

STEMCELLS INC  
Form DEF 14A  
April 30, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**SCHEDULE 14A**

(RULE 14a-101)

**INFORMATION REQUIRED IN PROXY STATEMENT**

**SCHEDULE 14A INFORMATION**

**Proxy Statement Pursuant to Section 14(a) of the**

**Securities Exchange Act of 1934**

(Amendment No. )

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

**Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to §240.14a-12

**STEMCELLS, INC.**

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

**STEMCELLS, INC.**

**7707 Gateway Blvd.**

**Newark, California 94560**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**To be Held on June 11, 2014**

To the Stockholders of STEMCELLS, INC.

Notice is hereby given that the Annual Meeting of Stockholders of StemCells, Inc. ( StemCells or the company ) will be held on Wednesday, June 11, at 2 p.m., local time, at 7707 Gateway Boulevard, Newark, California 94560 for the following purposes:

1. to elect the two Class II directors named in the accompanying proxy materials to serve until the 2017 Annual Meeting of Stockholders;
2. to consider and vote upon a proposal to ratify the selection of Grant Thornton LLP as independent public accountants for the company for the fiscal year ending December 31, 2014;
3. to conduct an advisory vote on executive compensation; and
4. to transact any and all other business that may properly come before the meeting.

The Board of Directors has fixed the close of business on Thursday, April 17, 2014, as the record date for determining those stockholders who are entitled to notice of, and to vote at, the annual meeting of stockholders and any postponements or adjournments thereof. The stock transfer books will not be closed between the record date and the date of the meeting.

Representation of at least a majority of all outstanding shares of common stock of StemCells is required to constitute a quorum. Accordingly, it is important that your shares be represented at the meeting. This year we are again taking advantage of Securities and Exchange Commission rules that allow issuers to furnish proxy materials to their stockholders on the Internet. We believe these rules allow us to provide our stockholders with the information they need, while lowering the costs of delivery and reducing the environmental impact of our Annual Meeting.

Please read the proxy materials carefully. All stockholders are invited to attend the Annual Meeting. Your vote is important, and we appreciate your cooperation in considering and acting on the matters presented.

By Order of the Board of Directors,

Kenneth B. Stratton, J.D.  
Secretary  
April 30, 2014

Newark, California

**PROXY STATEMENT**  
**ANNUAL MEETING OF STOCKHOLDERS**  
**OF**  
**STEMCELLS, INC.**

The accompanying proxy is solicited on behalf of the Board of Directors of StemCells, Inc. (the company) for use at its annual meeting of stockholders (the Annual Meeting) to be held on Wednesday, June 11, 2014, at 2:00 p.m., local time, at the company's headquarters at 7707 Gateway Boulevard, Newark, California 94560. The company will bear the cost of solicitation of proxies. Directors, officers and employees of the company may solicit proxies by telephone, facsimile or in person for no additional compensation. The company will reimburse banks, brokerage firms, proxy solicitors, and other custodians, nominees and fiduciaries for reasonable expenses incurred by them in sending proxy materials to the beneficial owners of shares.

The Board of Directors has fixed the close of business on Thursday, April 17, 2014, as the record date for determining stockholders entitled to notice of, and to vote at, the Annual Meeting or at any postponement or adjournment thereof. There were 55,495,192 shares of our common stock, \$.01 par value, outstanding on April 17, 2014, each of which is entitled to one vote for each share on the matters to be voted upon.

*Our 2014 Proxy Materials are Available on the Internet.* This year we have again elected to provide access to our proxy materials over the Internet in accordance with rules adopted by the Securities and Exchange Commission. Accordingly, we are sending a Notice of Internet Availability of Proxy Materials (the Notice) to our stockholders of record and beneficial owners, which will instruct them as to how they may access and review all of the proxy materials on the Internet and how they may submit their proxy on the Internet. We expect to begin delivering the Notice to our stockholders on or about May 1, 2014, our anticipated initial mailing date. Any stockholder wishing to receive a paper copy of our proxy materials can request them from us by following the instructions found in the Notice for requesting such materials, or by calling 1 (800) 579-1639. Requests for a paper copy of our proxy materials should be made on or before May 28, 2014 to facilitate timely delivery.

Stockholders are being asked to vote on three proposals at the company's 2014 Annual Meeting. The proposals to be voted on and related recommendations from the Board of Directors are as follows:

**Proposal Number 1** To elect the two director nominees named in this proxy statement to serve as Class II directors on the Board until our 2017 annual meeting of stockholders or until that person's successor is duly elected and qualified. The Board of Directors recommends that you vote **FOR** each of the nominees.

**Proposal Number 2** To ratify the appointment of Grant Thornton LLP as the company's independent registered public accounting firm for the fiscal year ending December 31, 2014. The Board of Directors recommends that you vote **FOR** this proposal.

**Proposal Number 3** To hold an advisory vote on executive compensation as disclosed in this proxy statement. The Board of Directors recommends that you vote **FOR** this proposal.

In the election of directors, which is Proposal Number 1, you may vote **FOR** both of the nominees or your vote may be **WITHHELD** with respect to one or both of the nominees. For Proposal Numbers 2 and 3, you may vote **FOR**, vote **AGAINST** or **ABSTAIN**. If you **ABSTAIN** as to Proposal Numbers 2 or 3, the abstention will have no effect.

Shares of our common stock represented by proxies in the form enclosed that are properly executed and returned to us and not revoked will be voted as specified in the proxy by the stockholder. In the absence of contrary instructions, or in instances where no specifications are made, the shares will be voted:

- (i) FOR the election as directors of the nominees as described herein under Proposal Number 1 Election of Directors;
- (ii) FOR ratification of the selection of accountants as described herein under Proposal Number 2 Ratification of Selection of Independent Public Accountants;
- (iii) FOR the advisory resolution to approve the compensation of the company's named executive officers as described herein under Proposal Number 3 Advisory Vote on Executive Officer Compensation; and
- (iv) in the discretion of the named proxies as to any other matter that may properly come before the Annual Meeting.

Any stockholder signing and delivering a proxy may revoke it at any time before it is voted by delivering to the company's corporate secretary a written revocation or a duly executed proxy bearing a date later than the date of the proxy being revoked. Any stockholder attending the Annual Meeting in person may revoke his, her or its proxy and vote his, her or its shares at the Annual Meeting.

***How to vote shares at our 2014 Annual Meeting.***

This year company stockholders may cast their vote in any of the following ways:

*Vote by Internet.* Any stockholder can vote over the Internet at [www.proxyvote.com](http://www.proxyvote.com) by following the instructions on the Notice or proxy card. Internet voting facilities for stockholders of record will be available 24 hours a day and will close at 11:59 p.m. (EDT) on June 10, 2014.

*Vote by Mail.* Any stockholder that receives proxy materials by mail can vote by mail by signing, dating and mailing the enclosed proxy card in the postage-paid envelope provided. If the envelope is missing, such a stockholder can mail the completed proxy card or voting instruction card to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, New York 11717. The completed card must be received no later than June 10, 2014.

*Voting at the Annual Meeting.* All company stockholders are invited to attend the Annual Meeting in person. Any stockholder that attends the meeting in person may deliver a completed proxy card in person or vote by completing a ballot, which will be available at the meeting. However, each stockholder intending to vote in person at the Annual Meeting should note that if his, her or its shares are held in the name of a bank, broker or other nominee, such stockholder must obtain a legal proxy, executed in his, her or its favor, from the holder of record to be able to vote at the Annual Meeting. Stockholders should allow enough time prior to the Annual Meeting to obtain this proxy from the holder of record, if needed.

The shares voted electronically or represented by the proxy cards received, properly marked, dated, signed and not revoked, will be voted at the Annual Meeting.

### **QUORUM, REQUIRED VOTES AND METHOD OF TABULATION**

Consistent with Delaware law and the company's amended and restated by-laws, a majority of the votes entitled to be cast on a particular matter, present in person or represented by proxy, constitutes a quorum as to such matter. The company will appoint one or more election inspectors for the meeting to count votes cast by proxy or in person at the Annual Meeting.

If you hold shares beneficially in street name and do not provide your broker or nominee with voting instructions, your shares may constitute broker non-votes. Generally, broker non-votes occur on a matter when a broker is not permitted to vote on that matter without instructions from the beneficial owner and instructions have not been given. This year if you hold shares beneficially in street name and do not vote your shares, your broker or nominee can vote your shares at its discretion only on Proposal Number 2. In tabulating the voting result for any proposal for which the required vote is based on the number of shares present, shares that constitute broker non-votes are not considered entitled to vote on that proposal. Thus, broker non-votes will not affect the outcome of Proposal Numbers 1 and 3 provided a quorum is established.

#### ***What vote is required to approve each item?***

Election of directors by stockholders, which is Proposal Number 1, will be determined by a plurality of the votes cast by the stockholders entitled to vote at the election that are either present in person or represented by proxy.

For Proposal Numbers 2, the affirmative FOR vote is required by the holders of a majority of the shares present at the Annual Meeting in person or by proxy and voting. Abstentions will have no effect on the outcome of this proposal.

For Proposal Number 3, the affirmative FOR vote of the holders of a majority of the shares present at the Annual Meeting in person or by proxy and voting is necessary to approve, on an advisory basis, the compensation of our named executive officers. Because this vote is advisory only, it will not be binding on the company, the Board or the Compensation Committee of the Board. However, the Board and the Compensation Committee will review the voting results and take them into consideration when making future decisions about executive compensation. Abstentions will have no effect on the outcome of this proposal.

Management does not know of any matters to be presented at this year's Annual Meeting other than those set forth in this proxy statement and in the notice accompanying this proxy statement. Stockholders will have no appraisal rights under Delaware law with respect to any of the matters expected to be voted on at the Annual Meeting. If other matters should properly come before the meeting, the proxy holders will vote such matters in their discretion. Any stockholder has the right to revoke his, her or its proxy at any time until it is voted.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The following table shows the number of shares of our common stock beneficially owned, as of April 15, 2014, by (i) each of our directors, (ii) each of our named executive officers, (iii) all of our current directors and executive officers as a group, and (iv) all those known by us to be to a beneficial owner of more than 5% of the company's common stock. In general, beneficial ownership refers to shares that an individual or entity has the power to vote or dispose of, and any rights to acquire common stock that are currently exercisable or will become exercisable within 60 days of April 15, 2014. Unless otherwise indicated, we believe that each person named below, based on information furnished by such owner, holds sole investment and voting power with respect to such shares, subject to community property laws where applicable. We calculated percentage ownership in accordance with the rules of the SEC. The percentage of common stock beneficially owned is based on 55,445,238 shares outstanding as of April 15, 2014. In addition, shares issuable pursuant to options, restricted stock units or other convertible securities that may be acquired within 60 days of April 15, 2014 are deemed to be issued and outstanding and have been treated as outstanding in calculating and determining the beneficial ownership and percentage ownership of those persons possessing those securities, but not for any other persons.

Name and Address of Beneficial Owner*	Amount and Nature of Beneficial Ownership	Percentage of Class Beneficially Owned
<b>Directors and Named Executive Officers</b>		
Eric Bjerkholt(1)	37,000	**
Stewart Craig(2)	170,028	**
R. Scott Greer(3)	31,000	**
Ricardo Levy(4)	9,000	**
Martin McGlynn(5)	504,427	**
Greg Schiffman(6)	1,511	
John Schwartz(7)	92,195	**
Ken Stratton(8)	165,262	**
Ann Tsukamoto(9)	205,828	**
Irving Weissman(10)	172,075	**
All current directors and executive officers as a group (ten persons)	<b>1,398,326</b>	<b>2.50%</b>
<b>5% Stockholders</b>		
Alpha Capital Anstalt(11)	3,332,660	6.01%

\* The address of all directors and executive officers listed in the table is c/o StemCells, Inc., 7707 Gateway Blvd., Newark, California 94560.

\*\* Less than one percent.

(1) Includes 5,000 shares issuable upon exercise of stock options exercisable within 60 days.

(2) Includes 9,791 shares issuable upon exercise of stock options exercisable within 60 days and 85,000 shares issuable upon the vesting of restricted stock units within 60 days. Includes 19,256 shares in Dr. Craig's 401(k) plan.

(3) Includes 10,000 shares issuable upon the vesting of restricted stock units within 60 days.

(4) Includes 5,000 shares issuable upon exercise of stock options exercisable within 60 days.

