

McJunkin Red Man Corp
Form 424B3
May 04, 2012

**Filed Pursuant to Rule 424(b)(3)
Registration Statement No. 333-173037**

PROSPECTUS SUPPLEMENT

(To Prospectus dated April 23, 2012)

MCJUNKIN RED MAN CORPORATION

\$1,050,000,000

9.50% Senior Secured Notes due December 15, 2016

Attached hereto and incorporated by reference herein is our Current Report on Form 8-K, filed with the Securities and Exchange Commission on May 4, 2012. This Prospectus Supplement is not complete without, and may not be delivered or utilized except in connection with, the Prospectus, dated April 23, 2012, with respect to the 9.50% Senior Secured Notes due December 15, 2016, including any amendments or supplements thereto.

INVESTING IN THE NOTES INVOLVES A HIGH DEGREE OF RISK. SEE RISK FACTORS BEGINNING ON PAGE 11 OF THE PROSPECTUS FOR A DISCUSSION OF CERTAIN FACTORS THAT YOU SHOULD CONSIDER IN CONNECTION WITH AN INVESTMENT IN THE NOTES.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

This prospectus has been prepared for and will be used by Goldman, Sachs & Co. in connection with offers and sales of the notes in market-making transactions. These transactions may occur in the open market or may be privately negotiated at prices related to prevailing market prices at the time of sales or at negotiated prices. Goldman, Sachs & Co. may act as principal or agent in these transactions. We will not receive any proceeds of such sales.

GOLDMAN, SACHS & CO.

May 4, 2012

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

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): May 4, 2012

MRC GLOBAL INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation)

011-35479
(Commission
File Number)
2 Houston Center

20-5956993
(I.R.S. Employer
Identification Number)

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909 Fannin, Suite 3100, Houston, TX 77010

(Address of principal executive offices, including zip code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- .. Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- .. Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- .. Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- .. Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02 Results of Operations and Financial Condition

On May 4, 2012, MRC Global Inc. (the Company) issued a press release announcing its financial results for the quarter ended March 31, 2012. A copy of the press release is furnished as Exhibit 99.1 to this Form 8-K and is incorporated herein by reference.

The information in this Current Report on Form 8-K and Exhibit 99.1 attached hereto is being furnished pursuant to Item 2.02 and Item 9.01 of Form 8-K and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or otherwise subject to the liabilities of that section, nor is it deemed incorporated by reference into any registration statement or other document filed pursuant to the Securities Act of 1933, as amended (the Securities Act), or any filing under the Exchange Act, except as shall be expressly set forth by specific reference in such filing, if any.

The press release furnished as Exhibit 99.1 to this Current Report on Form 8-K may contain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act and, as such, may involve known and unknown risks, uncertainties and assumptions. Such forward-looking statements may relate to the Company's current expectations and are subject to the limitations and qualifications set forth in the Company's other documents filed with the U.S. Securities and Exchange Commission, including, without limitation, that actual events and/or results may differ materially from those projected in such forward looking statements.

Item 9.01 Financial Statements and Exhibits

(d) *Exhibits.*

99.1 Press Release of MRC Global Inc. dated May 4, 2012

SIGNATURES

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

Date: May 4, 2012

MRC GLOBAL INC.

By: /s/ James E. Braun
James E. Braun
Executive Vice President and Chief Financial
Officer

INDEX TO EXHIBITS

Exhibit No.	Description
99.1	Press Release of MRC Global Inc. dated May 4, 2012

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MRC GLOBAL ANNOUNCES FIRST QUARTER 2012 RESULTS

Sales of \$1.383 billion, up 39%

Net income of \$37.5 million and diluted EPS of \$0.44

Adjusted EBITDA of \$115 million, up 92%

Houston, TX May 4, 2012 MRC Global Inc. (NYSE: MRC), the largest global distributor of pipe, valves and fittings and related products and services to the energy and industrial sectors based on sales, today announced first quarter 2012 financial results. Sales of \$1.383 billion were up 39% from \$992 million in the first quarter of 2011. Net income was \$37.5 million, or \$0.44 per diluted share, as compared to a net loss of \$1.1 million, or \$0.01 per share, in the first quarter of 2011. Adjusted EBITDA rose 92% to \$115.2 million for first quarter of 2012, compared to \$60.0 million for the same period in 2011. See the table below for a reconciliation of Adjusted EBITDA to net income and net loss.

Commenting on the company's results, Andrew R. Lane, chairman, president and chief executive officer, stated, "I am very pleased with the financial results in the first quarter. Our first quarter sales and net income reflect the continued strength of our North American segment from both our upstream and midstream sector activity levels and also from our International segment, primarily as a result of improved activity levels in the U.K., Southeast Asia as well as our Australian acquisitions."

Sales of \$1.383 billion set a record for the first quarter and increased 39% over the prior year. Within the company's North American segment, sales increased 35% to \$1.261 billion, driven by strengthening activity within the North American shale plays, particularly those areas with heavy concentrations of oil and wet gas. International segment sales increased 105% to \$122 million, due to the acquisitions of Australia-based Stainless Pipe & Fittings (MRC SPF) and OneSteel Piping Systems (MRC PSA) as well as improved overall business activity. Overall, organic growth contributed 34% to the top line increase and acquisitions accounted for the remaining 5%.

Sales to the upstream sector reached \$650 million, or 47% of sales, an increase of 39% over the prior year. Midstream sales increased 58% to \$360 million, or 26% of sales. The midstream sector

continues to be the company's fastest growing sector, driven by the increasing need for gathering and transmission infrastructure, as well as continued strong demand from its natural gas utility customers. Sales to the downstream sector grew 25% to \$373 million, driven by the company's Australian acquisitions which are more heavily weighted toward the downstream sector than the company as a whole. In North America, downstream sales increased 12% over the prior year.

Gross profit was \$236.6 million, or 17.1% of sales, compared with \$147.0 million, or 14.8% of sales, in the first quarter of 2011. The increase in gross profit percentage was driven primarily by improved product sales mix and the leveraging of the fixed cost component of cost of sales.

For the first quarter of 2012, selling, general and administrative expenses (SG&A) increased \$29.0 million compared to the same quarter in 2011. These increases are attributable primarily to an increase in variable personnel expenses and the inclusion of expenses from the acquisitions of MRC SPF and MRC PSA in Australia. As a percentage of sales, SG&A expenses declined to 10.6% versus 11.8% in the first quarter of 2011.

Mr. Lane continued, "We have completed several key objectives thus far in 2012. Our March acquisition of OneSteel Piping Systems was an important addition for us, giving us a complete PVF offering for our customers in Australia. We also closed on a new 5-year global credit facility that provides us with improved availability and financial flexibility to fund our operations. And finally, we completed our initial public offering in April 2012, netting \$334 million for the company to pay down debt. This milestone marked the culmination of over three years of effort to position MRC Global Inc. as a public company on the New York Stock Exchange after 90 years as a privately-held company."

