockholder of each of PhytoMedical Technologies, Inc., Entheos Technologies, Inc., Octillion Corp., MicroChannel Technologies Corporation and International Energy, Inc.

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

### **Off Balance Sheet Arrangements**

We do not currently have, nor have we ever had, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

---

### **Recent Accounting Pronouncements**

In December 2007, the FASB ratified EITF No. 07-1, *Accounting for Collaborative Arrangements*, that discusses how parties to a collaborative arrangement (which does not establish a legal entity within such arrangement) should account for various activities. The consensus indicates that costs incurred and revenues generated from transactions with third parties (i.e. parties outside of the collaborative arrangement) should be reported by the collaborators on the respective line items in their income statements pursuant to EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*.

Additionally, the consensus provides that income statement characterization of payments between the participants in a collaborative arrangement should be based upon existing authoritative pronouncements; analogy to such pronouncements if not within their scope; or a reasonable, rational, and consistently applied accounting policy election. EITF Issue No. 07-1 is effective for financial statements beginning after December 15, 2008 and is to be applied retrospectively to all periods presented for collaborative arrangements existing as of the date of adoption. The Company is

## Edgar Filing: HEPALIFE TECHNOLOGIES INC - Form 10-Q

evaluating the impact, if any, the adoption of this consensus will have on the results of operations, financial position or cash flows.

In December 2007, the FASB issued SFAS No. 141 (R), *Business Combinations*, and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. SFAS No. 141 (R) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. SFAS No. 141 (R) and SFAS No. 160 are effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. We have not yet determined the effect on our consolidated financial statements, if any, upon adoption of SFAS No. 141 (R) or SFAS No. 160.

In May 2008, the FASB issued Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. This Statement identifies the sources for generally accepted accounting principles (GAAP) in the U.S. and lists the categories in descending order. An entity should follow the highest category of GAAP applicable for each of its accounting transactions. The adoption will not have a material effect on the Company's consolidated financial statements.

In May 2008, the FASB issued FASB Staff Position (FSP) No. APB 14-1 *Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlements)* (previously FSP APB 14-a), which will change the accounting treatment for convertible securities which the issuer may settle fully or partially in cash. Under the final FSP, cash settled convertible securities will be separated into their debt and equity components. The value assigned to the debt component will be the estimated fair value, as of the issuance date, of a similar debt instrument without the conversion feature, and the difference between the proceeds for the convertible debt and the amount reflected as a debt liability will be recorded as additional paid-in capital. As a result, the debt will be recorded at a discount reflecting its below market coupon interest rate. The debt will subsequently be accreted to its par value over its expected life, with the rate of interest that reflects the market rate at issuance being reflected on the income statement. This change in methodology will affect the calculations of net income and earnings per share for many issuers of cash settled convertible securities. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of FSP No. APB 14-1 on the Company's consolidated financial statements.

### ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

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

### ITEM 4. Controls and Procedures

#### Disclosure controls and procedures.

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as of the end of the period covered by this quarterly report. Based on this evaluation, our chief executive officer and chief financial officer

---

concluded as of June 30, 2008 that our disclosure controls and procedures were effective such that the information required to be disclosed in our United States Securities and Exchange Commission reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

#### Internal control over financial reporting.

There have been no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2008 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

---

**PART II Other Information**

## Item 1. Legal Proceedings

None

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

None

## Item 3. Defaults Upon Senior Securities

None

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

None

## Item 5. Other Information

None

## Item 6. Exhibits and Reports on Form 8-K

## (a) Exhibits

31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)

31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)

32.1 Certification by the Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification by the Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

## (b) Reports on Form 8-K

May 28, 2008: On May 23, 2008, HepaLife Technologies, Inc. completed a private placement of 10,660,705 units at a price of \$0.425 per Unit or approximately, \$4,530,800 in the aggregate.

June 17, 2008: On June 11, 2008, pursuant and subject to the terms and conditions of the Company's incentive stock option plan, Mr. Frank Menzler, the Company's Chief Executive Officer and a director, was granted 500,000 stock options. On June 11, 2008, Mr. Frank Menzler was appointed to the office of Chairman of HepaLife Technologies, Inc., replacing Mr. Harmel S. Rayat, the Company's former chairman, who resigned from such position effective June 11, 2008.

June 20, 2008: On June 11, 2008, the Board of Directors appointed Mr. Roland Schomer to serve as a director of the Company commencing June 18, 2008, and to serve as such until the next annual meeting of the Company's shareholders and until his successor shall have been duly elected and qualified.

**SIGNATURES**

Pursuant to the requirements of Sections 13 or 15 (d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 14th day of August, 2008.

HepaLife Technologies, Inc.  
(Registrant)

<u>Date</u>	<u>Signature</u>	<u>Title</u>
August 14, 2008	<u>/s/ Frank Menzler</u> Frank Menzler	Director, President, CEO
August 14, 2008	<u>/s/ Harmel S. Rayat</u> Harmel S. Rayat	Director, Secretary, Treasurer, Chief Financial Officer, Principal Accounting Officer