(5) Includes 29,375 shares issuable upon exercise of stock options exercisable within 60 days and one hundred seventy-five thousand shares issuable upon the vesting of restricted stock units within 60 days. Includes 22,480 shares in Mr. McGlynn's 401(k) plan.



(6) Includes 1,511 shares in Mr. Schiffman's 401(k) plan.

- (7) Includes 6,500 shares issuable upon exercise of stock options exercisable within 60 days.
- (8) Includes 15,000 shares issuable upon exercise of stock options exercisable within 60 days and seventy-five thousand shares issuable upon the vesting of restricted stock units within 60 days. Includes 17,528 shares in Mr. Stratton's 401(k) plan.
- (9) Includes 20,000 shares issuable upon exercise of stock options exercisable within 60 days and seventy thousand shares issuable upon the vesting of restricted stock units within 60 days. Includes 22,766 shares included in Dr. Tsukamoto's 401(k) plan and 3,643 shares held in trust to which Dr. Tsukamoto disclaims beneficial ownership.
- (10) Includes 5,000 shares issuable upon exercise of stock options exercisable within 60 days. Includes 22,471 shares held in trust to which Dr. Weissman disclaims beneficial ownership.
- (11) Beneficial holdings based on a Schedule 13G filed by Alpha Capital Anstalt on February 28, 2012 and the Company's records of its outstanding warrants. According to the Schedule 13G filed February 28, 2012, Alpha Capital may be deemed to beneficially own all shares listed in the table, and has sole dispositive and voting power with respect to all shares listed in the table. The address of the principal place of business of Alpha Capital is Pradafant 7, Furstentums 9490, Vaduz, Liechtenstein.

**Board of Directors**

We currently have six directors serving on our Board of Directors. However, from June 2010 until December 2013, our Board was composed of seven directors—Drs. Ricardo Levy, Roger Perlmutter, John Schwartz, and Irving Weissman and Messrs. Eric Bjerkholt, Scott Greer, and Martin McGlynn. In December 2013, Dr. Perlmutter resigned from the Board due to his appointment as executive vice president of Merck & Co and president of Merck Research Laboratories, as of April 2013.

The following table shows the names, ages, principal occupations, and public company board memberships for the last five years of our directors, as of April 15, 2014:

Eric Bjerkholt	54	Eric Bjerkholt was elected to the Board of Directors in March 2004. He is Executive Vice President and Chief Financial Officer of Sunesis Pharmaceuticals, Inc., a biopharmaceutical company. Mr. Bjerkholt is a member of the board of directors of Round Table Pizza, Inc.
R. Scott Greer	55	Scott Greer was appointed to the Board of Directors in June 2010. He is currently a principal and managing director of Numenor Ventures LLC, which he founded in 2002 to provide funding and strategic advisory services to early stage enterprises. Mr. Greer currently serves as Chairman of Ablexis, a development stage biotechnology company, and he is also on the board of Nektar Therapeutics.

Ricardo Levy, Ph.D.	69	Ricardo Levy, Ph.D. was elected to the Board of Directors in September 2001. He currently serves as a director on the board of Accelrys, Inc., a public company focused on molecular modeling and simulation software for both life and materials science research.
Martin McGlynn	67	Martin McGlynn was elected to the Board of Directors in February 2001. He is President and Chief Executive Officer of the company, a position he has held since January 2001.
John Schwartz, Ph.D.	79	John Schwartz, Ph.D., was elected to the Board of Directors in December 1998 and was elected Chairman of the Board at the same time. He is currently President of Quantum Strategies Management Company, a registered investment advisor.
Irving Weissman, M.D.	74	Irving Weissman, M.D., was elected to the Board of Directors in September 1997. He is the Virginia and Daniel K. Ludwig Professor of Cancer Research, Professor of Pathology and Professor of Developmental Biology at Stanford University.

Because we have a classified board, with each of our directors serving a staggered three-year term, only two of our directors are standing for reelection at our 2014 Annual Meeting. The following table shows the current composition of the three classes of our Board:

Class I Directors (terms scheduled to expire in 2016):

Eric Bjerkholt  
R. Scott Greer

Class II Directors (terms scheduled to expire in 2014, but nominated to stand for reelection at our 2014 Annual Meeting):

Ricardo Levy, Ph.D.  
Irving Weissman, M.D.

Class III Directors (terms scheduled to expire in 2015):

Martin McGlynn  
John Schwartz, Ph.D.<sup>1</sup>

<sup>1</sup> In March 2014, we reclassified Dr. Schwartz, our chairman, from Class I to Class III in order to rebalance the board after Dr. Perlmutter's resignation in December 2013.

The independent members of our Board, as determined by the Board of Directors in accordance with the existing Nasdaq Listing rules, are Messrs. Bjerkholt and Greer and Drs. Levy and Schwartz. The Board of Directors held four regular meetings and two special meetings during the fiscal year ended December 31, 2013. Each of our directors attended more than 75% of the meetings of the Board of Directors and of the committees on which he served. In addition, we invite, but do not require, our directors and director nominees to attend our annual meetings of stockholders. Two directors attended our 2013 annual meeting of stockholders.

For many years the roles of chairman and chief executive officer at the company have been separated. We believe that this is appropriate under current circumstances, because it allows management to make the operating decisions necessary to manage the business, while helping to maintain Board independence so that it can provide an effective oversight function. We feel that this has provided an appropriate balance of operational focus, flexibility and oversight. Our independent directors meet at regularly scheduled executive sessions without members of management.

#### **Board Committees**

Presently, the Board has four standing committees – the Audit Committee, the Compensation and Stock Option Committee (the Compensation Committee), the Corporate Governance and Nominating Committee (the Corporate Governance Committee), and the Strategic Transactions Committee – as well as a single-member committee established under the company's 2004, 2006, and 2013 equity incentive plans and the Company's 2012 Commencement Incentive Plan. The Board created the Strategic Transactions Committee in March 2009 as an *ad hoc* committee with direction to consult with management and advise the full Board on various corporate initiatives. In June 2010, however, the Board reconstituted the Strategic Transactions Committee, which Mr. Greer currently chairs, as a standing committee of the Board. All members of the Audit Committee, the Compensation Committee, and the Corporate Governance Committee are, and are required by the charters of the respective committees to be, independent as determined under Nasdaq Listing rules.

*Audit Committee.* The Audit Committee is composed of Mr. Bjerkholt and Drs. Schwartz and Levy. The Audit Committee held five meetings during the fiscal year ended December 31, 2013. The primary function of the Audit Committee is to assist our Board in fulfilling its oversight responsibilities. The committee does this primarily by reviewing our financial reports and other financial information as well as the company's systems of internal controls regarding finance, accounting, legal compliance, and ethics that management and the Board have established. The committee also assesses our auditing, accounting and financial processes more generally. The Audit Committee meets at least quarterly, and at such other times as it finds necessary. It recommends to our Board the appointment of a firm of independent auditors to audit the financial statements of the company and meets with such personnel of the company to review the scope and the results of the annual audit, the amount of audit fees, the company's internal accounting controls, the company's financial statements contained in this proxy statement and other related matters. Each of the members of the Audit Committee is independent, and the Board has determined that Mr. Bjerkholt is an audit committee financial expert, as defined in SEC rules. The Audit Committee acts pursuant to a written charter which is available through our website at [www.stemcellsinc.com](http://www.stemcellsinc.com).

*Compensation Committee.* The Compensation Committee is composed of Drs. Schwartz and Levy and Mr. Bjerkholt. The Compensation Committee held eight meetings during the fiscal year ended December 31, 2013. The Compensation Committee makes recommendations to our Board and management concerning salaries in general, determines executive compensation and, except to the extent that such decisions have been delegated to, and made by, the single-member committee, approves incentive compensation for our employees and consultants. The Compensation Committee acts pursuant to a written charter which is available through our website at [www.stemcellsinc.com](http://www.stemcellsinc.com).

**Corporate Governance Committee.** In 2013, the Corporate Governance Committee was composed of Drs. Levy and Schwartz and a former member of our Board of Directors, Dr. Roger Perlmutter, who resigned from our Board in December 2013 for personal reasons. Following Dr. Perlmutter's resignation in December 2013, the Board appointed Mr. Greer to the Corporate Governance Committee. The Corporate Governance Committee held one meeting in 2013 to discuss a slate of actual and potential nominees to the Board of Directors. The committee oversees nominations to the Board and considers the experience, ability and character of potential nominees to serve as directors, as well as particular skills or knowledge that may be desirable in light of the company's position at any time. From time to time, the committee has engaged the services of a paid search firm to help the committee identify potential nominees to the Board. The Company's Governance Committee and Board seek to nominate and appoint candidates to the Board who have significant business experience, technical expertise or personal attributes, or a combination of these, sufficient to suggest, in the Board's judgment, that the candidate would have the ability to help direct the affairs of the company and enhance the Board as a whole. The Committee may identify potential candidates through any reliable means available, including recommendations of past or current members of the Board from their knowledge of the industry and of the company. The Committee also considers past service on the Board or on the board of directors of other publicly traded or technology focused companies. The committee has not adopted a formulaic approach to evaluating potential nominees to the Board; it does not have a formal policy concerning diversity, for example. Rather, the committee weighs and considers the experience, expertise, intellect, and judgment of potential nominees irrespective of their race, gender, age, religion, or other personal characteristics. The committee often looks for nominees that can bring new skill sets or diverse business perspectives. Potential candidates recommended by security holders will be considered as provided in the company's Policy Regarding Shareholder Candidates for Nomination as a Director, which sets forth the procedures and conditions for such recommendations. This policy is available through our website at [www.stemcellsinc.com](http://www.stemcellsinc.com). The Corporate Governance Committee operates pursuant to a written charter, a copy of which is also available through our website at [www.stemcellsinc.com](http://www.stemcellsinc.com). The members of the Corporate Governance Committee approved the nomination of the Class II directors standing for reelection at the 2014 Annual Meeting.

**Strategic Transactions Committee.** The Strategic Transactions Committee is composed of Messrs. Bjerkholt, Greer and McGlynn and Dr. Levy. The Strategic Transactions Committee held three meetings during the fiscal year ended December 31, 2013. The Committee was created at the suggestion of our Chief Executive Officer in March 2009 to provide advice and direction, on an *ad hoc* basis, on a range of strategic initiatives being considered at the time. The Committee does not have a formal charter. However, the Board of Directors has authorized the Committee to be available to advise, consult and participate with management, as requested by the company's Chief Executive Officer, with respect to the identification, implementation, evaluation, and negotiation of potential strategic corporate transactions, with the exception of financings. Since June 2010, the Strategic Transactions Committee has been the Board's fourth standing committee, and as such it routinely provides recommendations both to management and to the full Board with regard to such matters as the Committee may deem advisable.

The following table shows the members of our four standing Board committees:

Director	Independent	Audit Committee	Compensation Committee	Corporate Governance Committee	Strategic Transactions Committee
Eric Bjerkholt	Yes	Chair	ü		ü
R. Scott Greer	Yes			ü	Chair
Ricardo Levy, Ph.D.	Yes	ü	ü	Chair	ü
Martin McGlynn	No				ü
John Schwartz, Ph.D.	Yes	ü	Chair	ü	
Irving Weissman, M.D.	No				

## Director Oversight and Qualifications

While management is responsible for the day-to-day management of the risks the company faces, the Board, as a whole and through its committees, has responsibility for the oversight of risk management. An important part of risk management is not only understanding the risks facing the company and what steps management is taking to manage those risks, but also understanding what level of risk is appropriate for the company. In support of this oversight function, the Board receives regular reports from our Chief Executive Officer and members of senior management on operational, financial, legal, and regulatory issues and risks. The Audit Committee additionally is charged under its charter with oversight of financial risk, including the company's internal controls, and it receives regular reports from management, the company's internal auditors and the company's independent auditors. The chairman of the Board and independent members of the Board work together to provide strong, independent oversight of the company's management and affairs through its standing committees and, when necessary, special meetings of directors.