Conference Call

The Company will hold a conference call to discuss its first quarter 2012 results at 10:00 a.m. Eastern (9:00 a.m. Central) on Monday, May 7, 2012. To participate in the call, dial (480) 629-9692 and ask for the MRC Global conference call at least 10 minutes prior to the start time. To access it live over the Internet, please log onto the web at <http://www.mrcpvf.com>, and go to the "Investor Relations" page of the Company's website at least fifteen minutes early to register, download and install any necessary audio software. For those who cannot listen to the live call, a replay will be available through May 14, 2012 and may be accessed by dialing (303) 590-3030 and using pass code 4533752#. Also, an archive of the webcast will be available shortly after the call at www.mrcpvf.com for 90 days.

About MRC Global Inc.

Headquartered in Houston, Texas, MRC is the largest global distributor of pipe, valves and fittings and related products and services to the energy and industrial sectors, based on sales, and supplies these products and services across each of the upstream, midstream and downstream sectors.

Safe Harbor Statement

During a public investor call to discuss the results set forth in this announcement, we may make forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act, as amended, including, for example, statements about the company's business strategy, its industry, its future profitability, growth in the company's various markets, and the company's expectations, beliefs, plans, strategies, objectives, prospects and assumptions. These forward-looking statements are not guarantees of future performance. These statements involve known and unknown risks, uncertainties and other factors that may cause the company's actual results and performance to be materially different from any future results or performance expressed or implied by these forward-looking statements. These risks and uncertainties include, among other things: decreases in oil and natural gas industry expenditure levels, which may result from decreased oil and natural gas prices or other factors; increased usage of alternative fuels, which may negatively affect oil and natural gas industry expenditure levels; U.S. and international general economic conditions; our ability to compete successfully with other

companies in our industry; the risk that manufacturers of the products we distribute will sell a substantial amount of goods directly to end users in the industries we serve; unexpected supply shortages; cost increases by our suppliers; our lack of long-term contracts with most of our suppliers; increases in customer, manufacturer and distributor inventory levels; suppliers' price reductions of products that we sell, which could cause the value of our inventory to decline; decreases in steel prices, which could significantly lower our profit; increases in steel prices, which we may be unable to pass along to our customers, which could significantly lower our profit; our lack of long-term contracts with many of our customers and our lack of contracts with customers that require minimum purchase volumes; changes in our customer and product mix; risks related to our customers' credit; the potential adverse effects associated with integrating acquisitions into our business and whether these acquisitions will yield their intended benefits; the success of our acquisition strategies; our significant indebtedness; the dependence on our subsidiaries for cash to meet our debt obligations; changes in our credit profile; a decline in demand for certain of the products we distribute if import restrictions on these products are lifted; environmental, health and safety laws and regulations; the sufficiency of our insurance policies to cover losses, including liabilities arising from litigation; product liability claims against us; pending or future asbestos-related claims against us; the potential loss of key personnel; interruption in the proper functioning of our information systems; loss of third-party transportation providers; potential inability to obtain necessary capital; risks related to adverse weather events or natural disasters; impairment of our goodwill or other intangible assets; changes in tax laws or adverse positions taken by taxing authorities in the countries in which we operate; and adverse changes in political or economic conditions in the countries in which we operate. For a discussion of key risk factors, please see the risk factors disclosed in the company's SEC filings, which are available on the SEC's website at www.sec.gov and on the company's website, www.mrcpvf.com.

Undue reliance should not be placed on the company's forward-looking statements. Although forward-looking statements reflect the company's good faith beliefs, reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. The company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, changed circumstances or otherwise.

MRC Global Inc.

Condensed Consolidated Statements of Operations (Unaudited)

(Dollars in thousands, except per share amounts)

	Three Months Ended	
	March 31, 2012	March 31, 2011
Sales	\$ 1,382,632	\$ 991,813
Cost of sales	1,146,071	844,847
Gross profit	236,561	146,966
Selling, general and administrative expenses	146,384	117,357
Operating income	90,177	29,609
Other income (expense):		
Interest expense	(33,717)	(33,500)
Write off of debt issuance costs	(1,685)	
Change in fair value of derivative instruments	2,125	1,868
Other, net	1,747	205
	(31,530)	(31,427)
Income (loss) before income taxes	58,647	(1,818)
Income tax expense (benefit)	21,113	(690)
Net income (loss)	\$ 37,534	\$ (1,128)
Effective tax rate	36.0%	38.0%
Basic earnings (loss) per common share	\$ 0.44	\$ (0.01)
Diluted earnings (loss) per common share	\$ 0.44	\$ (0.01)
Weighted-average common shares, basic*	84,437	84,413
Weighted-average common shares, diluted*	84,756	84,413

* In April 2012, MRC Global issued 17.0 million shares of common stock as part of its initial public offering, resulting in a total of 101.5 million shares outstanding post transaction.

MRC Global Inc.

Condensed Consolidated Balance Sheets (Unaudited)

(Dollars in thousands)

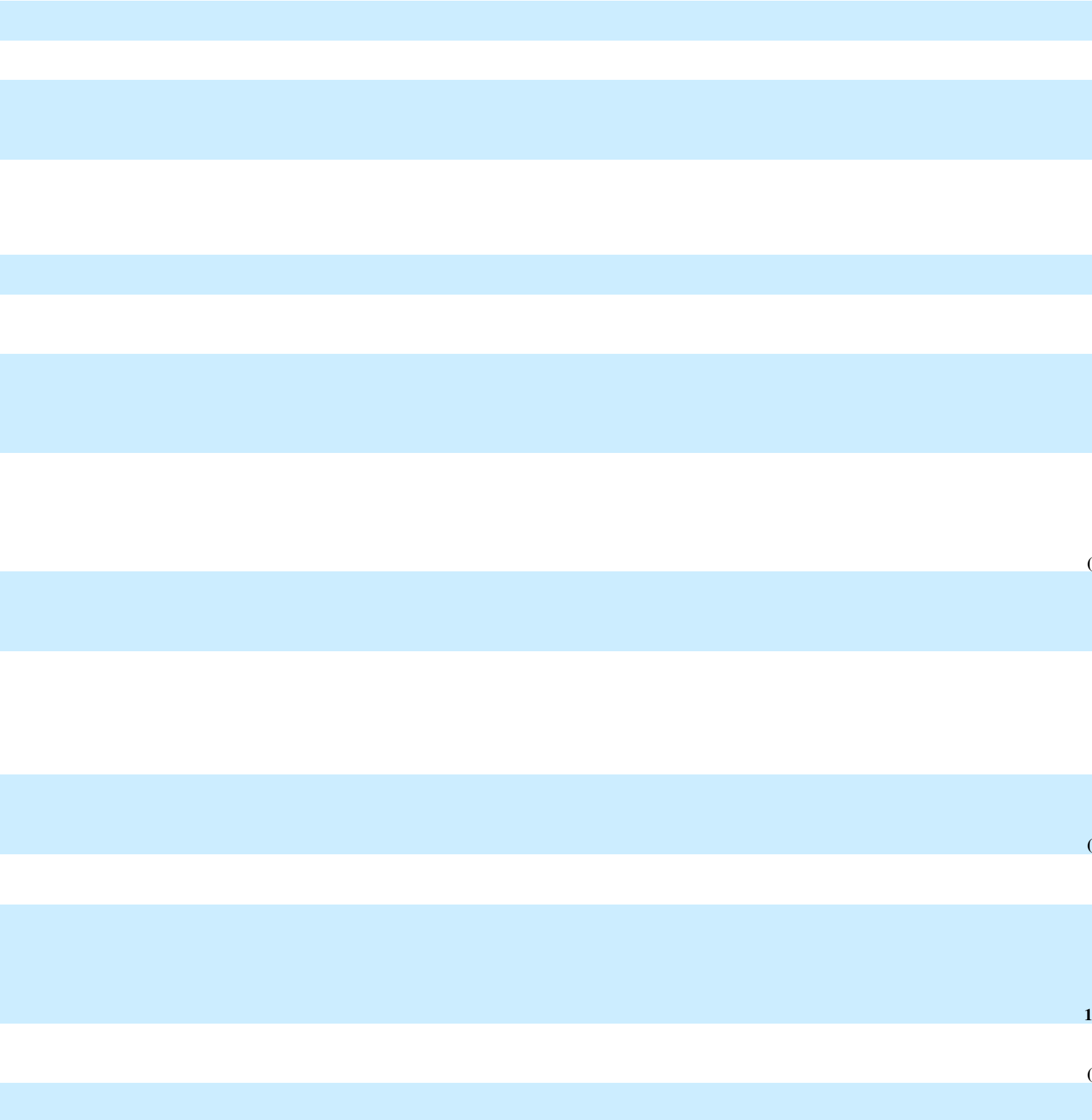
	March 31, 2012	December 31, 2011	March 31, 2011
Assets			
Current assets:			
Cash	\$ 58,833	\$ 46,127	\$ 42,080
Accounts receivable, net	871,227	791,280	594,892
Inventories, net	1,022,851	899,064	783,554
Other current assets	17,598	11,437	39,554
Total current assets	1,970,509	1,747,908	1,460,080
Other assets	44,767	39,212	45,534
Property, plant and equipment, net	114,173	107,430	103,950
Intangible assets:			
Goodwill, net	568,811	561,270	551,720
Other intangible assets, net	780,198	771,867	808,220
	1,349,009	1,333,137	1,359,940
	\$ 3,478,458	\$ 3,227,687	\$ 2,969,504
Liabilities and stockholders equity			
Current liabilities:			
Trade accounts payable	\$ 555,556	\$ 479,584	\$ 420,085
Accrued expenses and other current liabilities	142,500	108,973	106,909
Income taxes payable	26,133	11,950	
Deferred revenue	2,440	4,450	14,026
Deferred income taxes	69,155	68,210	70,825
Total current liabilities	795,784	673,167	611,845
Long-term obligations:			
Long-term debt, net	1,611,960	1,526,740	1,333,008
Deferred income taxes	287,585	288,985	302,274
Other liabilities	18,108	17,933	21,797
	1,917,653	1,833,658	1,657,079
Stockholders equity	765,021	720,862	700,580
	\$ 3,478,458	\$ 3,227,687	\$ 2,969,504

MRC Global Inc.

Condensed Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)

**Three Months Ended
March 31,
2012**



In August 2007, we awarded our employees stock options, on a company-wide basis, to purchase up to approximately 1.4 million shares of common stock at an exercise price of \$2.21 per share. The company's executive officers received, in the aggregate, options to purchase 750,000 shares. We may grant additional options to current employees in

unless otherwise specifically noted in the tables herein, all option awards:

to our employees, including our executive officers, are intended to be qualified incentive stock options (ISOs) to the fullest extent permitted by law;

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 (now the Nasdaq Global Market) is not open on the grant date; and

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

Of course, the Board or its committees have authority to make different provisions, but this seldom occurs and, in the case of executive officers, this has not occurred for at least five years, except as described below. All unvested options now held by executive officers are time-vesting rather than performance based.

Special note on 2006 equity compensation: As of 2006, employee ownership of the company, including ownership by executive officers, was less than for a number of years well below the norm for comparable biotechnology companies, and well below what the Compensation Committee considered desirable. Because biotechnology companies—and especially those pursuing truly novel therapeutics, as in our case—can face significant challenges

Table of Contents

and potential delays before they can expect to become profitable, company ownership in the form of stock options or other stock-based awards such as stock appreciation rights (SARs) is a powerful incentive to employees to remain with us. Even though we have been fortunate in securing the loyalty of our most valuable employees, including our executive officers, we think it desirable both to reinforce that loyalty with incentives to stay on and to demonstrate a reciprocal loyalty on the part of the Board.

The Board and the Compensation Committee had for some time been considering ways to address this sub-optimal degree of employee ownership (which we referred to as the Historical Issue), and in 2006, after reviewing data, including reports from two independent consultants, we took action to remedy the Historical Issue by increasing ownership levels and creating long-term compensation incentives for employees, including our executive officers. The results of these two reports proved similar. One of the reports, by Radford Consultants (the CEO Compensation Assessment), evaluated our chief executive officer's compensation against some 19 other companies approved by the Compensation Committee based upon criteria such as stage of development, employee size and market capitalization. (The company's Schedule 14A for 2007 lists these companies and provides additional discussion.) We also considered the table of ratios from the 2005 Share Options as a Percentage of Outstanding Shares Report (BIO) published by Radford (the Radford Ratios) which showed typical ownership of various officers and employees of biotech companies relative to the ownership of the chief executive officer.

Using the CEO Compensation Assessment and the Radford Ratios as a guideline for remedying the Historical Issue, the Compensation Committee recommended to the full Board that employee ownership be keyed to 2.8 percent ownership (of fully diluted outstanding stock) of the chief executive officer. The Board unanimously adopted this recommendation at its July 21, 2006 meeting, at which the Board granted employees a total of 1,389,600 cash-settled stock appreciation rights plus options to purchase up to 1,909,451 shares. The Compensation Committee further recommended that an additional grant of 175,000 SARs be made to Mr. McGlynn, bringing his percentage ownership to 2.8 percent, reflecting its view of his outstanding performance; this brought his equity ownership to a point between the 50th and the 75th percentile among the companies considered in the CEO Compensation Assessment Report. Again, the Board concurred unanimously with the exception of Mr. McGlynn, who was not present for the discussion or vote).

The effect of these decisions on the executive officers in July 2006 was as follows:

Name & Principal Position	Number of SARs Granted	Number of Shares Underlying Options Granted
Martin M. McGlynn - President and CEO	762,335	672,665
John Tsukamoto, Ph.D. - COO	145,874	184,976
Rodney K.B. Young - CFO		80,000

Special note on 2008 equity compensation: In January 2008 and then again in March 2008, the Compensation Committee, having noted the significant decline in market prices for biotechnology companies generally and the poor economic and market conditions in the United States, met to discuss how best to provide long-term incentives to key employees of the company. In particular, the Compensation Committee noted that at most (approximately 90%) of the outstanding employee options at the end of 2007 had a strike price significantly higher than the trading price of the company's common stock and that these options were therefore not likely to provide a strong retention incentive. The weighted average exercise price of outstanding employee options at the end of 2007 was \$2.36 and the average closing price for January 2008 was \$2.31.