We believe each of our directors brings valuable skills, experience, judgment, and perspectives to our company. The Board took the following qualifications into consideration, among other things, when nominating or appointing our current directors:

Eric Bjerkholt	Mr. Bjerkholt is a financial expert and currently serves as the Executive Vice President and Chief Financial Officer of Sunesis Pharmaceuticals, Inc., a biopharmaceutical company. His business experience spans more than 20 years, during which time he founded a nutraceutical company and worked as an investment banker. Mr. Bjerkholt currently serves on the board of directors of Round Table Pizza. We believe Mr. Bjerkholt's qualifications to serve on our Board of Directors include his considerable financial and business experience, especially in the life sciences industry. Mr. Bjerkholt has served on our Board for over ten years.
R. Scott Greer	Mr. Greer was appointed to our Board in June 2010. He is a financial expert with over 25 years of experience in the life sciences industry. He was founder, CEO and Chairman of Abgenix, Inc., a biotechnology company he took public in 1998 and then sold to Amgen in 2006. Mr. Greer currently serves as Chairman of Ablexis, a development stage biotechnology company, and is also on the board of Nektar Therapeutics. We believe Mr. Greer's qualifications to serve on our Board include his more than 25 years of experience in the life sciences industry.
Ricardo Levy, Ph.D.	Dr. Levy has over 40 years of experience leading technology companies in both North and South America. In 1974, he cofounded Catalytica, Inc., a manufacturing technology and energy systems company, and served as CEO from 1991 until the company was sold in 2000. Dr. Levy currently serves as director of Accerlys Inc. (formerly Pharmacopeia, Inc.) and NovoDynamics, Inc. We believe his qualifications to serve on our Board of Directors include his more than 40 years of business experience. Dr. Levy has served on our Board for over twelve years.

Martin McGlynn

Mr. McGlynn has been our President and Chief Executive Officer since January 2001. He has held management positions of increasing responsibility in several countries for more than 30 years. Prior to joining our company, Mr. McGlynn was President and Chief Executive Officer of Pharmadigm, Inc., a privately held company in the fields of inflammation and genetic immunization. Prior to this, he was President and General Manager of Abbott Canada Ltd. and President of Anaquest, Inc., a company focused on anesthesia and acute care pharmaceuticals. We believe Mr. McGlynn's qualifications to serve on our Board of Directors include his significant managerial experience in our industry and his intimate knowledge of our operations as a result of his day to day leadership as our President and Chief Executive Officer. Mr. McGlynn has served on our Board for over twelve years.

John Schwartz, Ph.D.

Dr. Schwartz has over 40 years of business and legal experience, including several years spent in the 1990s as President and Chief Executive Officer of Systemix, Inc., a cell-based therapeutics company which was acquired by Novartis in 1997. Before joining Systemix as its Senior Vice President and General Counsel in 1993, Dr. Schwartz served as the Vice President and General Counsel of Stanford University. He currently runs a registered investment advisor firm called Quantum Strategies Management Company. We believe Dr. Schwartz's qualifications to serve on our Board of Directors include his over 40 years of business and legal experience in our industry as well as his significant experience working at Stanford University. Dr. Schwartz has served on our Board for over fifteen years.

Irving Weissman, M.D.

Dr. Weissman has been a leader in the stem cell field for over 20 years. He is a professor at Stanford University and serves as the director of the Stanford Institute for Stem Cell Biology and Regenerative Medicine. He co-founded Systemix in 1988 and Cellerant Therapeutics, Inc., a hematopoietic stem cell development company, in 2001. He is a member of several scientific advisory boards and national science institutes, including the National Academy of Science, the American Academy of Arts and Science, and the Institute of Medicine of the National Academy of Sciences. We believe Dr. Weissman's qualifications to serve on our Board of Directors include the fact that he has been a leader in stem cell research for over 20 years as well as his substantial business experience in our industry. Dr. Weissman has served on our Board for over sixteen years and serves as the chairman of our Scientific Advisory Board.

Stockholders who wish to communicate with our Board of Directors or with a particular director may send a letter to our corporate secretary at the following address: StemCells, Inc., 7707 Gateway Blvd., Newark, California 94560 (c/o Legal Department). Any communication should clearly specify that it is intended to be made to the entire Board or to one or more particular director(s). Our corporate secretary will review all such correspondence and forward to our Board a summary of all such correspondence and copies of all correspondence that, in the opinion of the secretary, deals with the functions of the Board or committees thereof or that he otherwise determines requires their attention. The secretary maintains a log of all correspondence received by us that is addressed to members of the Board, and any director may at any time review and request copies of any such correspondence.

Concerns relating to accounting, internal controls or auditing matters will immediately be brought to the attention of the chairman of the Audit Committee and handled in accordance with established procedures, which are set out in the Audit Committee's Policy on Receipt, Retention and Treatment of Complaints Regarding Accounting, Internal Controls and Auditing Matters. A copy of this policy is available through our website at [www.stemcellsinc.com](http://www.stemcellsinc.com).

### Executive Officers, Positions Held

Following are the name, age and other information for our named executive officers, as of April 15, 2014. All company officers have been elected to serve until their successors are elected and qualified or until their earlier resignation or removal.

<p>Martin McGlynn</p> <p>President and Chief Executive Officer</p>	<p>67</p>	<p>Martin McGlynn joined the company in January 2001, when he was appointed President and Chief Executive Officer of the company and of its wholly-owned subsidiaries. Mr. McGlynn was elected to the Board of Directors in February 2001</p>
<p>Greg Schiffman</p> <p>Chief Financial Officer and Executive Vice President of Finance</p>	<p>56</p>	<p>Greg Schiffman joined the company in January 2014 as Chief Financial Officer and Executive Vice President of Finance, with responsibility for corporate financial management, financial reporting and controls, investor relations, corporate communications, and information technology. Prior to joining StemCells, Mr. Schiffman served as Executive Vice President and Chief Financial Officer of Dendreon Corporation. From 2006 to 2009, Mr. Schiffman served as a director of VNUS Technologies, Inc.</p>
<p>Stewart Craig, Ph.D.</p> <p>Executive Vice President, Manufacturing Operations and Regulatory Affairs</p>	<p>52</p>	<p>Stewart Craig, Ph.D., joined the company in September 2008 with responsibilities for Development, Manufacturing, Regulatory, Quality Systems, and Facilities. From 2005 to 2008, Dr. Craig was Chief Technology Officer and Vice President of Progenitor Cell Therapy, a contract services provider for research, development, manufacture, and commercialization of cell-based therapies, prior to which he has held executive positions at Xcyte Therapies, Osiris Therapeutics and SyStemix. In April 2014, Dr. Craig submitted his resignation from his position with the company, effective May 2014, for personal reasons.</p>



Ann Tsukamoto, Ph.D. Executive Vice President, Scientific and Strategic Alliances	61	Ann Tsukamoto, Ph.D., joined the company in November 1997 as Senior Director of Scientific Operations; was appointed Vice President, Scientific Operations in June 1998; Vice President, Research and Development in February 2002; Chief Operating Officer in November 2006; and Executive Vice President, Research and Development, in October 2008. In June 2013, Dr. Tsukamoto was appointed Executive Vice President, Scientific and Strategic Alliances, with responsibility for developing the Company's alliances with research institutions, corporations, government agencies, and disease foundations. Dr. Tsukamoto is married to one of our outside directors.
Ken Stratton, J.D.  General Counsel	45	Ken Stratton, J.D., joined the company in February 2007 as General Counsel, with responsibility for corporate compliance and legal affairs. In March 2008, he assumed responsibility for the Human Resources function. Prior to joining StemCells, Mr. Stratton served as Deputy General Counsel for Threshold Pharmaceuticals and as Senior Legal Counsel for Medtronic, Inc.'s Vascular business unit.

**Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), requires our executive officers, directors, and persons who own more than 10% of a registered class of our equity securities, to file with the SEC reports of ownership of our securities and changes in reported ownership. Executive officers, directors and greater than 10% beneficial owners are required by SEC rules to furnish us with copies of all Section 16(a) reports they file. Based solely on a review of the copies of such forms furnished to us, or written representations from the reporting persons that no Form 5 was required, we believe that, during the fiscal year ended December 31, 2013, all Section 16(a) filing requirements applicable to our officers, directors and greater than 10% beneficial owners have been met, with the following exception: In June 2013, Drs. Craig and Tsukamoto and Mr. Stratton each used shares to pay a tax liability incurred by each of them from the delivery of shares incident to the vesting of restricted stock units, but reported these dispositions of 16,206 shares in aggregate one week late.

**Code of Business Conduct and Ethics**

We have adopted a Code of Ethics and Conduct that applies to all of our directors, officers, employees, and consultants. A copy of our code of ethics is posted on our website at [www.stemcellsinc.com](http://www.stemcellsinc.com). We intend to disclose any substantive amendment or waivers to this code on our website. There were no substantive amendments or waivers to this code in 2013.

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**EXECUTIVE COMPENSATION**

**Compensation Discussion and Analysis**

We structure our compensation programs to attract and retain talented employees and reward them for helping us achieve our short-term and long-term goals. We intend for our compensation programs to be equitable and competitive when measured against those offered by companies against whom we compete for high-level scientific and executive personnel. We also intend for them to link pay to both company and individual performance.

In seeking to accomplish these objectives, we follow a compensation strategy designed, ultimately, to reward increasing stockholder value. However, because achievement of our principle mission—the research, development and commercialization of stem cell therapeutics and related tools and technologies for academia and industry—is a long, expensive and challenging process, we often set individual compensation by using surrogate endpoints to gauge employee contributions towards building sustained stockholder value, such as:

the achievement of stated corporate goals adopted from time to time by the Board;

the leadership an executive officer has shown in inspiring and marshaling excellent performances in his or her direct reports;

the anticipation, identification and successful disposition of issues and problems that, if not addressed timely and effectively, might have a deleterious effect on the company; and

the speed and effectiveness with which an executive officer discovers, assesses and, where appropriate, pursues promising opportunities for the company.

*Compensation elements.* We, like most biotechnology companies, use a combination of base salary, bonuses and equity awards to compensate our employees, including our executive officers. As a small company—we have approximately 55 employees in total and only five executive officers—we feel that having so few people in each job classification and level makes it inefficient to establish a formulaic allocation of total compensation among its various elements; we rely, instead, on our experience and judgment.

In exercising this judgment, we periodically collect and review information (i) from third party market reports such as the *Radford Biotechnology Survey Executive Report*; and (ii) from the proxy statements of other similar biotechnology companies, especially those operating in the San Francisco Bay Area, as well as those pursuing cell-based therapeutics.<sup>2</sup> In the case of the executive officers who report directly to our chief executive officer, we also carefully consider the recommendations of our chief executive officer when setting compensation. We integrate all of this information with our evaluation of the individual performance of each of our executive officers.

While we believe our officers and other employees are outstanding, we realize that the company is not yet profitable and that it is still in a relatively early stage of development. We therefore generally prefer to target our compensation practices so that our employees' base salaries, bonuses, equity compensation, and benefits all fall close to the 50th percentile paid by comparable companies for similar positions. Actual compensation may fall

<sup>2</sup> In 2012, for example, we collected executive compensation information from the recent SEC filings of Aastrom Biosciences, Inc.; Affymax, Inc.; Alexza Pharmaceuticals, Inc.; Anacor Pharmaceuticals, Inc.; Athersys, Inc.; Cerus Corporation; Cytokinetics, Incorporated; Cytori Therapeutics, Inc.; Dynavax Technologies Corporation; Geron Corporation; InterMune, Inc.; MAP Pharmaceuticals, Inc.; Maxygen, Inc.; Medivation, Inc.; Neuralstem, Inc.; Osiris Therapeutics, Inc.; Rigel Pharmaceuticals, Inc.; Sangamo Biosciences, Inc.; and Sunesis Pharmaceuticals, Inc.

slightly above or below these targets, however, because of any number of factors such as general economic conditions, market competition for specific jobs, personal performance, and the need for internal equities within the company. For example, we have recently paid many of our employees, including some of our executive officers, at below the 50th percentile because of the recent global recession and crisis in the financial markets. At the same time, however, we have paid many of our employees, including some of our executive officers, at above the 50th percentile because of highly competitive demand for workers with their unique skill sets.

*Interaction of compensation elements.* The basic compensation elements—base salary, bonuses and equity awards—are, as noted, standard in our industry. Though not set independently of one other, we use each element as a portion of total compensation because we believe we would not otherwise be competitive and because we feel that together they are the proper components of a balanced compensation package:

base salary is compensation for current efforts;

bonuses, whether in cash or equity, are paid at the Board's discretion typically for achievements in meeting or exceeding corporate goals; and

equity awards are inducements to remain with the company and to build future value.

On occasion, we have considered our employee compensation programs, including our executive compensation programs, and the effect they may have on company risk. We have concluded that our employee compensation programs are simple and straight-forward and consistent with those of similarly situated research and development companies. In determining that our compensation policies and practices do not present risks that are likely to have a material adverse effect on our business, our directors have, from time to time, discussed with management the various pay practices used to compensate our employees at both the executive and non-executive levels. These inquiries have included discussions about our three primary components of compensation, namely base compensation, cash bonuses and equity incentive compensation.

Our Board of Directors has also periodically considered how bonus awards are determined and calculated by the company, noting that all bonuses are awarded entirely at the discretion of our Board after taking into consideration the progress of our company's programs. Based on its review, our Board has concluded that our bonus program properly aligns compensation with our overall goals, all of which are designed to have a positive impact on our business.

In addition, our Board has periodically examined our equity compensation practices, noting that we typically grant customary equity awards that vest over many years after the date of grant. We believe discretionary compensation that vests over multiple years does not encourage short-term or high-risk opportunistic behavior and instead aligns our employees' interests with the long-term interests of our stockholders by encouraging activities intended to build long-term value for the company.

For these reasons, we have concluded that our employee compensation programs are designed with the appropriate balance of risk and reward in relation to our company's overall business strategy and do not incentivize executives or other employees to take unnecessary or excessive risks. As a result, we believe that risks arising from our employee compensation policies and practices are not reasonably likely to have a material adverse effect on the company.

*Other compensation elements and benefits.* We offer all employees various health and welfare benefit plans. Our executive officers may participate in these on the same terms as other employees. We do not have a

pension plan nor do we use non-qualified deferred compensation.<sup>3</sup> We offer our U.S. employees (again, including executive officers on the same terms as others) a 401(k) defined contribution plan, and match employee contributions on a 1:2 basis (*i.e.*, \$1 contribution by the company for every \$2 contribution made by the employee) up to a maximum of 3% of the employee's salary, subject to legal limitations. At this time, our 401(k) match is made in the form of shares of common stock in the company. We offer our U.K. employees a tax preferred pension scheme, and match employee contributions on a 1:1 basis up to a maximum of 12% of the employee's salary.

### **Compensation of Named Executive Officers**

*Base salary compensation; target bonuses.* We consider base salary to be a critical component of our executive officers' overall compensation packages. We intend the salaries of our executive officers to reflect their actual responsibilities and job scope. We also endeavor to set base compensation levels so that their salaries are competitive with salaries paid by comparable companies to employees with similar experience, taking into account the cost of living in the San Francisco Bay Area. Accordingly, we have made occasional adjustments to the salaries of certain employees to address perceived below market anomalies, address specific retention concerns or reward special contributions made to the company.

In addition to base salary, each full-time employee of the company, including each of our named executive officers, is given a personal target bonus (calculated as a percentage of base salary), based upon factors such as seniority, job title and the existing targets of co-workers with comparable job responsibilities within the company. Bonuses at the company are discretionary and awarded by the Board in its sole discretion. But when bonuses are awarded, we use the personal target of each employee to calculate his or her bonus amount.

With these various principles in mind, we recently took the following actions with respect to the base compensation and bonus targets of certain named executive officers:

Effective February 1, 2012, we increased Mr. McGlynn's base salary to \$550,000 from \$525,000 in recognition of contributions made on behalf of the company and market factors. More recently, effective June 17, 2013, we increased Mr. McGlynn's base salary to \$570,000 for the same reasons.

Effective February 1, 2012, we increased Dr. Tsukamoto's base salary to \$335,000 from \$300,000 in recognition of contributions made on behalf of the company and market factors. More recently, effective June 6, 2013, we increased Dr. Tsukamoto's base salary to \$350,000 in recognition of contributions made on behalf of the company, market factors and her new role and responsibilities as executive vice president of scientific and strategic alliances.

Effective February 1, 2012, we increased Dr. Craig's base salary to \$300,000 from \$275,000 in recognition of contributions made on behalf of the company, scope of responsibilities and market factors. More recently, effective June 17, 2013, we increased Dr. Craig's base salary to \$320,000 in recognition of contributions made on behalf of the company and market factors.

*Bonus compensation.* We view periodic bonuses, whether paid in cash or equity, as an important element of compensation for several reasons. Bonuses help align individual employee efforts with overall corporate strategies and objectives. Bonuses also help us manage salary expense, while still allowing us to reward successes. By using discretionary bonuses as part of the compensation mix, we have greater flexibility in managing the timing and amounts of compensation. Accordingly, each year we estimate for planning purposes an

<sup>3</sup> Accordingly, we omit tables showing pension benefits and non-qualified deferred compensation.

aggregate bonus pool, which is calculated by using the base salaries of all our full-time employees and their respective target bonuses, and which assumes the Board will elect to award each full-time employee 100% of his or her personal target bonus amount for the year. However, as explained below, the actual bonus award for any particular year is entirely within the Board's discretion.

With these various principles in mind, we recently took the following actions with respect to the base compensation and bonus targets of certain named executive officers:

In February 2011, we increased Dr. Tsukamoto's target bonus rate from 30% to 40% of her base salary to further align her compensation to corporate success.

In February 2011, we increased Dr. Craig's target bonus rate from 30% to 40% of his base salary to further align his compensation to corporate success.

Mr. McGlynn's target bonus has been 55 percent of his base salary, beginning with the 2009 fiscal year, to reflect the Board's view that Mr. McGlynn's leadership is a major factor in the achievement of the company's corporate goals and to further align his compensation to corporate success.

The base compensation and target bonus information presented above can be summarized as follows:

	Year Ended 12/31/11 Base Compensation/ Target Bonus	Year Ended 12/31/12 Base Compensation/ Target Bonus	Current Base Compensation/ Target Bonus
CEO	\$ 525,000/55%	\$ 550,000/55%	\$ 570,000/55%
EVP, Alliances(1)	\$ 300,000/40%	\$ 335,000/40%	\$ 350,000/40%
EVP, Manufacturing	\$ 275,000/40%	\$ 300,000/40%	\$ 320,000/40%

(1) The company's executive vice president of scientific and strategic alliances served as the company's executive vice president of research and development from October 2008 until June 2013.

In practice, over the past few years, we have awarded bonuses on an annual basis after considering, among other things, the company's accomplishments against stated corporate goals adopted by the Board, the company's financial position, the status of its development programs, clinical progress and corporate development activities, and general economic factors. This has necessarily involved a subjective assessment by the Compensation Committee of corporate performance and market conditions each year.

The process of establishing our corporate goals over the past few years has been a lengthy one. For each fiscal year, our executive officers have presented the Compensation Committee of the Board with approximately five to ten proposed corporate goals, each often consisting of multiple sub-parts. Management has usually presented its recommended corporate goals to the Compensation Committee concurrent with our proposed corporate budgets for the following fiscal year. Goals have been designed to be challenging, so that one would not expect consistent achievement of all of them. Typically these goals have included some preclinical and clinical goals for our HuCNS-SC cell-based platform technology, financing and corporate development goals, and goals related to advancement in cell manufacturing practices. While all these goals have been considered important, and we have used a cross-functional and balanced approach to setting them, we have typically prioritized our goals by assigning relative weightings to each of them, with all of them together adding up to 100%. However, by design, no one goal has ever accounted for a majority of the relative weightings.

After receiving management's recommended goals, members of the Compensation Committee typically review them with our executive officers and oftentimes provide suggestions for additional goals or changes to the recommended goals. After our executive officers and directors have completed this iterative process, which has

often taken several weeks, the Compensation Committee adopts revised corporate goals consistent with the foregoing principles and recommends the updated corporate goals to the full Board for consideration and approval.

Thereafter, during each fiscal year, our executive officers have used the Board-approved corporate goals as a management tool, for example to coordinate activities, motivate personnel and help prioritize the use of company resources. The executive officers have sometimes referred back to the corporate goals when providing business updates to the Board, similar to management's reference back to an approved annual budget.

Recently, at the end of each fiscal year or shortly afterwards, our chief executive officer (our CEO) has presented the Compensation Committee with his assessments of corporate performance against the Board-approved corporate goals, together with a summary of any important factors that weighed in his assessments, which he has provided as context.

Because our corporate goals have not been formulaic or quantitative in nature (we have not had a corporate goal tied to specific stock price, revenues or expenses, for example), our CEO's assessments have been largely qualitative in nature. Along with these assessments, our CEO has provided a percentage score for each goal reflecting the degree to which each goal was or was not, in his judgment, achieved during the year.

The Compensation Committee has usually considered these percentage scores as well as our CEO's commentary about corporate performance and more general assessments of the state of our business when determining whether to award employees a company-wide corporate bonus in any given year, and if so how much of the available bonus pool to award. However, the Compensation Committee members have used their own judgment to determine the size of any bonus award, if any. In any given year, the Board may decide in its judgment to award more than 100% of the bonus pool for the year. The Board may also decide to award less than 100% of the bonus pool, even if all of the corporate goals have been achieved, if it decides doing so would be in the best interests of the company. While the Compensation Committee and the Board as a whole use the corporate goals as a measure of success, the amount of any bonus grant, as well as how and when it will be paid, is completely within the Board's sole discretion.

With these various principles in mind, we recently took the following actions with respect to corporate bonuses for 2013.

In December 2013, as part of its annual year-end review of performance, the Compensation Committee (with input from our CEO and other Board members) considered, among other things, significant company performance accomplishments in 2013, the company's successes measured against its 2013 corporate goals, the degree of difficulty in achieving these goals, as well as other events and circumstances that affected performance. The 2013 goals, as approved by our Board, consisted generally of the following: (i) progress in our CNS Program, including activities aimed at broadening the testing of our proprietary HuCNS-SC cells in spinal cord injury and age related macular degeneration through various clinical operations and regulatory initiatives; (ii) timely publication of clinical data; (iii) build-out and qualification of GMP manufacturing facilities; (iv) execution of lending agreements with the California Institute for Regenerative Medicine; (v) partnering, litigation and corporate development activities; and (vi) successful fundraising efforts.

Highlights of the 2013 accomplishments taken into account by the Compensation Committee in determining the overall company performance included:

#### **Clinical Activities**

We published a comprehensive overview of the therapeutic potential and results from early clinical trials of our HuCNS-SC cells in *Stem Cell Research & Therapy*, a peer-reviewed journal considered the major forum for translational research into stem cell therapies.

We received authorization from Health Canada to expand our Phase I/II clinical trial for spinal cord injury into Canada.

Our collaborators at the University of Calgary successfully transplanted the first subject under the company's Phase I/II study in North America. The University of Toronto conducted the second transplant in North America shortly thereafter.

We received FDA authorization of an IND application for clinical testing of our HuCNS-SC cells as a potential treatment for spinal cord injury.

The first cohort, consisting of three patients with complete spinal cord injury, completed the company's Phase I/II clinical trial in 2013. The data from this cohort continued to demonstrate a favorable safety profile, and showed that the considerable gains in sensory function first observed at the six month assessment in two of the three patients had persisted to the 12 month assessment.

We published preclinical data in the peer-reviewed journal *Investigative Ophthalmology and Visual Science* confirming that our HuCNS-SC cells preserve photoreceptor cells and visual function.

We completed enrollment of the first of two planned patient cohorts in our clinical trial of our proprietary HuCNS-SC cells for age related macular degeneration (AMD). This cohort consisted of eight subjects, four of whom each received 200,000 cells and four of whom each received 1,000,000 cells.

We entered into an agreement with the California Institute for Regenerative Medicine (CIRM) under which CIRM will provide up to approximately \$19.3 million, in the form of a forgivable loan, to help fund preclinical development and IND-enabling activities of our HuCNS-SC cells for Alzheimer's disease.

We formally launched our Alzheimer's disease program with a goal of filing an Investigational New Drug (IND) application with the FDA in 2016.

We presented data showing that, two years after transplantation, the evidence of myelination from our clinical study in Pelizaeus-Merzbacher Disease (PMD) is more pronounced compared to one year post-transplantation and the gains in neurological function reported after one year were maintained.