After discussing this with management, the Compensation Committee determined it was in the company's interest to grant additional long-term equity compensation to a limited number of employees considered important to our long-term success. Consequently, in March 2008, the Compensation Committee approved the award of 1,650,000 restricted stock units to certain employees of the company. Each of the restricted stock grants vests over three years, with one-third vesting on each of the three anniversaries following the grant. Of this amount, the executive officers of the company received, in the aggregate, 825,000 restricted stock units. These restricted stock units were intended to augment the existing outstanding options held by employees, including our executive

Table of Contents

officers, to provide additional retention incentives and to encourage actions designed to increase long-term stockholder value.

The following table summarizes the restricted stock units awarded to our executive officers in March 2008:

Name & Principal Position	Number of Restricted Stock Units Granted
Martin M. McGlynn President and CEO	412,500
Ann Tsukamoto, Ph.D. COO	206,250
Rodney K.B. Young CFO	206,250

Employment, Severance and Change-in-Control Agreements

Employment agreements: Mr. Martin 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, the Board has increased his base salary and target bonus so that they are, as of March 2008, \$385,000 and 40% of his base salary, respectively. By virtue of his January 2001 employment agreement, Mr. McGlynn was granted an option to purchase 400,000 shares of our common stock with an exercise price equal to the fair market value of the common stock on the initial date of his employment, one fourth to vest on the first anniversary of his employment and the remaining three-fourths to vest in equal monthly installments during his second through fourth years of employment. The employment agreement also provided that the Board could, in its discretion, grant Mr. McGlynn a bonus option to purchase up to an additional 25,000 shares, which it did. We also agreed to pay Mr. McGlynn a \$50,000 relocation bonus and to reimburse him for relocation expenses, and have done so.

Dr. Ann Tsukamoto joined the company in November 1997 and has served as our chief operating officer since November 2006. 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, the Board has increased her base salary and target bonus so that they are, as of March 2008, \$300,000 and 25% of her base salary, respectively. Also pursuant to her employment agreement, we provide Dr. Tsukamoto with \$750,000 of term life insurance on an annual basis during her employment.

Mr. Rodney Young joined the company in September 2005 as our chief financial officer and vice president of finance. Under the terms of an employment agreement with the company, dated August 16, 2005, Mr. Young received an initial annual base salary of \$250,000 per year, with a target bonus of up to 25% of his base salary. Over time, however, the Board has increased his base salary so that they are, as of March 2008, \$375,000 and 25% of his base salary, respectively. By virtue of his August 2005 employment agreement, Mr. Young was granted an option to purchase 450,000 shares of our common stock. This option will vest over 48 months; with one-quarter of the shares vesting on the first anniversary of the date on which Mr. Young's employment began and the remaining shares vest, subject to his continued employment by the company, vesting at the rate of 1/48th per month on the last day of each month during the ensuing 36 months. In addition, the employment agreement provided for an option to acquire no less than 25,000 shares of our common stock at the closing price of the stock on the date of grant, the first anniversary of his employment. The grant of 25,000 shares was duly made, and will vest in the same manner as his earlier option grant over 48 months, subject to his continued employment by the company.

Severance arrangements: Each of the executive officers would receive payments upon termination of his or her employment by us without cause² 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 salary and provide benefits for one year, at the base wage rate then in effect. In the case of termination were associated with a

Or termination by the executive officer for good reason, as defined in the agreement.

Table of Contents

change of control, the company would pay (in a lump sum) (i) two years of 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. 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 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 12 months, at the rate then in effect. Dr. Tsukamoto's agreement provides that if the termination were associated with a change of control, any unvested options granted pursuant to the company's 1992 Equity Incentive Plan would vest upon termination.

In the case of Mr. Young, upon termination without cause, we would continue to pay salary and provide benefits for six months, at the rate then in effect. If the termination were associated with a change of control, we would continue to pay Mr. Young's salary and provide benefits, including his share of COBRA, grossing up for the tax effects, if any) for 12 months; in this event, any unvested options and any other stock awards held by him would vest upon termination.

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.

Potential Payments Upon Termination or Change-in-Control

The following table displays the value of what the executive officers would have received from us had their employment been terminated as of December 31, 2007:

Officer	Salary	Bonus	Health	Early Vesting of Options	Total
CEO					
Terminated without cause	\$ 385,000	0	\$ 19,439	0	\$ 404,439
Terminated, change of control	\$ 770,000	\$ 96,250	\$ 56,665(1)	\$ 1,969(2)	\$ 924,884
Terminated, disability(3)	\$ 192,500	0	0	0	\$ 192,500
Other	0	0	0	0	0
COO					
Terminated without cause	\$ 300,000	0	\$ 10,298	0	\$ 310,298
Terminated, change of control	\$ 300,000	0	\$ 10,298	\$ 1,266(4)	\$ 311,564
Other	0	0	0	0	0
FO					
Terminated without cause	\$ 137,500	0	\$ 6,196	0	\$ 143,696
Terminated, change of control	\$ 275,000	0	\$ 12,392	\$ 0(5)	\$ 287,392
Other	0	0	0	0	0

(1) Includes tax gross-up on 2 years of healthcare costs.

(2) By agreement, all options vest and remain exercisable for 2 years.

(3)

Payments stop before 6 months if individual obtains other full-time employment or qualifies for payments under any disability income plan provided by the company.

- (4) An agreement with Dr. Tsukamoto provided for vesting of her options issued under an equity incentive plan that did not provide for 100% automatic vesting on change of control, but those options have all vested. All of our other equity incentive plans provide for accelerated vesting of outstanding unvested options upon a change of control.
- (5) All unvested options issued under the applicable equity incentive plans vest upon a change of control under the terms of those plans.

Table of Contents**Compensation Committee Report**

The Compensation and Stock Option Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of SEC Regulation S-K with management. Based on this review and these discussions, the Compensation Committee has recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the company's proxy statement for 2008.

COMPENSATION AND STOCK OPTION COMMITTEE

John J. Schwartz, Ph.D., Chairman
 Eric Bjerkholt
 Desmond O'Connell

Notwithstanding anything to the contrary set forth in any of our previous filings under the Securities Act of 1933, as amended, or the Securities Exchange Act that incorporate future filings, in whole or in part, the foregoing Compensation and Stock Option Committee Report shall be incorporated by reference into any such filings.

Executive Officer Compensation Tables

The following tables set forth information with respect to the compensation of our executive officers for the fiscal year ended December 31, 2007.

Because the Option awards column in the table below reflects the dollar amounts recognized for financial statement reporting purposes for the fiscal year ended December 31, 2007 in accordance with SFAS 123(R), these imputed values include amounts from awards granted from January through 2007.

Summary Compensation Table for 2007

Name & Position	Year	Salary (\$)(1)	Bonus \$(2)	Option Awards (3)(\$)	All other Compensation \$(4)	Total \$
Martin McGlynn, President and CEO	2007	383,019	116,800	748,547	213,927(5)	1,462,293
	2006	357,115	90,720	497,604	213,110	1,158,549
John Tsukamoto, Ph.D., COO	2007	296,827	55,000	228,721	23,562(6)	604,110
	2006	270,192	50,000	155,008	13,650	488,850
Rodney Young, CFO	2007	271,731	50,000	518,908	21,668(7)	862,307
	2006	250,000	50,000	468,974	8,911	777,885

(1) Includes amounts earned but deferred at the election of the named executive officers, such as salary deferrals under the company's 401(k) plan established under Section 401(k) of the U.S. Internal Revenue Code.

(2) Each employee's target bonus is based on his or her salary as of January 1 of the year to which it applies. Salary increases for 2007 went into effect for the first pay period in March 2007, so bonuses were based on the salaries in effect before those increases. The Board awarded 80% of the target bonus for all company employees. For further description of the non-equity incentive plan see discussion in Compensation Discussion and Analysis and Compensation of Named Executive Officers, above.

- (3) Reference is made to Note 6 "Stock-Based Compensation" in our Form 10-K for the period ended December 31, 2007, filed with SEC on March 14, 2008, which identifies assumptions made in the valuation of option awards in accordance with SFAS 123R. The company's stock-based compensation expense recognized under SFAS 123R reflects an estimated forfeiture rate of 13.06% in 2007. The values recognized in the "Option Awards" column above do not reflect such expected forfeitures.
- (4) Amounts include employer contributions credited under our 401(k) plan. Under the 401(k) plan, which is open to substantially all our employees, we make matching contributions based on each participant's voluntary salary deferrals, subject to plan and Code limits, in the form of company common stock. We match participant

Table of Contents

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.

- (5) Includes \$10,609 in company contributions under the 401(k) plan, as well as an allowance for housing and transportation costs plus tax gross-up on that allowance (\$201,406).
- (6) Includes \$10,250 in company contributions under the 401(k) plan, as well as life insurance in addition to the group life coverage (\$1,180).
- (7) Includes \$7,750 in company contributions under the 401(k) plan.

Grants of Plan-Based Awards

The following table shows grants of plan-based awards made to our named executive officers during the fiscal year ended December 31, 2007.

Name & Principal Position	Grant Date	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards (\$/Share)	Grant Date Fair Value of Option Awards
Martin McGlynn President and CEO	8/23/07	450,000	2.21	783,000
John Tsukamoto, Ph.D. COO	8/23/07	150,000	2.21	261,000
Rodney K.B. Young CFO	8/23/07	150,000	2.21	261,000

With respect to non-equity incentive plan awards for fiscal year 2007, the Compensation Committee set specific corporate targets and goals as described in the Compensation Discussion and Analysis above.

The options granted in 2007 to our named executive officers were made pursuant to our 2004 and 2006 equity incentive plans. Generally, stock options granted to employees have a maximum term of 10 years, and vest over a four year period from the date of grant: 25% vest at the end of the first year, and 75% vest monthly in equal increments over the remaining three years. We may grant options with different vesting terms from time to time. However, the options granted in 2007 to our named executive officers have standard vesting terms. Unless an employee's termination of service is due to retirement, disability or death, upon termination of service, any unexercised vested options will be forfeited at the end of three months or the expiration of the option, whichever is earlier.

Table of Contents

Outstanding Equity Awards at Fiscal 2007 Year-End

The following table shows equity awards held by our named executive officers as of December 31, 2007:

	Option Grant Date	Option Awards			Option Expiration Date	Date of Award	SARs Awards			SAR Exercise Price (2)
		Number of Securities Underlying Unexercised Options (#) Exercisable(1)	Number of Securities Underlying Unexercised Options (#) Unexercisable(1)	Option Exercise Price (\$/sh)(1)			Number of Securities Underlying Unexercised SARs (#) Exercisable(2)	Number of Securities Underlying Unexercised SARs (#) Unexercisable(2)		
Lynn	1/15/2001	400,000		\$ 2.87	1/15/2011					
	10/2/2001	75,000		\$ 2.09	10/2/2011					
	2/12/2002	25,000		\$ 2.96	2/12/2012					
	5/2/2002	25,000		\$ 2.01	5/2/2012					
	2/5/2003	57,000		\$ 0.94	2/5/2013					
	9/2/2004	284,374	65,626	\$ 1.53	9/2/2014					
	7/21/2006	434,430	238,235	\$ 2.00	7/21/2016	7/21/2006	269,993	492,342	\$ 2.00	
	8/23/2007		450,000	\$ 2.21	8/23/2017					
oto,	2/2/1998	60,000		\$ 2.94	2/2/2008					
	7/10/1998	22,500		\$ 1.28	7/10/2008					
	9/1/1999	25,000		\$ 1.19	9/1/2009					
	10/19/1999	3,750		\$ 1.28	10/19/2019					
	6/26/2001(3)	12,000		\$ 3.10	6/26/2011					
	10/22/2001	30,000		\$ 2.62	10/22/2011					
	10/7/2002	60,000		\$ 0.61	10/7/2012					
	9/3/2004	182,812	42,188	\$ 1.53	9/3/2014					
	7/21/2006	65,512	119,464	\$ 2.00	7/21/2016	7/21/2006	51,663	94,211	\$ 2.00	
	8/23/2007		150,000	\$ 2.21	8/23/2017					
	9/6/2005	253,124	196,876	\$ 5.43	9/6/2015					
	7/21/2006	28,333	51,667	\$ 2.00	7/21/2016					
	9/6/2006	7,812	17,188	\$ 2.28	9/6/2016					
	8/23/2007		150,000	\$ 2.21	8/23/2017					

(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 is closed on the grant date); they vest over a period of four years as follows: twenty-five percent (25%) of the option vests on the first anniversary of the grant date and 1/48 of the original grant vests each additional month of service.

(2) SARs were granted to certain employees on July 21, 2006 to redress certain perceived inequities as described in the Compensation Discussion and Analysis, above. The terms of the SARs are essentially identical to those of the options granted on the same date; they have the same vesting schedule and same exercise price.

- (3) This was one of eight non-qualified, performance-based options granted by the Compensation Committee on June 26, 2001 to employees who had been given year-long goals in January 2001. The exercise price was set at \$3.10, which the committee determined to be approximately equal to the average market value during January 2001. The grants vested on December 31, 2001 to the extent the individual goals had been achieved by the respective employees. It was determined that 12,000 of the 12,500 shares originally covered by the option issued to Dr. Tsukamoto had been earned, and the remaining 500 shares were cancelled. In accordance with APB 25, the company recorded \$19,375 of compensation expense in 2001 in respect of this award.