We presented results of a four-year observation study of patients with neuronal ceroid lipofuscinosis (NCL), who had been transplanted with our HuCNS-SC cells in our initial Phase I study, at the Congress of Neurological Surgeons Annual Meeting in San Francisco, California. The study showed long-term evidence of safety at doses of up to one billion cells. The study is the longest follow-up study of patients transplanted with human neural stem cells.

**Other Business Activities**

We acquired certain patents and patent applications from NsGene A/S. These patents and patent applications claim a purified population of GFAP+ Nestin+ precursor cells in which one or more of the cells are capable of differentiating into neurons.



We acquired from NeuroSpheres the patents we had licensed on an exclusive worldwide basis. This patent portfolio, associated with research done by Samuel Weiss and Brent Reynolds at the University of Calgary, has repeatedly been recognized as the seminal intellectual property claiming purified populations of human neural stem cells.

Following this review, the Compensation Committee awarded a discretionary bonus equal to 95% of the available bonus pool, based upon the committee members' assessments of market conditions, corporate risks, our market comparables, and the company's performance in 2013 measured against its 2013 corporate goals, including the successes highlighted above, among other things. The bonuses were calculated using each employee's annual base salary as of January 1, 2013, and paid in January 2014.

Accordingly, in January 2014, the company paid Mr. McGlynn a 2013 bonus in the amount of \$287,375, because on January 1, 2013 his base salary and target bonus were, respectively, \$550,000 and 55%. The company paid Dr. Tsukamoto a 2013 bonus in the amount of \$127,300, because on January 1, 2013 her base salary and target bonus were, respectively, \$335,000 and 40%. The company also paid Dr. Craig a 2013 bonus in the amount of \$114,000, because on January 1, 2013 his base salary and target bonus were, respectively, \$300,000 and 40%.

*Equity Compensation general practices.* We believe that equity compensation awards are an important component of our overall compensation policy because equity compensation can provide strong inducement to remain with the company and to build future stockholder value. In order to achieve these objectives, we believe that equity compensation awards need to be structured to provide both meaningful value and a meaningful opportunity to realize that value. Accordingly, from time to time, we have considered several forms of equity compensation awards, including stock options, stock appreciation rights, restricted stock, and restricted stock units, because each of these have certain advantages and disadvantages relative to the others with respect to how they might reward effort and success and how they might help us retain high contributors. Generally speaking, over the years, we have used stock options and restricted stock units as the most common equity compensation instruments. We feel each of these forms of equity has unique and important features for employee retention and for incentivizing the executive officers to build a profitable and sustainable business. Unless otherwise specifically noted in the tables herein, all option awards:

have an exercise price set at the closing market price of our common stock on the grant date, or on an adjacent market trading date if the market on which we are listed (currently the Nasdaq Capital Market) is not open on the grant date; and

vest over four years, with one-fourth of the shares included in any grant vesting on the first anniversary of the grant and the remainder vesting 1/48th per month thereafter, always provided that the grantee remains in the company's employ on the vesting dates. These awards are time-vesting and do not depend on performance factors.

We have frequently granted either stock option awards or restricted stock units to newly hired employees, effective as of their date of hire, and occasionally to existing employees upon their promotion. Both on-hire awards to non-executive officers and awards upon the promotion of current employees are usually made by either Mr. McGlynn, acting as the Board's single-member committee, or by the Compensation Committee. Awards to executive officers are made by either the Compensation Committee or by the full Board. We have not granted company-wide equity awards to full-time employees since June 2010. Instead, we have granted targeted equity awards to individual employees within the company following a careful review of equity held by each of our employees and the retention value that such awards may provide. In awarding equity grants to existing employees, we consider their contributions to the company, their roles and responsibilities, their past performance, and market conditions generally for similarly situated employees.

With these various principles in mind, we recently took the following actions with respect to equity compensation.

In January 2012, after a review of the market and company-specific information described above, the Compensation Committee approved a targeted award of 1,231,000 restricted stock units, in aggregate, to certain employees considered to be key contributors with leadership roles within the company and therefore most likely to have a direct role in building stockholder value. Of particular importance, the Compensation Committee noted that a majority of the stock options issued to employees had strike prices significantly below the current market price of the company's stock and were therefore of limited retention value. All of the restricted stock units awarded at this time have four-year vesting, with one-fourth vesting on each of the first four anniversaries following the grant date, except for the restricted stock units granted to Mr. McGlynn and Dr. Tsukamoto, each of which has three-year vesting, with one-third vesting on each of the first three anniversaries following the grant date. In this January 2012 grant, our named executive officers received, in the aggregate, 796,000 restricted stock units.

In August 2012, all of our executive officers decided to voluntarily surrender certain of their stock option awards under our 2004 and 2006 equity incentive plans, so that the option shares would be available for future grants under these plans. Collectively, the executive officers surrendered both vested and unvested options to acquire a total of 297,336 shares.

In December 2012, our Compensation Committee engaged The Croner Company, an executive compensation consultancy firm referred to us by our outside corporate counsel, to advise the Committee on setting a compensation peer group for the purpose of evaluating the different components of compensation paid to our chief executive officer. During the first half of 2013, our Compensation Committee held six meetings, many of which were attended by representatives from The Croner Company, to discuss a variety of recommendations made by The Croner Company, including a recommendation that the company establish a new equity incentive plan. The Compensation Committee also discussed with representatives from both management and The Croner Company a possible peer group for evaluating executive compensation market practices. After considerable discussion and a review of peer information requested by the Committee, we agreed upon a peer group consisting of fifteen (15) publicly traded companies as being closely comparable to the company because of such business factors as location, nature of operations, industry, and size.<sup>4</sup>

Since these deliberations, and after consideration of our peer group's compensation practices, we have granted a number of equity awards to our executive officers and to other key employees. In May and June 2013, for example, we awarded a total of 1,120,000 million restricted stock units, each with four-year vesting, to key employees, including grants of 280,000 restricted stock units to each of Drs. Tsukamoto and Craig.

In June 2013, we granted our chief executive officer 700,000 restricted stock units with four-year vesting in recognition of his anticipated central role in achieving the company's short- and long-term growth and future programmatic success.

Also in 2013, we granted an aggregate of 846,965 restricted stock units to newly hired employees under our 2012 Commencement Incentive Plan.

<sup>4</sup> By June 2013, the company considered the following companies as being close comparables for purposes of evaluating executive compensation: Aastrom Biosciences, Inc.; Advanced Cell Technology, Inc.; Athersys, Inc.; BioCryst Pharmaceuticals, Inc.; BioTime, Inc.; Cel-Sci Corporation; Cytokinetics, Incorporated; Cytori Therapeutics, Inc.; Geron Corporation; Medicinova, Inc.; Neostem, Inc.; Neuralstem, Inc.; Nova Bay Pharmaceuticals, Inc.; Osiris Therapeutics, Inc.; and Sangamo Biosciences, Inc.

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## Employment, Severance and Change-in-Control Agreements

*Employment agreements of Certain Named Executive Officers.* Mr. McGlynn joined the company as our president and chief executive officer on January 15, 2001. Under the terms of an employment agreement between Mr. McGlynn and the company, dated January 2, 2001, as amended, Mr. McGlynn received an initial annual base salary of \$275,000 per year, reviewable annually by the Board of Directors, and a bonus, in the Board's sole discretion, of up to 25% of his base salary. Over time, however, we have increased Mr. McGlynn's base salary and target bonus so that they are, respectively, \$570,000 and 55% of his base salary. In his original employment agreement, we also agreed to pay Mr. McGlynn a \$50,000 relocation bonus and to reimburse him for relocation expenses, which we did. Since January 2009, we have been paying Mr. McGlynn an annual car allowance of \$10,000.

Dr. Tsukamoto joined the company in November 1997 and has served as our executive vice president of scientific and strategic alliances since June 2013. Under the terms of an employment agreement between Dr. Tsukamoto and the company, dated February 2, 1998, Dr. Tsukamoto received an annual base salary of \$130,000 per year and a discretionary target bonus of up to 10% of her base salary. Over time, however, we have increased her base salary and target bonus so that they are, respectively, \$350,000 and 40% of her base salary. Also pursuant to her employment agreement, we provide Dr. Tsukamoto with \$750,000 of term life insurance on an annual basis during her employment.

Dr. Craig joined the company in September 2008 as our senior vice president of development and operations. Under the terms of his agreement with the company, dated July 24, 2008, Dr. Craig has received an annual base salary of \$275,000 per year, with a target bonus of up to 25% of his base salary. Over time, however, we have increased Dr. Craig's base salary and target bonus so that they are, respectively, \$320,000 and 40% of his base salary. Pursuant to Dr. Craig's July 2008 employment agreement, we granted him an option to purchase 20,000 shares of our common stock. This option will vest over 48 months, with one-fourth of the shares having vested on the first anniversary of the date on which Dr. Craig's employment began and with the remaining shares vesting, subject to his continued employment by the company, at the rate of 1/48th per month on the last day of each month during the ensuing 36 months.

*Severance arrangements.* Each of our executive officers has entered into a severance agreement with the company under which he or she would receive payments upon termination of his or her employment by us without cause<sup>5</sup> or consequent to a change of control or, in the case of Mr. McGlynn, by virtue of disability.

In the case of Mr. McGlynn, upon termination without cause, we would continue to pay his salary and provide benefits for one year, at the base wage rate then in effect. If the termination of Mr. McGlynn's employment were associated with a change of control, the company would pay (in a lump sum) (i) two years of his salary and the reasonably projected cost of healthcare benefits, (ii) a bonus with respect to the termination year at 25% of the base salary, pro-rated for the portion of the year served, and (iii) a tax gross up for his continued healthcare benefits. In addition, all unvested stock options would vest and all stock options would be exercisable for two years after termination. If Mr. McGlynn's employment were terminated on account of disability, we would continue to pay his salary for up to six months (or until he obtained other employment or became eligible for disability income under a company plan, if sooner).

In the case of Dr. Tsukamoto, upon involuntary termination without cause, whether or not associated with a change of control, we would continue to pay Dr. Tsukamoto's salary and provide benefits for twelve months, at the rate then in effect.

<sup>5</sup> Or termination by the executive officer for good reason, as defined in their respective agreements.

In the case of Dr. Craig, upon involuntary termination without cause, whether or not associated with a change of control, we would continue to pay his salary and provide benefits for six months, at the rate then in effect.

If we terminate the employment of any executive officer for cause, or if the officer resigns without good cause, he or she would not be entitled to any severance or other benefits.

**Executive Officer Compensation Tables**

The following tables set forth information with respect to the compensation of certain named executive officers for the fiscal years ended December 31, 2013 and 2012.

**Summary Compensation Table**

Name and Principal Position	Year	Salary	Bonus	Stock	All Other	Total (\$)
		(\$)(1)	(\$)(2)	Awards (\$)(3)	Compensation (\$)(4)	
Martin McGlynn President and CEO	2013	548,461	287,375	1,239,000	43,258	2,118,094
	2012	548,076	202,125	430,360	50,590	1,231,151
Ann Tsukamoto, Ph.D. EVP, Scientific and Strategic Alliances	2013	330,019	127,300	515,200	27,014	999,533
	2012	332,307	84,000	137,800	26,457	580,564
Stewart Craig, Ph.D. EVP, Manufacturing Operations and Regulatory Affairs	2013	298,461	114,000	512,400	34,239	959,100
	2012	298,076	77,000	137,800	29,867	542,743

- (1) We pay salaries on a bi-weekly basis. There were 27 pay periods in 2010 and 26 pay period in both 2011 and 2012.
- (2) Each employee's target bonus is based on his or her salary as of January 1 of the year to which it applies. For 2012, the Board awarded 70% of the target bonus for all company employees. For 2013, the Board awarded 95% of the target bonus for all company employees. For further description of the non-equity incentive plan see the discussion in our Compensation Discussion and Analysis and Compensation of Named Executive Officers, above.
- (3) Amounts shown represent the full grant date value of the equity awards granted in each year as computed in accordance with FASB ASC Topic 718. Assumptions used in the calculation of these amounts are included in Note 9, Stock-Based Compensation in our Form 10-K for the period ended December 31, 2013, filed with the SEC on March 13, 2014.
- (4) The amounts shown in the All Other Compensation column for 2013 include the following:

Name and Principal Position	Employer Match of Defined Contribution Plans	Transportation Allowance	Employee health and Welfare Benefit Plans	Total All Other Compensation
	(\$)(a)	(\$)	(\$)(b)	(\$)
Martin McGlynn President and CEO	7,650	10,000	25,608	43,258
Ann Tsukamoto, Ph.D. EVP, Scientific and Strategic Alliances	7,650		19,364(c)	27,014
Stewart Craig, Ph.D. EVP, Manufacturing Operations and Regulatory Affairs	7,650		26,589	34,239

(a)

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Under a 401(k) plan, which is open to substantially all of our employees, we make matching contributions in the form of company common stock based on each participant's voluntary salary deferrals, subject to plan

and legal limits. We match participant contributions on a 1:2 basis up to a maximum of 3% of the employee's salary. Registered stock is valued and transferred to the employee's 401(k) account at the end of calendar each quarter.