Table of Contents**Option Exercises**

The following table shows option and stock exercises during the fiscal year ended December 31, 2007 by our named executive officers:

Name & Principal Position	Option Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)
Martin McGlynn President and CEO	146,000	\$ 376,680
John Tsukamoto, Ph.D. COO		
Rodney K.B. Young CFO		

(1) Represent the excess of the fair market value of the shares exercised on the exercise date over the aggregate exercise price of such shares.

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.

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 \$100,000 per year for his services and we granted him, in 1997, an option to purchase 500,000 shares of common stock for \$5.25 per share. This option expired in 2007 on the ten-year anniversary of its grant without being exercised. 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 2007, Dr. Weissman was a member of the board of directors and co-chairman of the scientific advisory board of Cellerant Therapeutics, Inc. (Cellerant), a privately-owned biotechnology company that was a tenant in the building in which we are located. (Cellerant was formerly

own as Celtrans, LLC, and Dr. Weissman was at one time its interim chief executive officer and a member of its board of managers.) We have also provided Cellerant use of part of our animal facility and access to our irradiator under space-sharing and other agreements. These agreements expired as of June 30, 2006. Dr. Weissman resigned from Cellerant's board of directors and its scientific advisory board in January 2008.

Table of Contents**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, 2008.

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, 2007.

The Audit Committee received the following information concerning the fees of the independent accountants for the years ended December 31, 2006 and 2007, has considered whether the provision of these services is compatible with independence of the independent accountants, and concluded that it is:

	Year Ended	
	12/31/07	12/31/06
Audit fees(1)	\$ 480,029	\$ 425,630
Tax fees	\$ 31,376	\$ 21,000

(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 2007 and fees for auditing management's assessment of internal controls in 2006. 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 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 2007 and 2006, 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 2007, Grant Thornton LLP, had the primary 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 applicable 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 control over financial reporting, 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 2007 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 internal control over financial reporting, has received the written disclosures and the letter from Grant Thornton LLP required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees), 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 ended December 31, 2007 for filing with the SEC.

AUDIT COMMITTEE

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

Table of Contents**PROPOSAL NUMBER 1****Election of Directors**

The number of directors is currently fixed at seven. 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 in favor of the nominees named below, who are now Class II directors, as Class II directors for a term of three years expiring at the 2011 Annual Meeting of Stockholders and until their successors are duly elected and qualified. 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.

On April 25, 2008, Mr. O'Connell informed our Board that he had decided, for personal reasons, not to stand for reelections as a director at the 2008 annual stockholder meeting. Accordingly, the nominees for election as Class II directors, and the incumbent and continuing Class II and Class I directors, are as follows:

NOMINEES FOR ELECTION AS CLASS II DIRECTORS TERMS EXPIRE 2011

Name	Principal Occupation	Age	Position
Cardo B. Levy, Ph.D.	Chairman of the Board, Catalytica Energy Systems, Inc.	63	Director
Living L. Weissman, M.D.	Professor, Stanford University	68	Director

Cardo B. Levy, Ph.D. was elected to the company's Board of Directors in September 2001. Dr. Levy is the lead director of Renegy Holdings, Inc. and has been a member of its board of directors since October 2007. Dr. Levy served as chairman of the board of Catalytica Energy Systems, Inc., between 1995 and 2007 when the company merged to form Renegy. He also served as director of Catalytica Pharmaceuticals, Inc. from 1995 to 2000. Prior to this, in 1974, Dr. Levy cofounded Catalytica, Inc., a manufacturing technology and components company. He served as Catalytica's chief operating officer from 1974 until 1991 and as its president and chief executive officer until December 2000. Catalytica and Catalytica Pharmaceuticals were both sold to DSM N.V. Before founding Catalytica, Dr. Levy was a founding member of Exxon's chemical physics research team, and prior to that he served as the chief executive officer of Sudamericana C.A. in Quito, Ecuador. Dr. Levy currently also serves on the board of directors of Accelrys Inc. (formerly Pharmacoepia, Inc.) and NovoDynamics, Inc. Dr. Levy holds an M.S. from Princeton University and a Ph.D. in chemical engineering from Stanford University.

Living L. 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 the Virginia and Daniel K. Ludwig Professor of Cancer Research, Professor of Pathology and Professor of Developmental Biology at Stanford University. He is also the director of the Stanford Institute for Stem Cell Biology and Regenerative Medicine and the director of the Stanford Comprehensive Cancer Center. Previously, Dr. Weissman was a cofounder of SyStemix, Inc. and cofounder and a director of Cellerant Therapeutics, Inc., both stem cell sciences companies. He has also served on the scientific advisory boards of several biotechnology companies, including Amgen, DNAX and T-Cell Sciences. Dr. Weissman is a member of the National Academy of Science, the Institute of Medicine of the National Academies, the American Academy of Arts and Sciences, the American Society of Microbiology, and several other societies.

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

Table of Contents**INCUMBENT CLASS III DIRECTORS TERMS EXPIRE 2009**

Name	Principal Occupation	Age	Position
Martin McGlynn	President and Chief Executive Officer, StemCells, Inc.	62	Director, Executive Officer
Roger Perlmutter, M.D., Ph.D.	Executive Vice President, Research and Development, Amgen, Inc.	55	Director

Martin M. McGlynn joined the company on January 15, 2001, when he was appointed president and chief executive officer of the company and of its wholly-owned subsidiary, StemCells California, Inc. He was elected to the Board of Directors in February 2001. Mr. McGlynn began his career with Becton Dickinson, Ireland Ltd., and spent 8 years in manufacturing operations. He joined Abbott Labs in 1977 where he held positions as the general manager of Abbott Ireland Ltd., the president and general manager of Abbott Canada Ltd. and the vice president of Abbott International Ltd. In 1990, he joined the BOC Group as the president of Anaquest, Inc., a company focused on anesthesia and other pharmaceuticals. From 1994 until he joined StemCells, Mr. McGlynn was the president and chief executive officer of Pharmadigm, a privately held company in Salt Lake City, Utah, engaged in research and development in the fields of inflammation and genetic immunization. Mr. McGlynn is a native of Dublin, Ireland. He received a Bachelor of Commerce degree from University College, Dublin, Ireland in 1968, a diploma in industrial engineering from the Irish Institute of Industrial Engineering in 1970, and a diploma in production planning from the University of Birmingham, England in 1971. He is a former member of the board of directors of the Confederation of Industries and the Pharmaceutical Manufacturers Association of Canada.

Roger M. Perlmutter, M.D., Ph.D., was elected to the company's Board of Directors in December 2000. Dr. Perlmutter is the executive vice president of research and development of Amgen, Inc., a position he has held since January 2001. Prior to joining Amgen, he was the executive vice president of worldwide basic research and preclinical development of Merck Research Laboratories, a division of Merck & Co., a position he had held since August 1999. He joined Merck in February 1997 as the senior vice president of Merck Research Laboratories, from February 1997 to December 1998 and as its executive vice president from February 1999 to January 2001. Prior to joining Merck, Dr. Perlmutter was a professor in the Departments of Immunology, Biochemistry and Medicine at the University of Washington from January 1991 to January 1997 and served as chairman of the Department of Immunology at the University of Washington from May 1989 to January 1997. He also was an investigator at the Howard Hughes Medical Institute from October 1991 to January 1997. Dr. Perlmutter was a member of the board of directors of The Irvington Institute for Immunological Research from 1997 to 2001 and of the Institute for Systemic Immunology, where he has been its chairman of the board since 1999. Dr. Perlmutter is licensed to practice medicine in the State of Washington. He graduated from Reed College in 1973 and received his M.D. and Ph.D. degrees from Washington University, St. Louis, Missouri in 1975.

Table of Contents**INCUMBENT CLASS I DIRECTORS TERMS EXPIRE 2010**

Name	Principal Occupation	Age	Position
Eric H. Bjerkholt	Senior Vice President and CFO, Sunesis Pharmaceuticals, Inc.	48	Director
John J. Schwartz, Ph.D.	President, Quantum Strategies Management Company	73	Director, Chairman of the Board

Eric H. Bjerkholt was elected to the Board of Directors of the company in March 2004. He is senior vice president and chief financial officer of Sunesis Pharmaceuticals, Inc., a small molecule biopharmaceutical company in South San Francisco, CA. Before joining Sunesis, Mr. Bjerkholt served as the senior vice president and chief financial officer of IntraBiotics Pharmaceuticals, Inc. Previously, Mr. Bjerkholt co-founded LifeSpring Nutrition, Inc., a privately held nutraceutical company, and served as its chief financial officer, and later as its president and chief executive officer. From 1990 to 1997, Mr. Bjerkholt was an investment banker at J.P. Morgan & Co., Inc. Mr. Bjerkholt holds a M.B.A. from Harvard Business School and a Cand. Oecon degree in economics and econometrics from the University of Oslo, Norway. He is a member of the board of directors of Round Table Pizza, Inc.

John J. Schwartz, Ph.D., was elected to the Board of Directors of the company in December 1998 and was elected the chairman of the Board at the same time. He is the former president and chief executive officer of SyStemix, Inc. Dr. Schwartz is currently the president of Quantum Strategies Management Company, a registered investment advisor located in Palo Alto, California. Prior to his positions at SyStemix, he served as assistant professor, vice president and general counsel at Stanford University in California. Dr. Schwartz graduated from Harvard Law School in 1958 and received his Ph.D. degree in physics from the University of Rochester in 1965.

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, 2008. 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 direction to select other auditors for the subsequent year. Even if the selection is ratified, the Audit Committee of the Board at its discretion could determine 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, 2008.

PROPOSAL NUMBER 3**Amendment to Restated Certificate of Incorporation to Increase Authorized Shares of Common Stock**

The Board of Directors expects that the company will need to raise significant additional funds in order to advance the company's various development programs, including the continued clinical testing of its HuCNS-SC[®] product candidate (purified human neural stem cells). Accordingly, the Board of Directors approved, by unanimous resolution, an amendment to the company's restated certificate of incorporation to increase the company's authorized capital by an additional one hundred twenty-five million (125,000,000) shares of common stock, subject to obtaining requisite stockholder approval.

These shares may be used to raise additional capital to fund the company's working capital and other corporate needs, for future acquisitions, assets, programs or businesses, and for other corporate purposes. However, as of the mailing date of these proxy materials, the company has no immediate plans to use these additional one hundred twenty-five million shares of common stock, whether to raise additional capital, to acquire additional businesses or assets, or otherwise.

If our stockholders approve this proposal, our Board of Directors may, in its discretion, proceed to amend and restate the portions of Article III of our restated certificate of incorporation to increase the number of authorized shares of capital stock from 126,000,000 total shares to 251,000,000 total shares.

At present, the company has 125,000,000 shares designated as common stock. If the company's stockholders approve the increase in the number of authorized shares to 251,000,000, the Board will have authority to file with the Secretary of State of Delaware an amendment to the company's restated certificate of incorporation to designate an additional 125,000,000 shares of common stock, bringing the total number of authorized shares of common stock to 250,000,000. Upon approval and following this filing with the Secretary of State of the State of Delaware, the amendment will become effective on the date it is filed. The amendment proposed by the Company to the Article III of our restated certificate of incorporation (assuming approval of proposal 3) is attached to this proxy statement as Schedule 1.

At the time of any future capital raising transactions or in connection with any future share issuance, the company will evaluate the applicable requirements for such action. We intend to comply with all requirements for the issuance of these shares, including all disclosure and other requirements pursuant to the Securities Act of 1933, as amended, and the Exchange Act.

The following chart summarizes the company's outstanding shares of common stock and rights convertible or exercisable as of the date of this proxy statement (not giving effect to this proposal number 3 to increase the company's authorized capital by one hundred million shares)

Authorized Shares of Common Stock	Issued and Outstanding Shares of Common Stock	Authorized, not Outstanding but Reserved for Issuance Pursuant to Convertible Securities, Equity Incentive Plans, and Other Reserve Accounts	Authorized and Unreserved
125,000,000	80,810,302	24,671,284	19,518,414

on issuance, the additional shares of authorized common stock would have rights identical to the currently outstanding shares of common stock. Adoption of the amendment to the restated certificate of incorporation would not have any immediate effect on the proportionate voting power or other rights of the existing stockholders.

to the extent that the additional authorized shares of capital stock are issued in the future, they may decrease existing stockholders' percentage ownership in the company and, depending on the price at which they are issued, could be dilutive to the voting rights of existing stockholders and have a negative effect on the market price of the common stock. Current stockholders have no preemptive or similar rights, which means that current stockholders do not have a prior right to purchase any new issue of capital stock in order to maintain their proportionate ownership of the company.

Table of Contents

The company could also use the additional shares of capital stock for potential strategic transactions including, among other things, acquisitions, spin-offs, strategic partnerships, joint ventures, restructurings, divestitures, business combinations, and investments, although the company has no present plans to do so. The company cannot provide assurances that any such transactions will be consummated on favorable terms or at all, that they will enhance stockholder value or that they will not be adversely affect the company's business or the trading price of its stock.

Management is unaware of any specific effort to obtain control of the company, and has no present intention of using the proposed increase in the number of authorized shares of common stock as an anti-takeover device. However, the company's authorized, but unissued, capital stock could be used to make an attempt to effect a change in control more difficult.

Under either Delaware law, the company's restated certificate of incorporation, nor the Company's amended and restated by-laws provides for appraisal or other similar rights for dissenting stockholders in connection with this proposal. Accordingly, the company's stockholders will have no right to dissent and obtain payment for their shares.

RECOMMENDATION

The Board of Directors of the company has unanimously approved the proposal to adopt the amendment to the restated certificate of incorporation set forth above and has recommended that the proposed amendment be submitted to the company's stockholders for consideration and approval at the Annual Meeting. The proposal to authorize the Board to amend the company's restated certificate of incorporation to increase the authorized capital stock will require the affirmative vote of a majority of the shares outstanding entitled to vote thereon.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE FOR THE AMENDMENT OF THE RESTATED CERTIFICATE OF INCORPORATION AS SET FORTH HEREIN TO INCREASE THE AUTHORIZED NUMBER OF SHARES OF COMMON STOCK BY 125,000,000 SHARES.