- (b) We offer all employees various health and welfare benefit plans. Our executive officers may participate in these on the same terms as other employees.
- (c) Includes life insurance benefit of \$1,180.

### Outstanding Equity Awards at Fiscal 2013 Year-End

The following tables show equity awards held by certain of our named executive officers as of December 31, 2013:

Name	Option Grant Date	Option Awards		Option Exercise Price (\$/sh)(1)	Option Expiration Date
		Number of Securities Underlying Unexercised Options (#) Exercisable(1)	Number of Securities Underlying Unexercised Options (#) Unexercisable(1)		
Martin McGlynn President and CEO	6/25/2010	26,249	3,751	\$ 10.50	6/25/2020
Ann Tsukamoto, Ph.D. EVP, Scientific and Strategic Alliances	6/1/2010	17,499	2,501	\$ 10.20	6/1/2020
Stewart Craig, Ph.D. EVP, Manufacturing Operations and Regulatory Affairs	6/1/2010	8,749	1,251	\$ 10.20	6/1/2020

Name	Date of Award	Stock Awards	
		Number of Securities Underlying Restricted Stock Units That Have Not Vested (2)	Market Value of Securities of Restricted Stock Units That Have Not Vested (3)
Martin McGlynn President and CEO	1/27/2012 6/3/2013	270,666 700,000	\$ 332,919 \$ 861,000
Ann Tsukamoto, Ph.D. EVP, Scientific and Strategic Alliances	1/27/2012 6/6/2013	86,666 280,000	\$ 106,599 \$ 344,400
Stewart Craig, Ph.D. EVP, Development and Operations	6/1/2010 1/27/2012 5/24/2013	5,000 97,500 280,000	\$ 6,150 \$ 119,925 \$ 344,400

- (1) Unless otherwise noted, options are granted at the close of market price on the grant date (or on an adjacent market trading day if the Nasdaq Capital Market is closed on the grant date). They vest over a period of four years as follows: one-fourth of the option vests on the first anniversary of the grant date and 1/48th of the original grant vests each additional month of service.
- (2) Restricted stock units granted under our 2006 Equity Incentive Plan. These restricted stock units vest ratably over a three to four-year period on each grant date anniversary.
- (3) Based on the per share closing market price of \$1.23 for our common stock on December 31, 2013.

#### Director Compensation



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*Cash Compensation.* From December 2009 through 2013, outside directors received quarterly retainers for Board service in the amount of \$6,250 (\$12,500 for the chairman of the Board). The chairs of the standing committees received quarterly stipends of either \$2,500 (Audit Committee) or \$1,250 (Compensation Committee, Corporate Governance Committee and, since it became a standing committee in June 2010, the Strategic Transactions Committee). Non-employee directors also received \$2,000 for each board meeting attended in person or by videoconference and \$1,000 for each board meeting attended by phone, as well as \$1,000 for each standing committee meeting attended in person or by videoconference and \$500 for each committee meeting attended by phone. Board service fees were typically paid in cash. However, in March 2011,

the Board approved a sub-plan under our 2006 Amended and Restated Equity Incentive Plan, called the Directors' Fee Plan, which permits directors to elect to receive all or a portion of their board fees in the form of company common stock. We issued 39,950 shares of stock under our Directors' Fee Plan as consideration for Board service in 2012. We issued 12,745 shares of stock under our Directors' Fee Plan as consideration for Board service in 2013.

In mid-2013, we asked Dr. Levy, the chairman of our Corporate Governance Committee, to review board compensation practices at the company. In particular, we wanted to assess whether we were being responsive to market dynamics, as we had not adjusted director compensation for almost four years. To evaluate current market practices, Dr. Levy assembled a working group consisting of himself, the chairman of our Compensation Committee and our CEO, who worked together with company management to analyze the compensation practices at the fifteen companies previously identified by The Croner Company as being our closest market comparables.<sup>6</sup> At the working group's request, the company prepared for the Board's review a broad survey of director compensation paid by these market comparables. From this information, we determined that our annual retainers paid for board and committee service fell below the median (i.e., 50th percentile) and in some ways below the 25th percentile of cash compensation paid by comparable companies to their outside directors, even though our total board cash compensation, including meeting attendance fees, was only slightly below the median paid by our market comparables. Moreover, we determined that the equity compensation paid to our outside directors was significantly below the market median, with the full value of our annual awards being less than half the median paid by our closest market comparables. In addition to reviewing this market data, the working group discussed among other things the relative value of continued use of restricted stock units as director compensation, the company's interest in making director compensation competitive insofar as there would be one unfilled seat on the Board following Dr. Perlmutter's planned resignation in December 2013, as well as the company's business prospects and agenda more generally.

Following this, in December 2013, Dr. Levy presented to the Board a series of recommendations from the working group to change both the cash and equity compensation paid to our outside directors. The Board considered in particular the market data from the comparable companies collected by management, as recommended by The Croner Company and adopted by the working group. With respect to cash compensation, in recognition of the fact that the company's director compensation fell below the average compensation paid by our market comparables and to help garner interest in board service, the Board approved the recommended changes to the cash-based compensation to increase expected cash compensation from \$36,000 to \$40,000 per year, consisting of both quarterly retainers and regular board attendance fees, effective April 1, 2014.

Accordingly, our outside directors now receive quarterly retainers for Board service in the amount of \$7,500 (\$15,000 for the chairman of the Board). Also, the chairs of our standing committees receive quarterly stipends of \$2,500 (Audit Committee), \$1,500 (Compensation Committee and Corporate Governance Committee), and \$1,250 (Strategic Transactions Committee). Non-employee directors also receive \$2,000 for each board meeting attended in person or by videoconference and \$1,000 for each board meeting attended by phone. Members of the standing committees receive attendance fees, as follows: \$2,000 per Audit Committee meeting attended in person (\$1,000 for attendance by phone), \$1,500 per Compensation Committee or Corporate Governance Committee meeting attended in person (\$750 for attendance by phone), and \$1,000 per Strategic Transactions Committee attended in person (\$500 for attendance by phone).

<sup>6</sup> As explained above, by June 2013, and with the advice and guidance of The Croner Company, we determined that the following companies are close comparables for purposes of evaluating our compensation practices: Aastrom Biosciences, Inc.; Advanced Cell Technology, Inc.; Athersys, Inc.; BioCryst Pharmaceuticals, Inc.; BioTime, Inc.; Cel-Sci Corporation; Cytokinetics, Incorporated; Cytori Therapeutics, Inc.; Geron Corporation; Medicinova, Inc.; Neostem, Inc.; Neuralstem, Inc.; Nova Bay Pharmaceuticals, Inc.; Osiris Therapeutics, Inc.; and Sangamo Biosciences, Inc.

Directors are also reimbursed for their expenses in attending meetings of the Board and meetings of committees of the Board; and have been for many years.

*Equity Compensation.* In June 2009, the Board adopted management's recommendation to award outside directors with annual equity grants paid in restricted stock units rather than common stock options. The Board's decision to change the annual grants followed several months of deliberation by the company's management and Compensation Committee, which considered among other things equity compensation practices at various comparable companies, outside reports, the company's trading history, and market trends, such as the growing use of restricted stock units as director compensation by comparable companies.

Then, in December 2009 and June 2010, the Board approved further changes proposed by management to the equity compensation practices for outside directors. Among other changes, the Board approved management's recommendation to award newly appointed directors an initial grant of restricted stock units rather than options. At the time, newly appointed outside directors received an initial grant upon their first appointment to the Board of 15,000 restricted stock units, with one third of this grant vesting on each of the three anniversaries following the grant. Thereafter, each non-employee director, other than the chairman of the Board, received an annual grant on each anniversary of his or her appointment to the Board in the form of 1,000 restricted stock units, vesting on the first anniversary of the grant. In addition, the chairman of the Board received an annual grant of 1,500 restricted stock units, vesting on the first anniversary of the grant. Each of the annual grants from June 2010 to December 2011 was for 1,000 restricted stock units (1,500 for the chairman), vesting on the first anniversary of the grant.

In March 2012, however, the Board approved a further change proposed by management to the equity compensation practices for outside directors given the Company's stock trading price and our desire to fairly compensate our outside directors for continued Board service and incentivize them to build stockholder value. Accordingly, from January 1, 2012 through 2013, each non-employee director, other than the chairman of the Board, received an annual grant on each anniversary of his or her appointment to the Board in the form of 10,000 restricted stock units, vesting on the first anniversary of the grant. In addition, the chairman of the Board received an annual grant of 15,000 restricted stock units, vesting on the first anniversary of the grant.

Then, in December 2013, following the review of market comparables by the chairs of our Corporate Governance and Compensation Committees and our CEO described above, the Board replaced the annual grants of 10,000 restricted stock units (15,000 for our chairman) with annual grants, on January 1st of each year for all outside directors, of restricted stock units worth \$60,000, in each case with one-year vesting. Because we had previously made annual equity awards to our outside directors on their board service anniversary dates, the Board agreed to reduce the 2014 awards to the extent each director's 2013 award already compensated him for Board service through part of 2014. Accordingly, on January 1, 2014, we made the following grants of restricted stock units: 47,164 restricted stock units to Mr. Bjerkholt; 44,588 restricted stock units to Mr. Greer; 41,438 restricted stock units to Dr. Levy; 44,383 restricted stock units to Dr. Schwartz; and 41,301 restricted stock units to Dr. Weissman. Beginning in January 2015, we expect to grant each of our outside directors on a yearly basis the same number of restricted stock units equal to \$60,000 divided by the then current trading price of our stock.

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**Director Compensation Table**

The following table summarizes cash-based and equity compensation information for our outside directors, including annual Board and committee retainer fees and meeting attendance fees, for the year ended December 31, 2013:

Name	Fees Earned			Total (\$)
	or Paid in Cash (\$)	Stock Awards (\$)(1)	All Other Compensation (\$)	
Eric Bjerkholt	57,500(2)	17,000(3)		74,500
R. Scott Greer	43,000(4)	17,800(5)		60,800
Ricardo Levy, Ph.D.	56,000(6)	17,900(7)		73,900
John Schwartz, Ph.D.	57,750(8)	24,750(9)		82,500
Irving Weissman, M.D.	33,000(10)	16,800(11)	50,000(12)	99,800

- (1) The amounts shown in this column represent the full grant date fair value of restricted stock unit grants in 2013 as computed in accordance with FASB ASC Topic 718. Assumptions used in the calculation of these amounts are included in Note 10, Stock-Based Compensation in our Form 10-K for the period ended December 31, 2013, filed with the SEC on March 13, 2014.
- (2) Includes an annual retainer of \$25,000, a fee for Mr. Bjerkholt's role on the Audit Committee of \$10,000, and additional fees of \$17,500 for Board and committee meetings attended. Also includes \$14,250 earned in 2012 but paid in 2013.
- (3) Mr. Bjerkholt was granted 1,000 restricted stock units on March 1, 2012, vesting on the one year anniversary of the grant, and 9,000 restricted stock units on April 18, 2012, vesting on March 1, 2013. As of December 31, 2013, he had stock options and restricted stock units outstanding for the purchase of 17,000 shares of common stock, in the aggregate.
- (4) Includes an annual retainer of \$25,000, a fee for Mr. Greer's role on the Strategic Transactions Committee of \$5,000, and additional fees of \$11,500 for Board and committee meetings attended. Also includes \$11,000 earned in 2012 but paid in 2013.
- (5) Mr. Greer was granted 10,000 restricted stock units on June 3, 2012, vesting on the one year anniversary of the grant. As of December 31, 2013, he had restricted stock units outstanding for the purchase of 15,000 shares of common stock, in the aggregate.
- (6) Includes an annual retainer of \$25,000, a fee for Dr. Levy's role on the Corporate Governance Committee of \$5,000, and additional fees of \$22,500 for Board and committee meetings attended. Also includes \$15,500 earned in 2012 but paid in 2013.
- (7) Dr. Levy was granted 10,000 restricted stock units on September 26, 2012, vesting on the one year anniversary of the grant. As of December 31, 2012, Dr. Levy had stock options and restricted stock units outstanding for the purchase of 17,073 shares of common stock, in the aggregate.
- (8) Includes an annual retainer of \$50,000, a fee for Dr. Schwartz's role on the Compensation Committee of \$5,000, and additional fees of \$18,000 for Board and committee meetings attended. Also includes \$8,875 earned in 2012 but paid in 2013.
- (9) Dr. Schwartz was granted 15,000 restricted stock units on April 18, 2012, vesting on the one year anniversary of the grant. In addition, from March 2012 and until October 2012, Dr. Schwartz elected to receive 100% of his future board service fees in the form of company

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common stock. As of December 31, 2013, Dr. Schwartz had stock options and restricted stock units outstanding for the purchase of 21,500 shares of common stock, in the aggregate. Also includes \$20,750 earned in 2012 but paid in 2013 in common shares under the Directors Fee Plan.

- (10) Includes an annual retainer of \$25,000 and additional fees of \$7,000 for Board and committee meetings attended. Also includes \$7,250 earned in 2012 but paid in 2013.
- (11) Dr. Weissman was granted 10,000 restricted stock units on October 1, 2012, vesting on the one year anniversary of the grant. As of December 31, 2013, Dr. Weissman had stock options and restricted stock units outstanding for the purchase of 22,141 shares of common stock, in the aggregate.
- (12) Dr. Weissman receives \$50,000 per year for his services as a consultant and as the chairman of our Scientific Advisory Board. Since May 2011, Dr. Weissman has received his consultancy fees under this agreement in the form of company common stock.

**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Related parties can include any of our directors or executive officers, certain of our stockholders and their immediate family members. Each year, we prepare and require our directors and executive officers to complete Director and Officer Questionnaires identifying any transactions with us in which the officer or director or their family members have an interest. This helps us identify potential conflicts of interest. A conflict of interest occurs when an individual's private interest interferes, or appears to interfere, in any way with the interests of the company as a whole. Our code of ethics requires all directors, officers and employees who may have a potential or apparent conflict of interest to immediately notify our general counsel, who serves as our compliance officer. In addition, the Corporate Governance Committee of the Board of Directors is responsible for considering and reporting to the Board any questions of possible conflicts of interest of Board members. Our code of ethics further requires pre-clearance before any employee, officer or director engages in any personal or business activity that may raise concerns about conflict, potential conflict or apparent conflict of interest. Copies of our code of ethics and the Corporate Governance Committee charter are posted on the corporate governance section of our website at [www.stemcellsinc.com](http://www.stemcellsinc.com).

In evaluating related party transactions and potential conflicts of interest, our compliance officer and independent directors apply the same standards of good faith and fiduciary duty they apply to their general responsibilities. They will approve a related party transaction only when, in their good faith judgment, the transaction is in the best interest of the company.

Dr. Weissman, a member of the Board of Directors, was retained in September 1997 to serve as a consultant to us. Pursuant to his consulting agreement, Dr. Weissman provides consulting services to us and serves on our Scientific Advisory Board. In return, we pay Dr. Weissman \$50,000 per year for his services. We also agreed to nominate Dr. Weissman for a position on the Board of Directors, and he agreed to serve if elected. Since October 1, 2000, he has been compensated for this service in the same manner and amount as other non-employee members of the Board. The consulting agreement with Dr. Weissman contains confidentiality, non-competition, and assignment of invention provisions and is for a term of fifteen years, subject to earlier termination by either party. In May 2011, Dr. Weissman's consulting agreement was amended by the parties so that the company could choose to pay fees owed to Dr. Weissman under the agreement in the form of company common stock.

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**PRINCIPAL ACCOUNTING FEES AND SERVICES**
**Audit and Tax Fees**

The Board of Directors, upon the recommendation of the Audit Committee, has selected the independent accounting firm of Grant Thornton LLP to audit the accounts of the company for the year ending December 31, 2014.

The Audit Committee considered the tax compliance services provided by Grant Thornton LLP, concluded that provision of such services is compatible with maintaining the independence of the independent accountants, and approved the provision by Grant Thornton LLP of tax compliance services with respect to the year ending December 31, 2013.

The Audit Committee received the following information concerning the fees of the independent accountants for the years ended December 31, 2012 and 2013, has considered whether the provision of these services is compatible with independence of the independent accountants, and concluded that it is:

	Year Ended	
	12/31/13	12/31/12
Audit fees(1)	\$ 427,615	\$ 432,693
Tax fees	\$ 45,743	\$ 46,866

- (1) Audit fees represents fees for the integrated audit of our annual consolidated financial statements and reviews of the interim consolidated financial statements, and review of audit-related SEC filings; also includes fees related to issuing comfort letter(s) in 2012 and 2013. Audit and tax fees include administrative overhead charges and reimbursement for out-of-pocket expenses.

**Pre-Approval Policies and Procedures**

The Audit Committee has adopted policies and procedures for pre-approving all services (audit and non-audit) performed by our independent auditors. In accordance with such policies and procedures, the Audit Committee is required to pre-approve all audit and non-audit services to be performed by the independent auditors in order to assure that the provision of such services is in accordance with the rules and regulations of the SEC and does not impair the auditors' independence. Under the policy, pre-approval is generally provided up to one year and any pre-approval is detailed as to the particular service or category of services and is subject to a specific budget. In addition, the Audit Committee may pre-approve additional services on a case-by-case basis. During 2013 and 2012, all services performed by our independent auditors were pre-approved.

**REPORT OF THE AUDIT COMMITTEE**

The Audit Committee oversees our accounting and financial reporting processes and the audits of our financial statements on behalf of the Board, and selects an independent public accounting firm to perform these audits. Management has the primary responsibility for establishing and maintaining adequate internal control over financial reporting, preparing the financial statements, and establishing and maintaining adequate controls over public reporting. Our independent registered public accounting firm for fiscal 2013, Grant Thornton LLP, had responsibility for conducting an audit of our annual financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States) and expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles.

The Audit Committee oversaw the independent public accounting firm's qualifications and independence, as well as its performance. The Audit Committee assisted the Board in overseeing the preparation of the company's financial statements, the company's compliance with legal and regulatory requirements, and the performance of the company's internal audit function. The Audit Committee met with personnel of the company and Grant Thornton LLP to review the scope and the results of the annual audit, the amount of audit fees, the company's internal accounting controls, the company's financial statements contained in the company's Annual Report to Stockholders and other related matters.

The Audit Committee has reviewed and discussed with management the financial statements for fiscal year 2013 audited by Grant Thornton LLP, as well as management's report on internal control over financial reporting, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. The Audit Committee has discussed with Grant Thornton LLP various matters related to the financial statements, including those matters required to be discussed by SAS 114 (The Auditor's Communication with Those Charged with Governance). The Audit Committee has also discussed with Grant Thornton LLP its report on internal control over financial reporting, has received the written disclosures and the letter from Grant Thornton LLP required by Public Company Accounting Oversight Board (PCAOB) Ethics and Independence Rule 3526, *Communication with Audit Committees Concerning Independence* (Rule 3526), and has discussed with Grant Thornton LLP its independence.

Based upon such review and discussions, the Audit Committee recommended to the Board of Directors, and the Board approved the recommendation, that the audited financial statements be included in the company's Annual Report on Form 10-K for the fiscal year ending December 31, 2013 for filing with the SEC.

**AUDIT COMMITTEE**

Eric Bjerkholt, Chairman  
Ricardo Levy, Ph.D.  
John Schwartz, Ph.D.



**PROPOSAL NUMBER 1****Election of Directors**

The number of directors is currently fixed at seven, with one seat unfilled. Both our restated certificate of incorporation, as amended to date, and our amended and restated by-laws provide for the classification of the Board of Directors into three classes (Class I, Class II and Class III), as nearly equal in number as possible, with the term of office of one class expiring each year.

Unless otherwise instructed, the enclosed proxy will be voted to elect the nominees named below, who are now Class II directors, as Class II directors for a term of three years expiring at the 2017 Annual Meeting of Stockholders and until their successors are duly elected and qualified. Both Class II director nominees have been recommended by the Board of Directors because of their past experience serving on the company's Board of Directors, the breadth of their business expertise, sound judgment, and demonstrated leadership, among other things. In prior years, the Class I and Class III directors were nominated for appointment to the Board for similar reasons. Proxies cannot be voted for a greater number of persons than the number of nominees named below. It is expected that the nominees will be able to serve, but if any are unable to serve, the proxy will be voted for a substitute nominee or nominees designated by the Board of Directors.

The nominees for election as Class II directors are as follows:

**NOMINEES FOR ELECTION AS CLASS II DIRECTORS**

<b>Name</b>	<b>Principal Occupation</b>	<b>Age*</b>	<b>Position</b>
Ricardo Levy, Ph.D.	Independent Director	69	Director
Irving Weissman, M.D.	Professor, Stanford University	74	Director

\* Ages are as of April 15, 2014.

*Ricardo Levy, Ph.D.* was elected to the company's Board of Directors in September 2001. He most recently served as Lead Director of Renegy Holdings, the successor of Catalytica Energy Systems, Inc., an environmental emissions solutions provider. Prior to his role with Renegy Holdings, Dr. Levy served as Chairman of the Board of Catalytica Energy Systems from 1995, when the company was formed as a subsidiary of Catalytica, Inc., until October 2007 when the company merged to form Renegy. Dr. Levy was a founder of Catalytica, Inc. in 1974, serving as Chief Operating Officer from 1974 until 1991, and President and Chief Executive Officer until December 2000, when Catalytica, Inc. and its subsidiary Catalytica Pharmaceuticals, Inc. were sold to DSM N.V. Before founding Catalytica, Inc., Dr. Levy was a founding member of Exxon's chemical physics research team, and prior to that served as Chief Executive Officer of Sudamericana C.A. in Quito, Ecuador. He continues to serve as Special Advisor to the Board of Directors of Renegy Holdings, and also as a member of the Board of Directors of Accelrys Inc. (formerly Pharmacopeia, Inc.) and NovoDynamics, Inc., a private company focused on advanced image discovery. Dr. Levy holds Bachelor of Science and PhD degrees in Chemical Engineering from Stanford University, and a Master of Science Degree from Princeton University.

*Irving Weissman, M.D.* was elected to the Board of Directors of the company in September 1997 and has served as the chairman of the company's Scientific Advisory Board since that time. Dr. Weissman is Professor of Pathology and Developmental Biology at Stanford University, Director of the Stanford University Institute for Stem Cell Biology and Regenerative Medicine, and Director of the Stanford Ludwig Center for Cancer Stem Cell Research and Medicine. Among his many scientific achievements, Dr. Weissman's laboratory was the first to discover the mammalian stem cell and the hematopoietic (blood-forming) stem cell. Dr. Weissman was also

responsible for the formation of three stem cell companies: SyStemix, Inc., StemCells, Inc., and Cellerant, Inc. Dr. Weissman received his B.S. from Montana State College in 1961 and an M.D. from Stanford University in 1965. During medical school he conducted research on thymus cell migration for nine months with Sir James Gowans at Oxford University, England. He was a postdoctoral fellow in Dr. H. S. Kaplan's laboratory at Stanford University from 1965-1967, and was appointed as a Research Associate in the Department of Radiology upon completion of the fellowship. He was appointed Assistant Professor of Pathology, Stanford School of Medicine in 1969, Associate Professor in 1974, and Professor in 1981. He was an Investigator of the Howard Hughes Medical Institute from 1990-1992. He was the Karel Beekhuis Professor of Cancer Biology from 1987 until 2005 and the Chair of the Immunology Program, a degree-granting program from 1986-2001. In 2002 he became Director of the Stanford Cancer/Stem Cell Institute, which was split into the Stanford Institute of Stem Cell Biology and Regenerative Medicine, and the Stanford Cancer Center in 2003; Weissman was Director of both, and was principal investigator on the successful NCI Cancer Center grant. He stepped down as Cancer Center Director in 2008, but remains director of the Stem Cell Institute. In May 2005, he was named the Virginia and D. K. Ludwig Professor for Clinical Investigation in Cancer Research. Dr. Weissman is an elected member of the National Academy of Sciences (1989-present), the Institute of Medicine at the National Academy (2002-present), the American Academy of Arts and Sciences (1990-present), The American Association for the Advancement of Science (1990), the American Academy of Microbiology (1997-present), and the American Philosophical Society (2008-Present), and also served as President of the International Society of Stem Cell Research (ISSCR) from 2009 to 2010. Dr. Weissman has received numerous awards for his many achievements throughout his career. Dr. Weissman was elected to the National Academy of Sciences Council in 2011 and recently elected as a Fellow of the American Association of Cancer Research Academy. He holds honorary doctorates from Columbia University, Montana State University, and the Mt. Sinai School of Medicine in New York City.

**THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE FOR THE ELECTION OF THE NOMINEES DESCRIBED ABOVE.**

**PROPOSAL NUMBER 2**

**Ratification of Selection of Independent Public Accountants**

The company is asking the stockholders to ratify the selection of Grant Thornton LLP as the company's independent public accountants for the fiscal year ending December 31, 2014. The affirmative vote of the holders of a majority of the shares represented and voting at the Annual Meeting will be required to ratify the selection of Grant Thornton LLP.

In the event the stockholders fail to ratify the appointment, the Audit Committee of the Board of Directors will consider it as a recommendation to select other auditors for the subsequent year, which the Audit Committee would then take under advisement. Even if the selection is ratified, the Audit Committee of the Board at its discretion could decide to terminate the engagement of Grant Thornton LLP and engage another firm at any time if the Audit Committee determines that such a change would be necessary or desirable in the best interests of the company and its stockholders.

A representative of Grant Thornton LLP is expected to attend the Annual Meeting and is not expected to make a statement, but will be available to respond to appropriate questions and may make a statement if such representative desires to do so.

**THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE FOR THE PROPOSAL TO RATIFY THE SELECTION OF GRANT THORNTON LLP AS THE COMPANY'S INDEPENDENT PUBLIC ACCOUNTANTS FOR THE FISCAL YEAR ENDING DECEMBER 31, 2014.**

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**PROPOSAL NUMBER 3**

**Advisory Vote on Executive Officer Compensation**

**Say on Pay Vote**

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 enables our stockholders to cast an advisory vote at the Annual Meeting to approve the compensation of our named executive officers as disclosed in the Executive Compensation section of this proxy statement, including the Compensation Discussion and Analysis (the CD&A), and the related tables and narrative. The vote on this resolution is not intended to address any specific element of compensation; rather the vote relates to the compensation of our named executive officers generally, as described in this proxy statement. Stockholders are urged to read carefully the CD&A and other information in the Executive Compensation section of this proxy statement before casting their vote.

The Board believes that this advisory vote is an important way of obtaining feedback from our stockholders about executive compensation, which is set by the Compensation Committee and the independent directors and is designed to link pay with performance. Although this vote is non-binding, our Board of Directors and Compensation Committee value the opinions of our stockholders and will consider the outcome of this vote when making future compensation decisions affecting our executive officers.

**Our Compensation Philosophy**

The key elements of our compensation programs, which are described at length in the CD&A, can be summarized as follows:

*We seek to link pay to performance in a manner that promotes the company's long-term success.* We structure our compensation programs to attract and retain talented employees and reward them for helping us achieve our short-term and long-term goals. We intend for our compensation programs to be equitable and competitive when measured against those offered by companies against whom we compete for high-level scientific and executive personnel. We also intend for them to link pay to both company and individual performance.

In seeking to accomplish our objectives and commitment to good corporate governance, we follow a compensation strategy designed, ultimately, to reward increasing stockholder value. However, because achievement of our principle mission—the research, development and commercialization of stem cell therapeutics and related tools and technologies for academia and industry—is a long, expensive and challenging process, we often set individual compensation by using surrogate endpoints to gauge employee contributions towards building sustained stockholder value, such as the achievement of stated corporate goals adopted from time to time by the Board and the speed and effectiveness with which an executive officer discovers, assesses and, where appropriate, pursues promising opportunities for the company.

*We use customary compensation components.* We, like most biotechnology companies, use a combination of base salary, bonuses and equity awards to compensate our employees, including our executive officers:

base salary is compensation for current efforts;

bonuses, whether in cash or equity, are typically paid for achievements in meeting stated corporate goals; and

equity awards are inducements to remain with the company and to build future value.

We are a small company and principally focused on advancing our HuCNS-SC therapeutic candidate through clinical development. We therefore do not employ compensation practices that we feel are better managed by larger companies or earnings driven companies, such as employee stock purchase plans, annual compensation benchmarking, and defined benefit pension plans.

*We target the 50% percentile.* While we believe our officers and other employees are outstanding, we realize that the company is not yet profitable and that it is still in a relatively early stage of development. We therefore generally prefer to target our compensation practices so that our employees' base salaries, bonuses, equity compensation, and benefits all fall close to the 50th percentile paid by comparable companies for similar positions. We also endeavor to set base compensation levels so that their salaries are competitive with salaries paid by comparable companies to employees with similar experience, taking into account the cost of living in the San Francisco Bay Area.

*We try to minimize risk and opportunistic behavior.* On occasion, we have considered our employee compensation programs, including our executive compensation programs, and the effect they may have on company risk. We believe our compensation practices are simple and straight-forward and consistent with those of similarly situated research and development companies. We believe further that our bonus and equity grant practices are well designed to reduce the likelihood of short-term profiting at the expense of the company's long-term interests. All bonuses are awarded entirely at the discretion of our Board, for example, after taking into consideration the progress of our company's programs and long-term prospects. We do not make formulaic bonus payments, such as bonuses driven by our financial reports, which we feel helps guard the company against opportunistic financial reporting. Instead, we believe our cash bonus program properly aligns compensation with the achievement of our overall operational goals, all of which are designed to have a positive impact on our business. With regard to equity compensation, which is customary in our industry, we typically grant equity awards that vest over many years after the date of grant. We believe discretionary equity compensation that vests over multiple years does not encourage short-term or high-risk opportunistic behavior and instead aligns our employees' interests with the long-term interests of our stockholders by encouraging activities intended to build company long-term value. We also believe that equity compensation awards are an important component of our overall compensation policy because equity compensation can provide strong inducement to remain with the company and to build future stockholder value. For all these reasons, we have concluded that our employee compensation programs are designed with the appropriate balance of risk and reward in relation to our company's overall business strategy and do not incentivize executives or other employees to take unnecessary or excessive risks.

Further details concerning how we implement our philosophy and goals, and how we apply the above principles to our compensation program, are provided in the CD&A.

#### **Directors' Recommendation**

The Compensation Committee and the Board of Directors believe that the information provided in our proxy statement demonstrates that our executive compensation programs align our executives' compensation with the company's short-term and long-term performance and provides the compensation and incentives needed to attract, motivate and retain key executives who are crucial to the company's long-term success. Accordingly, the following resolution will be submitted for a stockholder advisory vote at the 2014 Annual Meeting:

RESOLVED, that the stockholders of StemCells, Inc. (the company) approve, on an advisory basis, the compensation of the company's named executive officers, as disclosed pursuant to Item 402 of Securities and Exchange Commission Regulation S-K, including the Compensation Discussion and Analysis, the compensation tables and narrative disclosures.

**THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE FOR THE ADVISORY RESOLUTION TO APPROVE THE COMPENSATION OF THE COMPANY'S NAMED EXECUTIVE OFFICERS AS PRESENTED IN ITS PROXY STATEMENT.**

## OTHER MATTERS

### Stockholder Proposals

Stockholders who wish to present proposals for inclusion in the company's proxy materials for the 2015 Annual Meeting of Stockholders may do so by following the procedures prescribed in Rule 14a-8 under the Exchange Act. To be eligible, the stockholder proposals must be received by our corporate secretary on or before January 1, 2015.

Stockholders who wish to make a proposal at the 2015 Annual Meeting of Stockholders, other than one that will be included in our proxy materials, must notify us no later than March 17, 2015 (see Rule 14a-4 under the Exchange Act). If a stockholder who wishes to present a proposal at the 2015 Annual Meeting of Stockholders fails to notify us by March 17, 2015, the proxies that management solicits for the meeting will confer discretionary authority to vote on the stockholder's proposal if it is properly brought before the meeting.

### Stockholder Nominations of Directors

Stockholders or groups of stockholders that, individually or as a group, have beneficially owned at least 5% of the company's common stock for at least one year prior to the date of such submission (the Nominating Stockholder) may submit a candidate for nomination for election as a director at any annual meeting of stockholders in accordance with Board policy. The submission must be in writing and delivered to StemCells, Inc., Attn: Secretary, Board of Directors, 7707 Gateway Blvd., Newark, California 94560, no later than on or about July 7, 2014 for nominees to be considered for nomination at the 2015 annual meeting. Submissions must include the name, address and number of shares of common stock beneficially owned by each participant in the Nominating Stockholder group, a representation that the Nominating Stockholder meets the requirements described in the Board policy and will continue to meet them through the date of the annual meeting, a description of all arrangements or understandings between or among the Nominating Stockholder group (or any participant in the Nominating Stockholder group) and the candidate or any other person or entity regarding the candidate, all information regarding the candidate that the company would be required to disclose in a proxy statement under SEC rules, including whether the candidate is independent or, if not, a description of the reasons why not, the consent of the candidate to serve as a director, and representations by the candidate regarding his or her performance of the duties of a director. Full details may be obtained from the secretary of the Board of Directors at the address above or on our website at [www.stemcellsinc.com](http://www.stemcellsinc.com). The Corporate Governance Committee will consider and evaluate up to two candidates recommended in accordance with this policy in connection with any annual meeting. The Corporate Governance Committee will consider and evaluate candidates recommended by stockholders on the same basis as candidates recommended by other sources.

In addition, the company's by-laws provide that a stockholder entitled to vote for the election of directors at a meeting may nominate persons for election as directors by giving timely notice thereof in proper written form to the Secretary accompanied by a petition signed by at least 100 record holders of capital stock of the company representing in the aggregate 1% or more of the outstanding shares entitled to vote in the election of directors, which petition must show the class and number of shares held by each person. To be timely, such notice and petition must be received at the principal executive offices of the company not less than 60 days nor more than 90 days prior to the meeting, except if less than 70 days notice of the date of the meeting is given to stockholders, in which case the notice and petition must be received not later than the close of business on the tenth day following the day on which notice of the date of the meeting was mailed or public disclosure of such date was made. The requesting stockholder is required to provide information with respect to the nominee(s) for director similar to that described above, as more fully set forth in the company's by-laws.

**Form 10-K**

The company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013, as amended, as filed with the SEC, is available without charge upon request by writing to StemCells, Inc. at 7707 Gateway Blvd., Newark, California 94560, Attention: Investor Relations. A copy of this report is also available through our website at [www.stemcellsinc.com](http://www.stemcellsinc.com) or, alternatively, at [www.sec.gov](http://www.sec.gov).

**Householding of Proxy Materials**

The SEC has adopted rules that permit companies and intermediaries such as brokers to satisfy delivery requirements for proxy statements with respect to two or more stockholders sharing the same address by delivering a single proxy statement addressed to those stockholders. This process, which is commonly referred to as "householding," potentially provides extra convenience for stockholders and cost savings for companies. The company and some brokers household proxy materials, delivering a single proxy statement to multiple stockholders sharing an address unless contrary instructions have been received from the affected stockholders. Once you have received notice from your broker or us that they or we will be householding materials to your address, householding will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate proxy statement, or if you are receiving multiple copies of the proxy statement and wish to receive only one, please notify your broker if your shares are held in a brokerage account or us if you hold registered shares. We undertake to deliver promptly upon any request a separate or single copy of the proxy materials. You can notify us by sending a written request to StemCells, Inc., 7707 Gateway Blvd., Newark, California 94560, Attention: Investor Relations or by calling us at (510) 456-4000.

**Other Business**

The Board of Directors knows of no business that will come before the meeting for action except as described in the accompanying Notice of Meeting. However, as to any such business, the persons designated as proxies will have authority to act in their discretion.

By Order of the Board of Directors

Kenneth B. Stratton, J.D.  
Secretary  
April 30, 2014