OTHER MATTERS

Stockholder Proposals

Stockholders who wish to present proposals for inclusion in the company's proxy materials for the 2009 Annual Meeting of Stockholders must 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 February 4, 2009.

Stockholders who wish to make a proposal at the 2009 Annual Meeting of Stockholders, other than one that will be included in our proxy materials, must notify us no later than April 10, 2009 (see Rule 14a-4 under the Exchange Act). If a stockholder who wishes to present a proposal fails to notify us by April 10, 2009, 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

The Corporate Governance Committee will consider and evaluate up to two candidates recommended by 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 the Nominating Stockholder submits a candidate (a Nominating Stockholder) for nomination for election as a director at any meeting of stockholders in accordance with Board policy. The submission must be in writing and delivered to StemCells, Inc., Attn: Secretary, Board of Directors, 3155 Porter Drive, Palo Alto, California 94304, no later than on or about February 4, 2009 for nominees to be considered for nomination at the 2009 Annual Meeting. Submissions must include the name, address and number of shares of common stock beneficially owned by the Nominating Stockholder, a representation the Nominating Stockholder meets the requirements described above and will continue to meet them through the date of the annual meeting, a description of all arrangements or understandings between or among the

ominating Stockholder (or any participant in a Nominating Stockholder group) and the candidate or any other person or entity regarding
ndidate, all information regarding the candidate that the company would be required to disclose in a proxy statement under SEC rules,
cluding whether the candidate is independent or if not,

Table of Contents

Description of the reasons why not, 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. The 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 10 record holders of capital stock of the corporation that shows the class and number of shares held by each person and that represent in aggregate 1% of the outstanding shares entitled to vote in the election of directors. To be timely, notice by the stockholder must be received at the principal executive offices 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, 2007, as filed with the SEC, is available without charge upon request by writing to StemCells, Inc. at 3155 Porter Drive, Palo Alto, CA 94304, Attention: Investor Relations.

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 in one 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 the same 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 request a separate proxy statement. 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. You can notify us by sending a written request to StemCells, Inc., 3155 Porter Drive, Palo Alto, CA 94304, Attention: Investor Relations.

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
Secretary

June 4, 2008

**SCHEDULE 1
INCREASE TO AUTHORIZED CAPITAL**

RESOLVED that:

The stockholders of StemCells, Inc. (the company or Corporation) hereby ratify and approve the company s increase to its authorized capital of 125,000,000 shares of common stock, par value of \$0.01 per share;

Further to the foregoing increase in the company s authorized capital, the stockholders ratify and approve the decision by the company s Board of Directors to effect an amendment to the first paragraph of section THREE of the company s Restated Certificate of Incorporation to amend and replace said paragraph entirely with the following:

The total number of shares of stock that this Corporation shall have authority to issue is 251,000,000, constituting of 250,000,000 shares of Common Stock, with a par value of \$0.01 per share (the Common Stock), and 1,000,000 shares of Undesignated Preferred Stock with a par value of \$0.01 per share (the Undesignated Preferred Stock).

Notwithstanding that this resolution has been duly passed by the stockholders of the company and subject to the rights of any third party, the directors of the company be, and they hereby are, authorized and empowered to revoke this resolution and/or postpone or terminate the corresponding amendment to the company s Restated Certificate of Incorporation at any time prior to the filing of a certificate and/or articles giving effect to the increase to the company s authorized capital approved by these resolutions, and may do so without further approval of the stockholder of the company; and

Any one director or officer of the company be, and hereby is, authorized and directed to take all necessary steps and proceedings, and execute, deliver and file all necessary or appropriate certificates, articles or other instruments, as well as any and all declarations, agreements, documents, and other instruments, and to do all such other acts and things (whether under corporate seal of the company or otherwise) that may be necessary or desirable to give effect to the provisions of these resolutions.

DETACH HERE

ZS

PROXY

STEMCELLS, INC.

ANNUAL MEETING OF STOCKHOLDERS, July 22, 2008

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned stockholder, by completing this card, hereby appoints Martin McGlynn and Kenneth Stratton, or either of them, as proxies of the undersigned to vote at the Annual Meeting of Stockholders of StemCells, Inc. to be held on July 22, 2008 at 3155 Porter Drive, Palo Alto, California at 2:00 p.m., local time, or at any postponements or adjournments thereof, all of which are of Common Stock, par value \$.01 per share, of StemCells, Inc. that the undersigned would be entitled to vote if personally present. The undersigned instructs such proxies or their substitutes to act on the following matters as specified by the undersigned, and to vote in the manner as they may determine on any other matter that may properly come before the meeting.

**SEE REVERSE
SIDE**

CONTINUED AND TO BE SIGNED ON REVERSE SIDE

**SEE REVERSE
SIDE**

Table of Contents

**STEMCELLS, INC.
C/O EQUISERVE TRUST COMPANY N.A.
P.O. BOX 8694
MORRISON, NJ 08818-8694**

DETACH HERE IF YOU ARE RETURNING YOUR PROXY CARD BY MAIL

ZS

**Please mark
votes as in
this example.**

This proxy when properly executed will be voted in the manner specified by the undersigned stockholder(s). If no contrary direction is made, this proxy will be voted FOR the election of the nominees for director named below and FOR proposals 2 and 3, and in the discretion of the named proxies as to any other matter that may come before the meeting.

THE BOARD OF DIRECTORS OF STEMCELLS, INC. RECOMMENDS A VOTE FOR THE NOMINEES FOR DIRECTOR LISTED BELOW AND A VOTE FOR PROPOSALS 2 AND 3.

To elect the following nominees as Class II directors:

- Nominees:** (01) Ricardo B. Levy, Ph.D.
- (02) Irving Weissman, M.D.

FOR	WITHHELD	
ALL	FROM ALL	
	NOMINEES	
NOMINEES		ABSTAIN
o	o	o

(INSTRUCTION: To withhold authority to vote for any individual nominee, write that nominee's name in the space provided above.)

	FOR	AGAINST	ABSTAIN
To ratify the	o	o	o
election of Grant			
Thornton LLP as			
independent public			
accountants of the			
company for the			
fiscal year ending			
December 31, 2008.			

FOR AGAINST ABSTAIN

To amend the company's restated certificate of incorporation to increase the number of authorized shares of common stock by one hundred twenty-five million (25,000,000) shares.

o o o

By my signature below, I confer to the named proxies discretionary authority to vote upon such other business as may properly come before the meeting or any postponements, continuations and adjournments thereof.

o

MARK HERE FOR ADDRESS CHANGE AND NOTE AT LEFT

Note: Please sign exactly as name appears on this card. All joint owners should sign. When signing as an executor, administrator, attorney, guardian or as a custodian for a minor, please give full title as such. If a corporation, please sign in full corporate name and indicate the state. If a partner, sign in partnership name.

Signature:

Date:

Signature:

Date: