HEPALIFE TECHNOLOGIES INC
Form 10-Q
August 14, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For quarterly period ended June 30, 2006

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

For the transition period from _____ to _____

000-29819

(Commission File Number)

HEPALIFE TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Florida

(State or other jurisdiction of incorporation)

58-2349413

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

1628 West 1st Avenue, Suite 216, Vancouver, British Columbia, V6J 1G1

(Address of principal executive offices)

(800) 518-4879

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated.

Large Accelerated Filer

[ ]

Accelerated Filer

[ ]

Non-accelerated Filer

[X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 71,768,388 shares of Common Stock, par value $.001, were outstanding on July 31, 2006.

TABLE OF CONTENTS

HEPALIFE TECHNOLOGIES, INC.

FORM 10-Q, QUARTER ENDED JUNE 30, 2006

PART I FINANCIAL INFORMATION

HEPALIFE TECHNOLOGIES, INC.
(A Development Stage Company)

BALANCE SHEETS
June 30, 2006 and December 31, 2005

(Expressed in U.S. Dollars)	**June 30, 2006 (Unaudited)**	**December 31, 2005 (Audited)**
ASSETS		
Current assets		
Cash	$296,375	$107,263
Total current assets	296,375	107,263
Fixed Assets, net (Note 7)	4,194	5,674
Total assets	$300,569	$112,937
LIABILITIES		
Current		
Accounts payable and accrued liabilities	$87,635	$106,237
Accounts payable - related parties (Note 4)	123,980	106,357
Notes payable - related party (Note 4)	1,125,000	1,150,000
Total liabilities	1,336,615	1,362,594
STOCKHOLDERS' EQUITY		
Stockholders' Deficiency		
Preferred stock: $0.10 par value; Authorized: 1,000,000		
Issued and outstanding: none	-	-
Common stock: $0.001 par value; Authorized: 300,000,000		
Issued and outstanding: 71,208,365 (2005: 70,064,430)	71,208	70,065

Additional paid-in capital	7,623,954	5,241,651
Loss accumulated during the development stage	(8,731,208)	(6,561,373)
Total stockholders' deficiency	(1,036,046)	(1,249,657)
Total liabilities and stockholders' deficiency	$300,569	$112,937

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

HEPALIFE TECHNOLOGIES, INC.

(A Development Stage Company)

STATEMENTS OF OPERATIONS

For the three-month and six-month periods ended June 30, 2006 and 2005

and from Inception (October 21, 1997) to June 30, 2006

(Unaudited)

	Three months ended June 30,		Six months ended June 30,		From Inception (October 21, 1997) to June 30,
(Expressed in U.S. Dollars)	2006	2005	2006	2005	2006
Revenue	$-	$-	$-	$-	$-
Expenses					
Administrative and general	$22,331	$16,260	$28,851	$8,792	$318,137
Depreciation	740	131	1,480	261	6,286
Interest on promissory note	24,358	20,187	48,461	37,494	187,694
Interest, bank charges and foreign exchange loss	2,321	(892)	3,753	(674)	9,135
Professional fees- accounting and legal	30,137	8,492	117,005	23,029	360,069
Management and consulting fees (Note 4)	4,095	5,098	12,620	11,051	951,859
Research and development (Notes 5 and 6)	66,423	65,423	131,846	130,846	677,983
Salary and benefits	52,231	7,199	81,506	14,769	138,043
Shareholder and investor relations	67,981	151,267	71,106	679,215	2,863,807
Stock offering costs	-	-	505,917	-	1,926,713
Transfer agent and filing	768	2,346	973	4,092	8,595
Travel	22,143	17,415	23,526	62,460	176,894
Stock based compensation expenses (Note 10)	1,147,530	-	1,147,530	-	1,147,530
	1,441,058	292,926	2,174,574	971,335	8,772,745
Operating Loss	(1,441,058)	(292,926)	(2,174,574)	(971,335)	(8,772,745)
Other income and expenses					

Interest income	3,662	828	4,739	2,223	41,537
	3,662	828	4,739	2,223	41,537
Net loss available to common shareholders	$(1,437,396)	$(292,098)	$(2,169,835)	$(969,112)	$(8,731,208)
Loss per share - basic and diluted	$(0.02)	$(0.00)	$(0.03)	$(0.01)	
Weighted average number of common shares outstanding - basic and diluted	71,026,187	69,214,041	70,735,292	67,841,064	

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

HEPALIFE TECHNOLOGIES, INC.

(A Development Stage Company)

STATEMENT OF STOCKHOLDERS' DEFICIENCY

from Inception (October 31, 1997) to June 30, 2006

(Unaudited)

(Expressed in U.S. Dollars)	Common Stock Shares	Common Stock Amount	Additional paid-in capital	Loss accumulated during development stage	Total Stockholders' equity (deficiency)
Common stock issued for service rendered at $0.00025 per share, October 21, 1997	12,000,000	$12,000	$(9,000)	$-	$3,000
Common stock issued for cash at $0.0625 per share during 1997	1,200,000	1,200	73,800	-	75,000
Comprehensive income					
Income from inception (October 21, 1997) to December 31, 1997	-	-	-	42	42
Balance, December 31, 1997	13,200,000	13,200	64,800	42	78,042
Common stock issued for service rendered at $0.025 per share, December 15, 1998	16,000,000	16,000	384,000	-	400,000
Comprehensive income (loss)					
Loss, year ended December 31, 1998	-	-	-	(471,988)	(471,988)

Balance, December 31, 1998	29,200,000	29,200	448,800	(471,946)	6,054
Common stock issued for cash at $0.025 per share, March 1999	12,000,000	12,000	288,000	-	300,000
Comprehensive income (loss)					
Loss, year ended December 31, 1999	-	-	-	(121,045)	(121,045)
Balance, December 31, 1999	41,200,000	41,200	736,800	(592,991)	185,009
Comprehensive income (loss)					
Loss, year ended December 31, 2000	-	-	-	(80,608)	(80,608)
Balance, December 31, 2000	41,200,000	41,200	736,800	(673,599)	104,401
Conversion of debt to equity at $0.015 per share, July 31, 2001	8,933,332	8,933	125,067	-	134,000
Comprehensive income (loss)					
Loss, year ended December 31, 2001	-	-	-	(160,364)	(160,364)
Balance, December 31, 2001	50,133,332	50,133	861,867	(833,963)	78,037

Common stock issued for services at $0.06 per share, April 23, 2002	10,000	10	590	-	600
Conversion of debt to equity at $0.05 per share, April 26, 2002	2,160,000	2,160	105,840	-	108,000
Common stock issued for investor relations services at $0.05 per share, July 25, 2002	2,390,000	2,390	117,110	-	119,500
Conversion of debt to equity at $0.05 per share, December 18, 2002	1,920,000	1,920	94,080	-	96,000
Comprehensive income (loss)					
Loss, year ended December 31, 2002	-	-	-	(375,472)	(375,472)
Balance, December 31, 2002	56,613,332	56,613	1,179,487	(1,209,435)	26,665
Common stock issued pursuant to exercise of stock options during the year at between $0.07 to $2.11 per share	282,500	283	398,317	-	398,600
Common stock issued pursuant to exercise of share purchase warrants in November 2003 at $0.025 per share	7,300,000	7,300	175,200	-	182,500

Comprehensive income (loss)					
Loss, year ended December 31, 2003	-	-	-	(1,102,723)	(1,102,723)
Balance, December 31, 2003	64,195,832	64,196	1,753,004	(2,312,158)	(494,958)
Common stock issued pursuant to exercise of stock options during the year between $0.07 to $2.11 per share	1,622,000	1,622	1,339,998	-	1,341,620
Common stock issued pursuant to exercise of share purchase warrants in December 2004 at $0.025 per share	2,000,000	2,000	48,000	-	50,000
Comprehensive income (loss)					
Loss, year ended December 31, 2004	-	-	-	(1,435,613)	(1,435,613)
Balance, December 31, 2004	67,817,832	67,818	3,141,002	(3,747,771)	(538,951)
Common stock issued pursuant to exercise of stock options in March 2005 at $3.10 per share	50,000	50	154,950	-	155,000
Common stock issued pursuant to exercise of stock options in May 2005 at $2.11 per share	45,000	45	94,905	-	94,950

Common stock issued pursuant to exercise of stock options in June 2005 at $2.11 per share	100,000	100	210,900	-	211,000
Common stock issued pursuant to exercise of stock options in October 2005 at $2.11 per share	40,000	40	84,360	-	84,400
Common stock issued pursuant to exercise of stock options in March 2005 at $2.11 per share	50,000	50	105,450	-	105,500
Common stock issued pursuant to exercise of share purchase warrants in March 2005 at $0.025 per share	1,250,000	1,250	30,000	-	31,250
Restricted common stock issued in June 2005 pursuant to share purchase agreement	20,000	20	37,580	-	37,600
Restricted common stock issued in July 2005 pursuant to share purchase agreement	691,598	692	1,382,504	-	1,383,196
Comprehensive income (loss)					
Loss, year ended December 31, 2005				(2,813,602)	(2,813,602)

Balance, December 31, 2005	70,064,430	70,065	5,241,651	(6,561,373)	(1,249,657)
Restricted common stock issued in January 2006 pursuant to share purchase agreement	374,753	375	505,542	-	505,917
Common stock issued for cash	769,182	768	729,231	-	729,999
Stock based compensation expenses	-	-	1,147,530	-	1,147,530
Comprehensive income (loss)					
Loss, six months ended June 30, 2006				(2,169,835)	(2,169,835)
Balance, June 30, 2006	71,208,365	$71,208	$7,623,954	$ (8,731,208)	$ (1,036,046)

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

HEPALIFE TECHNOLOGIES, INC.

(A Development Stage Company)

STATEMENTS OF CASH FLOWS

for the six months ended June 30, 2006 and 2005

and from Inception (October 21, 1997) to June 30, 2006

(Unaudited)

(Expressed in U.S. Dollars)	June 30, 2006	June 30, 2005	From Inception (October 21, 1997) to June 30, 2006
Cash flows from (used in) operating activities			
Net Loss	$(2,169,835)	$(969,112)	$(8,731,208)
Adjustments for items not involving cash:			
Depreciation	1,480	261	6,286
Common stock issued for services	-	20	861,100
Common stock issued as stock offering costs	505,917	-	1,926,713
Stock compensation expenses	1,147,530	-	1,147,530
Change in assets and liabilities			
Increase (decrease) in accounts payable	(18,602)	52,882	87,635
Increase in accounts payable - related party	17,623	9,003	123,980
	(515,887)	(906,946)	(4,577,964)
Cash flows used in investing activities			
Purchase of property and equipment	-	-	(10,480)
	-	-	(10,480)
Cash flows from financing activities			
Proceed from issuance of common stock	729,999	597,700	3,759,819
Net proceeds from (Repayment of) promissory notes	(25,000)	(50,000)	1,125,000
	704,999	547,700	4,884,819

Increase (decrease) in cash and cash equivalents	189,112	(359,246)	296,375
Cash and cash equivalents, beginning of period	107,263	613,523	-
Cash and cash equivalents, end of period	$296,375	$254,277	$296,375
Supplemental disclosure of cash flow information:			
Interest paid in cash	$107	$9,432	$52,016
Non-cash Investing and Financing Activities:			
Common stock issued for services	$-	$20	$861,000
Issuance of common stock as stock offering costs	$505,917	$-	$1,926,713

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

HEPALIFE TECHNOLOGIES, INC.

(A Development Stage Company)

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

JUNE 30, 2006

(Unaudited)

(Expressed in US Dollars)

NOTE 1 BASIS OF PRESENTATION GOING CONCERN UNCERTAINITIES

The Company has incurred net operating losses since inception. The Company faces all the risks common to companies in their early stages of development, including under capitalization and uncertainty of funding sources, high initial expenditure levels, uncertain revenue streams, and difficulties in managing growth. The Company s recurring losses raise substantial doubt about its ability to continue as a going concern. The Company s financial statements do not reflect any adjustments that might result from the outcome of this uncertainty. The Company expects to incur losses from its business operations and will require additional funding during 2006. The satisfaction of our cash needs hereafter will depend in large part on the Company s ability to successfully raise capital from external sources to pay for planned expenditures and to fund operations.

To meet these objectives, the Company has arranged a Common Stock Purchase Agreement with Fusion Capital Fund II, LLC to purchase from the Company up to $15,000,000 of the Company s common stock over a thirty month period (Note 8). Management believes that its current and future plans enable it to continue as a going concern. The Company's ability to achieve these objectives cannot be determined at this time. These financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying financial statements.

Principles of Consolidation

The accompanying consolidated financial statements have been prepared on the accrual basis in accordance with accounting principles generally accepted in the United States, and include the accounts of HepaLife Technologies, Inc. and its wholly-owned subsidiary, Phoenix BioSystems, Inc., which was incorporated under the laws of the State of Nevada on June 6, 2006. All significant intercompany transactions and accounts have been eliminated in

consolidation.

NOTE 2 STATEMENT OF INFORMATION FURNISHED

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with Form 10-Q instructions and in the opinion of management contains all adjustments (which are of a normal recurring nature) necessary to present fairly the financial position as of June 30, 2006 and December 31, 2005, and the results of operations for three and six months ended June 30, 2006 and 2005 and cash flows for the six months ended June 30, 2006 and 2005. These results have been determined on the basis of generally accepted accounting principles and practices in the United States and applied consistently with those used in the preparation of the Company's 2005 Annual Report on Form 10-K.

NOTE 3 - LOSS PER SHARE

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

The computation of basic and diluted loss per share is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Numerator - net loss available to common stockholders	$(1,437,396)	$ (292,098)	$(2,169,835)	$ (969,112)
Denominator - weighted average number of common shares outstanding	71,026,187	69,214,041	70,735,292	67,841,064
Basic and diluted loss per common shares	$ (0.02)	$ (0.00)	$ (0.03)	$ (0.01)

NOTE 4 RELATED PARTY TRANSACTIONS

Management Fees: During the three-month and six-month periods ended June 30, 2006, the Company paid management fees of $3,800 (2005: $5,098) and $3,800 (2005: $11,051) to the directors respectively. There is no management or consulting agreement in effect nor is there an agreement in place to convert debt to equity.

Notes Payable and Accrued Interest: During the quarter ended June 30, 2006, the Company made a partial repayment of $25,000 to the outstanding notes payable. As of June 30, 2006, notes payable of $1,125,000 was made up from unsecured loans of $225,000, $700,000 and $200,000, all bearing interest at the rate of 8.50%, due to a director and major shareholder of the Company. The entire amounts of principal and interest accrued are due and payable on demand. Accrued and unpaid interest on these notes during the three-month and six-month periods ended June 30, 2006, amounted to $23,317 and $47,420 respectively.

Rent: The Company s principal office is located at 1628 West 1st Avenue, Suite 216, Vancouver, British Columbia, Canada, V6J 1G1. These premises are owned by a private corporation controlled by a director and majority shareholder. The Company pays a monthly rent of C$3,200 effective from April 1, 2006. The Company paid rent of $8,634 (2005: $nil) and $8,634 (2005: $nil) for the three-month and six-month periods ended June 30, 2006, respectively.

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

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

NOTE 5 COOPERATIVE AGREEMENT

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

On May 24, 2004, the Agreement was extended to September 30, 2007, and the required total payments to ARS were amended to $807,828. The revised schedule of payments is as follows:

- $65,422.80 on or before 8/1/04 (paid in 2004);
- $65,422.80 on or before 11/1/04 (paid in June 2005);
- $65,422.80 on or before 2/1/05 (paid in October 2005);
- $65,422.80 on or before 5/1/05 (paid in October 2005);
- $65,422.80 on or before 8/1/05 (paid in December 2005);
- $65,422.80 on or before 11/1/05 (paid in March 24, 2006);
- $65,422.80 on or before 2/1/06 (paid in June 6, 2006);

- $65,422.80 on or before 5/1/06 (included in accounts payable);

- $65,422.80 on or before 8/1/06; and

- $65,422.80 on or before 11/1/06.

As of June 30, 2006, total payments of $676,983 have been paid/accrued.

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

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

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

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

NOTE 6 LICENSE AGREEMENT

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

The license agreement gives the Company exclusive rights to five issued patents. Under the terms of the License Agreement, the Company agreed to pay MSU an initial fee of $1,000 (paid) upon execution of the License Agreement. A 2.5% annual royalty based on future sales is payable, with an annual minimum payment of $10,000 from 2010 to 2014 and $20,000 from 2015 onwards.

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

As of June 30, 2006, total payment of $1,000 has been paid.

NOTE 7 EQUIPMENT

	June 30, 2006	December 31, 2005
Computer equipment	$9,392	$9,392
furniture and fixtures	1,089	1,089
	10,481	10,481
Less: accumulated depreciation	(6,287)	(4,807)
	$4,194	$5,674

Depreciation expenses charged to operations for the three-month and six-month periods ended June 30, 2006 were $740 (2005: $131) and $1,480 (2005: $261) respectively.

NOTE 8 SHARE CAPITAL

On July 8, 2005, the Company entered into a Common Stock Purchase Agreement (Purchase Agreement) and a Registration Rights Agreement (Registration Agreement) with Fusion Capital Fund II, LLC (Fusion Capital). Fusion Capital has agreed to purchase from the Company up to $15,000,000 of the Company s shares of common stock over a thirty month period. Pursuant to the terms of the Registration Agreement, the Company has filed a registration statement (the Registration Statement) with the Securities and Exchange Commission covering shares which may be purchased by Fusion Capital under the Purchase Agreement. Pursuant to the terms of the Purchase Agreement, the Company issued to Fusion 711,598 shares of its common stock, which Fusion Capital has agreed to hold for thirty months. The agreement was mutually cancelled on January 18, 2006, and replaced by a new Common Stock Purchase Agreement (New Purchase Agreement). The Company has issued an additional 374,753 shares in January 2006, for an aggregate number of 1,066,351 shares to Fusion Capital as the commitment fee and another 20,000 shares were issued to Fusion Capital upon signing of a term sheet on June 28, 2005. The fair value of the stock issued has been expensed in 2005.

Under the New Purchase Agreement with Fusion Capital dated January 20, 2006, Fusion Capital has agreed to purchase from the Company up to $15,000,000 of the Company s share of common stock over a thirty month period after the related registration statement is declared effective by the U.S. Securities and Exchange Commission, subject to earlier termination at the discretion of the Company.

After the registration statement had been declared effective on February 14, 2006, on each trading day during the term of the New Purchase Agreement the Company had the right to sell to Fusion Capital $25,000 of the Company s

common stock at a purchase price equal to the lower of (a) the lowest sale price of the common stock on such trading day and (b) the arithmetic average of the three lowest closing sale prices for the common stock during the twelve consecutive trading days immediately preceding the date of purchase, provided that the purchase price will not be less than $0.50 per share. At the Company s option, Fusion Capital can be required to purchase fewer or greater amounts of common stock each month. The Company has the right to control the timing and the number of shares sold to Fusion Capital.

The Company shall always have the right at any time to decrease the amount of the daily purchase amount by delivering written notice to the buyer which notice shall specify the new daily purchase amount. The decrease in the daily purchase amount shall become effective one trading day after receipt by the buyer of the daily purchase amount decrease notice. The Company shall have the right (but not the obligation) to increase the amount of the daily purchase amount in accordance with the terms and conditions set forth in the Common Stock Purchase Agreement by delivering written notice to the buyer stating the new amount of the daily purchase amount. With respect to increases in the daily purchase amount above the original daily purchase amount, as the market price for the Common Stock increases the Company shall have the right from time to time to increase the daily purchase amount as follows. For every $0.10 increase in threshold price above $1.00 (subject to equitable adjustment for any reorganization, recapitalization, non-cash dividend, stock split or other similar transaction), the Company shall have the right to increase the daily purchase amount by up to an additional $2,500 in excess of the original daily purchase amount.

Threshold price for purposes hereof means the lowest sale price of the Common Stock during the five (5) consecutive trading days immediately prior to the submission to the buyer of a daily purchase amount increase notice (subject to equitable adjustment for any reorganization, recapitalization, non-cash dividend, stock split or other similar transaction). For example, if the threshold price is $1.50, the Company shall have the right to increase the daily purchase

amount to up to $37,500 in the aggregate. If the threshold price is $2.50, the Company shall have the right to increase the daily purchase amount to up to $62,500 in the aggregate.

Fusion Capital does not have the right or the obligation to purchase shares of our common stock in the event that the price of our common stock is less than $0.50.

During the three-month and six-month periods ended June 30, 2006, Fusion Capital has purchased 358,423 and 769,182 shares of common stock of the Company for total proceeds of $375,000 and $729,999 respectively.

NOTE 9 WARRANTS

The movement of share purchase warrants can be summarized as follows:-

	Number of warrants	Weighted average exercise price
Balance, December 31, 2003	4,700,000	$0.025
Exercised	(2,000,000)	0.025
Balance, December 31, 2004	2,700,000	0.025
Exercised	(1,250,000)	0.025
Expired	(1,450,000)	0.025
Balance, June 30, 2006 and December 31, 2005	-	

As of June 30, 2006, there are no outstanding share purchase warrants.

NOTE 10 - STOCK OPTIONS

The movement of stock options can be summarized as follows:

		Weighted average

	Number of options	exercise price
Balance, December 31, 2003	12,755,000	$0.520
Exercised	(1,622,000)	0.830
Balance, December 31, 2004	11,133,000	0.476
Granted	6,000,000	2.860
Exercised	(285,000)	2.284
Balance, December 31, 2005	16,848,000	1.295
Granted	6,000,000	0.850
Cancelled	(13,118,000)	1.594
Balance, June 30, 2006	9,730,000	0.617

Effective from January 1, 2006, the Company has adopted SFAS 123(R) using a modified version of prospective application.

On April 24, 2006, the Company cancelled 13,118,000 stock options previously granted to officers, directors, employees and consultants, comprising of 5,500,000, 1,668,000, 2,000,000 and 3,950,000 options at an exercise price of $0.07, $2.11, $2.38 and $3.10 each, respectively.

On April 24, 2006, the Company granted 6,000,000 stock options at an exercise price of $0.85 to two employees, who simultaneously terminated 6,118,000 stock options on the same date, expiring on April 24, 2016. The vesting periods for the options are as follows: 30% of the stock options are exercisable on or after July 24, 2006, another 30% of the stock options are exercisable on or after October 24, 2006 and the remaining 40% of the stock options are exercisable on or after April 24, 2007. The Company cancelled 7,000,000 stock options granted to the President of the Company, and to minimize further dilution, did not grant any stock options to the President.

The fair value of the options granted in the period ended June 30, 2006 was estimated at $0.47 each, for a total amount of $2,820,000, by using the Black-Scholes Option Pricing Model with the following weighted average assumptions: dividend yield of 0%, expected volatility of 81.9%, risk-free interest rates of 4.23%, and expected lives of three years. During the three-month and six-month periods ended June 30, 2006, compensation expense (related to the 6,000,000 options granted) of $1,147,530 and $1,147,530, respectively, were recognized for these options.

The weighted average remaining contractual life of the outstanding stock options at June 30, 2006 is 8.61 years.

For the three and six months ended June 30, 2005, the Company was filing APB 25 for stock-based compensation, but followed the disclosure provisions of SFAS 123. Had compensation expense for the Company's stock-based compensation plans been determined under SFAS No. 123, based on the fair market value at the grant dates, the Company's pro-forma net loss and pro-forma net loss per share would have been reflected as follows:

	Three months ended June 30, 2005	Six months ended June 30, 2005
Net loss as reported:	$ (292,098)	$ (969,112)
Stock-based employee compensation expense as determined under the fair value based method	-	(10,320,000)
Pro-forma, net loss	$ (292,098)	$ (11,289,112)
Net loss per share - basic and diluted:		
As reported	$ (0.00)	$ (0.01)
Pro-forma	$ (0.00)	$ (0.17)

The weighted average fair value of the options granted in the period ended March 31, 2005 was estimated at $1.72 by using the Black-Scholes Option Pricing Model with the following weighted average assumptions: dividend yield of 0%, expected volatility of 93%, risk-free interest rates of 3.5%, and expected lives of three years.

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

Forward-Looking Statements

Except for the historical information presented in this document, the matters discussed in this Form 10-Q for the three and six months ending June 30, 2006, this report contains forward-looking statements. Such forward-looking statements include statements regarding, among other things, (a) our projected sales and profitability, (b) our growth strategies, (c) anticipated trends in our industry, (d) our future financing plans, and (e) our anticipated needs for working capital. Forward-looking statements, which involve assumptions and describe our future plans, strategies, and expectations, are generally identifiable by use of the words may, will, should, expect, anticipate, estimate, intend, or project or the negative of these words or other variations on these words or comparable terminology. This information may involve known and unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from the future results, performance, or achievements expressed or implied by any forward-looking statements. These statements may be found under Management's Discussion and Analysis of Financial Condition and Results of Operations, Business, Properties, as well as in this report generally. Actual events or results may differ materially from those discussed in forward-looking statements as a result of various factors, including, without limitation, the risks outlined under Risk Factors and matters described in this report generally. In light of these risks and uncertainties, there can be no assurance that the forward-looking statements contained in this filing will in fact occur.

Overview

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

Current cell-based technologies under development by HepaLife include 1) the first-of- its-kind artificial liver device, 2) proprietary in-vitro toxicology and pre-clinical drug testing platforms, and 3) cell-culture based vaccines to protect against the spread of influenza viruses among humans, including potentially the high pathogenicity H5N1 virus.

Critical Accounting Policies

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

We consider an accounting estimate to be critical if it requires assumptions to be made that were uncertain at the time the estimate was made; and changes in the estimate or different estimates that could have been made could have a material impact on our results of operations or financial condition. While our significant accounting policies are described in more detail in the notes to our financial statements included in this prospectus, we believe the following accounting policies to be critical to the judgments and estimates used in the preparation of our financial statements.

General and Administrative Expenses

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

Research and Development Costs

Research and development costs represent costs incurred to develop our technologies incurred pursuant to our CRADA with the USDA s Agricultural Research Service, and our License Agreement with Michigan State University, and include salaries and benefits for research and development personnel, allocated overhead and facility occupancy costs, contract services and other costs. We charge all research and development expenses to operations as they are incurred. We do not track research and development expenses by project.

Cooperative Agreement

On November 1, 2002, we entered into a CRADA with the USDA s Agricultural Research Service and committed to pay a total of $292,727 to USDA s Agricultural Research Service over a two-year period ending February 19, 2005. On May 24,

2004, we amended the CRADA, and agreed to pay a total of $807,828 through September 30, 2007, of which $153,600 had already been paid under the original agreement.

Effective on November 28, 2002, we amended our CRADA, in writing, to provide for the addition of Dr. Thomas Caperna as a co authorized departmental officer s designated representative.

Effective on July 12, 2003, we amended our CRADA, in writing, to reflect the change of our name from Zeta Corporation to HepaLife Technologies, Inc.

In February 2004, we orally amended our CRADA to modify the payment schedule so as to delay payment of installments due in August and November of 2004 and thereafter until and unless funds are actually required.

Contractual Responsibilities under the CRADA

Under the terms of the CRADA, as amended, the USDA s Agricultural Research Service is responsible for:

- Hiring one post-doctoral research associate, one support scientist, and one technician for a 2 to 3 year period.

- Providing laboratory and office space for the research associate.

- Providing a fully equipped cell culture laboratory and protein chemistry laboratory.

- Providing experimental animals (pigs) and slaughter facilities.

- Acquiring specific laboratory equipment, e.g., rotating cell culture system and supplies to conduct the CRADA objectives.

- Conducting research on the optimization of the PICM-19 Cell Line, or its derivative cell lines (or related pig epiblast-derived cell lines), as an in-vitro pig liver cell model, and adapt the PICM-19 liver Cell Line technology to an

extracorporeal liver assist device and to in-vitro formats for metabolic, toxicological, and carcinogenicity assay.

- Preparing progress reports on project objectives.

- Preparing and submit technical reports for publication.

- Providing access to 1850 square feet of laboratory space in the Beltsville Agricultural Research Center for our personnel assigned to work on the project.

- Providing utilities, services, and general support to our personnel, on an as needed and available basis.

We, in turn, our responsible for:

- Providing funds for one post-doctoral research associate, one support scientist, and one technician for a 2 to 3 year period.

- Providing funds for project related laboratory equipment, supplies, and off site research services such as electron microscopy and bioreactor component manufacturing.

- Providing funds for position advertisement and travel expenses for position interviews.

- Providing funds for professional activities of research associate such as travel to meetings and project specific training activities.

- Preparing and filing patent applications.

Generally, the terms of the CRADA also require our interaction with USDA s Agricultural Research Service personnel on the technical details involved with pig liver cell culture development, providing the necessary funds for the purpose above, preparing and filing any patent applications, and reviewing reports and implementing procedures for the

development of an artificial liver device utilizing the pig liver cell line. There has not been any material change in the relative responsibilities of the parties to the CRADA since its execution.

Payment Requirements and Budget Under the CRADA

Under the terms of the CRADA, we are obligated to make payments aggregating $807,828.00 to the USDA s Agricultural Research Service over the term of the CRADA, as listed below:

Amount	**Date Due**
$65,422.80	on or before August 1, 2004;
$65,422.80	on or before November 1, 2004;
$65,422.80	on or before February 1, 2005;
$65,422.80	on or before May 1, 2005;
$65,422.80	on or before August 1, 2005;
$65,422.80	on or before November 1, 2005;
$65,422.80	on or before February 1, 2006;
$65,422.80	on or before May 1, 2006;
$65,422.80	

on or before August 1, 2006;

$65,422.80

on or before November 1, 2006

In February 2004, we orally amended our CRADA to modify the payment schedule so as to delay payment of installments due in August and November of 2004 and thereafter until and unless funds are actually required.

The payments are to fund salaries, equipment, travel and other indirect costs of one post-doctoral researcher, one support scientist, and one technician up to September 30, 2007, as well as funds for the associated laboratory supplies and professional activities involved with conducting the CRADA objectives.

More specifically the agreed to budget for the CRADA contemplates the expenditure of these funds substantially as follows:

BUDGET CATEGORY	**AMOUNT**
A. Salaries and Wages	$408,400.00
B. Equipment	$28,025.00
C. Materials and Supplies	$265,500.00
D. Travel	
1. Domestic	$14,000.00
2. Foreign	
E. Facilities	-0-
F. Other Direct Costs	$11,126.00
G. TOTAL DIRECT COSTS	$727,051.00
H. Indirect Costs	$80,777.00
I. TOTAL COSTS	$807,828.00

Research Objectives of the CRADA.

The initial research objectives of the CRADA included:

-

Developing feeder-cell-independent and serum-free medium cell culture systems allowing the growth and differentiation of the PICM-19 Cell Line, or subclones or subpopulations of the PICM-19 Cell Line, under defined

conditions.

As of the date of this 10-Q, the PICM-19 Cell Line has been assayed for its response to several specific growth factors and cell attachment factors. Two specific growth stimulating factors have been identified and two attachment factors that enable the attachment and maintenance of the PICM-19 Cell Lines have been identified.

-

Developing spheroid cultures (self-assembling balls of cells) of the PICM-19 Cell Line without STO feeder cells and testing of rotating cell culture system for production and maintenance of spheroids.

As of the date of this 10-Q, this objective has been redirected to the testing of PICM-19 Cell Line growth and maintenance on various types of commercially available glass or plastic micro- and macro-spheres. One type each of plastic microsphere and macrosphere has been successfully tested and are now in use in a model flow-through

bioreactor that is currently in its testing phase.

-

Investigating effects of accessory cells obtained from pig liver on the PICM-19 Cell Line growth, differentiation, and metabolic function.

As of the date of this 10-Q, these studies are not anticipated to be necessary for completion of the CRADA objectives and accordingly, are not longer deemed a priority.

-

Assaying the PICM-19 Cell Line and spheroids for liver specific functions by measuring P450 activity, liver enzyme activities, urea production, and ammonia clearance.

As of the date of this 10-Q, P450 activity, urea production, and ammonia clearance activity of the PICM-19 cell line and three derivative cell lines (PICM-19H, PICM-19-3BT, PICM-19HA) have been confirmed and completed. Gamma-glutamyltranspeptidase enzyme (a key bile duct enzyme for the processing of inflammatory and anti-inflammatory molecules) activity has been confirmed and completed in the PICM-19 cell line and in two of the three PICM-19 derivative cell lines. Gamma-glutamylcysteine synthetase (a secondary detoxification liver enzyme) activity assays are on-going.

-

Assaying the PICM-19 Cell Line liver specific protein synthesis and secretion by protein identification techniques. As of the date of this prospectus, liver specific protein synthesis by the PICM-19 cell line has been completed. Several liver specific proteins secreted by the PICM-19 cells were identified by Western blotting, 2-D gel electrophoresis, and mass spectrophotometric analysis.

-

Developing and testing, by in-vitro assay, flow-through bioreactors that enable the growth, differentiation, and maintenance of metabolic function of the PICM-19 Cell Line, or its derivative cell lines, over long term culture (1-3 months). As of the date of this prospectus, three flow-through bioreactor model systems incorporating the PICM-19 cells are being tested for cell viability, ammonia clearance activity, P450 enzyme activity, and urea production activity.

-

Developing and testing multi-well cell culture formats for the in-vitro assay of the effects of various test compounds on the metabolism and viability of the PICM-19 Cell Line derived hepatocytes or bile ductules (liver cell channels).

As of the date of this 10-Q, multi-cell cell culture formats have been successfully tested and P-450 enzyme assays are currently being tested and standardized in 6-well, 24-well, and 96-well formats.

-

Genetically engineering the PICM-19 Cell Line to create derivative cell lines containing gene reporter constructs, e.g., green fluorescent protein (GFP) based constructs, so that GFP expression is linked to various cell metabolic responses or stimulation of various cell signal transduction pathways.

As of the date of this 10-Q, STO cell lines have been created by genetic engineering that express GFP and the neomycin-resistance gene. The construction of GFP and RFP (red fluorescent protein) mammalian expression vectors under the control of the alpha-fetoprotein promoter is currently underway for use in the genetic engineering of the PICM-19 Cell Line.

-

Developing cell transformation assay formats to demonstrate and enable the utilization of the PICM-19 Cell Line for the study of mutagenic or carcinogenic processes.

As of the date of this 10-Q, this aspect of the CRADA has the lowest priority and no work is anticipated on this aspect of the project for at least two years.

Ownership of Developed Technologies Under the CRADA

Under the terms of the CRADA all rights, title and interest in any subject invention made solely by USDA s Agricultural Research Service employees are owned by USDA s Agricultural Research Service, solely by us are owned by us, and any such inventions are owned jointly by us and USDA s Agricultural Research Service if made jointly by USDA s Agricultural Research Service and us. Under the CRADA, we have an option to negotiate an exclusive license in each subject invention owned or co-owned by USDA s Agricultural Research Service for one or more field (s) of use encompassed by the CRADA. The option terminates when and if we fail to:

- submit a complete application for an exclusive license within sixty days of being notified by USDA s Agricultural Research Service of an invention being available for licensing; or

- submit a good faith written response to a written proposal of licensing terms within forty five days of such proposal.

The USDA s Agricultural Research Service has the first option to prepare and prosecute patent or Plant Variety Protection Certificate applications, on subject inventions that are owned or co-owned by the USDA s Agricultural Research Service, which option may be waived in whole or in part.

Although the termination date of the CRADA is September 30, 2007, the CRADA is subject to earlier termination at any time by mutual consent. Moreover, either party may unilaterally terminate the entire agreement at any time by giving the other party written notice not less than sixty calendar days prior to the desired termination date. To date, we have neither given nor received any such written notice.

License Agreement

On June 15, 2006, we, through our wholly owned subsidiary, Phoenix BioSystems, Inc. entered into an exclusive worldwide License Agreement with Michigan State University (MSU) for the development of new cell-culture based flu vaccines to protect against the spread of influenza viruses.

The license agreement gives HepaLife exclusive rights to five issued patents, including US patent 5,989,805 (Immortal Avian Cell Line To Grow Avian and Animal Viruses To Produce Vaccines), US patent 5,827,738, US patent 5,833,980, US patent 5,866,117 and US patent 5,874,303.

Under the terms of the agreement, HepaLife agreed to pay MSU undisclosed milestone payments and royalty payments based on future sales.

Project Description

Under this agreement, Michigan State University scientists will direct work involved with initial testing of the OU2 cells and evaluation of their ability to grow various human and animal influenza viruses. Specifically:

1)

Up to 3 freeze dates of OU2 cells will be thawed and started in culture within the MSU DCPAH BSL-3 laboratory. Cells will be expanded with each freeze date kept separate.

2)

Cells will be sent to a commercial testing facility for testing under the USDA 9CFR guidelines. Specific testing will include: retrovirus (p27 antigen), mycoplasm, hemagglutinating virus, cytopathogenic or hemabsorbing agents, detection of extraneous viable bacteria and fungi. Additional testing to be conducted will include PCR assays for Marek s disease virus, LCMV, and Newcastle disease virus.

3)

Cells will be tested for their ability to grow common vaccine strains of human influenza virus, low and high pathogenicity avian influenza.

4)

An attempt to adapt the cells to serum free growth conditions will be made.

5)

An attempt to adapt the cells to growth on glass microspheres will be made.

Cells will be evaluated for their ability to grow high pathogenicity H5N1 avian influenza virus.

Results of Operation

The Company has yet to establish any history of profitable operations. The Company has incurred operating losses of $1,441,058 and $292,926 for the three months ended June 30, 2006 and June 30, 2005, respectively. As a result, at June 30, 2006, the Company has an accumulated deficit of $8,731,208.

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

19

Three and Six Months Ended June 30, 2006 and 2005

The Company had no revenues in the three and six months ended June 30, 2006 and June 30, 2005. Our expenses increased 392% to $1,441,058 in the three months ended June 30, 2006, from $292,926 in the same period in 2005. This increase of $1,148,132 for the three months ended June 30, 2006 compared to the same period in 2005 was primarily attributable to an increase of $1,147,530 in stock based compensation expenses.

Our expenses increased 124% to $2,174,574 in the six months ended June 30, 2006, from $971,335 in the same period in 2005. This increase of $1,203,239 from the six months ended June 30, 2006 compared to the same period in 2005 was primarily attributable an increase of $1,147,530 in stock based compensation expenses.

Interest income increased 342% to $3,662 in the three months ended June 30, 2006, from $828 during the same period in 2005, reflecting higher than average cash balances maintained during most of the second quarterly period in 2006. For the six months ended June 30, 2006 and in the same period in 2005, interest income has increased 113% to $4,739 from $2,223, reflecting higher than average cash balances maintained during most of the first two fiscal quarterly periods in 2006.

We incurred net losses of $1,437,936 and $292,098 during the three months ended June 30, 2006 and in the same period in 2005, respectively, and we also incurred net losses of $2,169,835 and $969,112 for the six months ended June 30, 2006 and June 30, 2005. The increase in our net loss amounting to $1,145,838 and $1,200,723 for the three and six months ended June 30, 2006 from the same period in 2005, respectively, was principally caused by the increase in our stock based compensation expenses.

Liquidity and Capital Resources

As at June 30, 2006, the Company had a cash balance of $296,375. The Company has financed its operations primarily from cash on hand, through loans from shareholders, proceeds from stock option and warrant exercises, and through the common stock purchase agreement with Fusion Capital, during the six month period ending June 30, 2006.

Net cash flows used in by operating activities was $515,887 for the six month period ending June 30, 2006, compared to net cash flows used of $906,946 for the same period in 2005.

Net cash provided by financing activities was $704,999 for the six months period ending June 30, 2006 compared to $547,700 for the same period in 2005. The Company has financed its operations primarily from cash on hand, through

loans from shareholders, proceeds from stock option and warrant exercises, and through the common stock purchase agreement with Fusion Capital.

During the three-month and six-month periods ended June 30, 2006, Fusion Capital has purchased 410,759 and 769,182 shares of common stock of the Company for total proceeds of $354,999 and $729,999 respectively.

At this time, except for our agreement with Fusion Capital, we have no agreements or understandings with any third party regarding any financings.

Related Party Transactions

Management Fees: During the three-month and six-month periods ended June 30, 2006, the Company paid management fees of $3,800 (2005: $5,098) and $3,800 (2005: $11,051) to the directors respectively. There is no management or consulting agreement in effect nor is there an agreement in place to convert debt to equity.

Notes Payable and Accrued Interest: During the quarter ended June 30, 2006, the Company made a partial repayment of $25,000 to the outstanding notes payable. As of June 30, 2006, notes payable of $1,125,000 was made up from unsecured loans of $225,000, $700,000 and $200,000, all bearing interest at the rate of 8.50%, due to a director and major shareholder of the Company. The entire amounts of principal and interest accrued are due and payable on demand. Accrued and unpaid interest on these notes during the three-month and six-month periods ended June 30, 2006, amounted to $23,317 and $47,420 respectively.

Rent: The Company s principal office is located at 1628 West 1st Avenue, Suite 216, Vancouver, British Columbia, Canada, V6J 1G1. These premises are owned by a private corporation controlled by a Director and majority shareholder. The

Company pays a monthly rent of C$3,200 effective from April 1, 2006. The Company paid rent of $8,634 (2005: $nil) and $8,634 (2005: $nil) for the three-month and six-month periods ended June 30, 2006, respectively.

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

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

Off Balance Sheet Arrangements

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

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment* . SFAS 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS 123(R) requires that the fair value of such equity instruments be recognized as expense in the historical financial statements as services are performed. Prior to SFAS 123(R), only certain pro-forma disclosures of fair value were required. SFAS 123(R) was effective for our Company as of the beginning of the first interim or annual reporting period that begins after December 15, 2005.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections . SFAS No. 154 replaces APB Opinion No. 20 Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements . SFAS No. 154 requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109.* This Interpretation provides guidance for recognizing and measuring uncertain tax positions, as defined in Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes*. FIN No. 48 prescribes a threshold condition that a tax position must meet for any of the benefit of an uncertain tax position to be recognized in the financial statements. Guidance is also provided regarding derecognition, classification and disclosure of uncertain tax positions. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect that this Interpretation will have a material impact on their financial position, results of operations or cash flows.

Risk Factors

We have sought to identify what we believe to be the most significant risks to our business. However, we cannot predict whether, or to what extent, any of such risks may be realized nor can we guarantee that we have identified all possible risks that might arise. Investors should carefully consider all of such risk factors before making an investment decision with respect to our Common Stock. We provide the following cautionary discussion of risks, uncertainties and possible inaccurate assumptions relevant to our business. These are factors that we think could cause our actual results to differ materially from expected results. Other factors besides those listed here could adversely affect us.

Risks Associated With Our Business

We Have Experienced Significant Losses And Expect Losses To Continue For The Foreseeable Future.

We have yet to establish any history of profitable operations. We have incurred annual operating losses of $2,818,065 and $1,437,534, respectively, during the past two fiscal years of operation. As a result, at June 30, 2006, we had an accumulated deficit of $8,731,208. We had no revenues during the last five fiscal years and we do not expect to generate revenues from our operations for the foreseeable future. Our profitability will require the successful completion of our sponsored research, development efforts and the subsequent commercialization of our products, if any, derived from our sponsored research and

development activities regarding our artificial liver device and in-vitro toxicology testing methodologies. No assurances can be given when this will occur or that we will ever be profitable.

We Currently Do Not Have, And May Never Develop, Any Commercialized Products.

We currently do not have any commercialized products or any significant source of revenue. We have invested substantially all of our time and resources over the last three years in identification, research and development of technologies and products for liver toxicity detection and the treatment of various forms of liver dysfunction and disease. The technologies, which are the subject of our ongoing sponsored research programs, will require additional development, clinical evaluation, regulatory approval, significant marketing efforts and substantial additional investment (beyond the $807,828 to which we have committed under the terms of our CRADA) before they can provide us with any revenue. We cannot currently estimate with any accuracy the amount of these funds because it may vary significantly depending on the results of our current sponsored research and development activities, product testing, costs of acquiring licenses, changes in the focus and direction of our research and development programs, competitive and technological advances, the cost of filing, prosecuting, defending and enforcing patent claims, the regulatory process, manufacturing, marketing and other costs associated with the commercialization of products following receipt of approval from regulatory bodies and other factors.

Our efforts may not lead to commercially successful products for a number of reasons, including:

- we may not be able to obtain regulatory approvals or the approved indication may be narrower than we seek;
- our technologies or products, if any, derived from our research and development efforts may not prove to be safe and effective in clinical trials;
- physicians may not receive any reimbursement from third-party payors, or the level of reimbursement may be insufficient to support widespread adoption of any products derived from our research and development efforts;
- any products that may be approved may not be accepted in the marketplace by physicians or patients;
- we may not have adequate financial or other resources to complete the development and commercialization of products derived from our research and development efforts;

-

we may not be able to manufacture our products in commercial quantities or at an acceptable cost; and

-

rapid technological change may make our technologies and products derived from those technologies obsolete.

We Will Require Additional Financing To Sustain Our Operations And Without It We Will Not Be Able To Continue Operations.

Our independent auditors have added an explanatory paragraph to their audit opinion issued in connection with the financial statements for the years ended December 31, 2005 and 2004, relative to our ability to continue as a going concern. Our ability to obtain additional funding will determine our ability to continue as a going concern. Our financial statements do not include any adjustments that might result from the outcome of this uncertainty.

At June 30, 2006, we had a working capital deficit of $1,040,240. We have an operating cash flow deficit of $1,332,440 in 2005 and $1,364,209 in 2004. Although we believe that we have sufficient financial resources and commitments to sustain our current level of research and development activities, any expansion, acceleration or continuation of such activities will require additional capital which may not be available to us, if at all, on terms and conditions that we find acceptable.

On January 20, 2006 we entered into a new common stock purchase agreement with Fusion Capital Fund II, LLC pursuant to which Fusion Capital has agreed, so long as no event of default exists, to purchase on each trading day $25,000 of our common stock up to an aggregate of $15.0 million over a 30 month period subject to earlier termination at our discretion. In our discretion, we may elect to sell more of our common stock to Fusion Capital than the minimum daily amount. The purchase price of the shares of common stock will be equal to a price based upon the future market price of the common stock without any fixed discount to the market price. Fusion Capital does not have the right or the obligation to purchase shares of our common stock in the event that the price of our common stock is less than $0.50.

The extent we rely on Fusion Capital as a source of funding will depend on a number of factors including, the prevailing market price of our common stock and the extent to which we are able to secure working capital from other sources, including other debt and equity financings.

We May Not Be Able To Repay Loans We Have Received From Harmel S. Rayat, Our President, Director And Majority Stockholder, To Fund Our Operation.

We have borrowed an aggregate of $1,055,000 from Harmel S. Rayat, our president, director and majority stockholder, pursuant to his $1,600,000 loan commitment to us. The loans are due upon the receipt of the written demand from Mr.

Rayat. The loans bear interest at the rate of 8.50% per annum. We do not currently have sufficient capital on hand to repay these loans. We may prepay these loans, at any time, without penalty. We expect to repay these amounts from the proceeds, if any, we receive under the common stock purchase agreement with Fusion Capital. There is no assurance that we will be able to repay all or a part of these loans or obtain any additional loans from Mr. Rayat in the event we do not receive the proceeds from Fusion Capital.

The Success Of Our Sponsored Research And Development Program Is Uncertain And We Expect To Be Engaged In Research And Development Efforts For A Considerable Period Of Time Before We Will Be In A Position, If Ever, To Develop And Commercialize Products Derived From Our Sponsored Research Program.

We expect to continue our current sponsored research and development program through at least 2007. Research and development activities, by their nature, preclude definitive statements as to the time required and costs involved in reaching certain objectives. Actual costs may exceed the amounts ($807,828) we have budgeted and actual time may exceed our expectations. If our research and development requires more funding or time than we anticipate, then we may have to reduce technological development efforts or seek additional financing. There can be no assurance that we will be able to secure any necessary additional financing or that such financing would be available to us on favorable terms. Additional financings could result in substantial dilution to existing stockholders. Even if we are able to fully fund our research and development program, there is no assurance that, even upon successful completion of our program, we will ever be able to commercialize products if any, derived from our research efforts or that we will be able to generate any revenues from operations.

Our Sponsored Research and Development Program Is In The Preliminary Development Stage And The Results We Attain May Not Prove To Be Adequate For Purposes of Developing and Commercializing Any Products Or Otherwise To Support A Profitable Business Venture.

Our sponsored research and development program is in the preliminary development stage. Our program is targeting specifically in-vitro toxicology and drug testing platforms and the development of an artificial liver device. We will require significant further research, development, testing and regulatory approvals and significant additional investment (beyond the $807,828 to which we have committed under the terms of our CRADA) before we will be in a position to attempt to commercialize products derived from our research and development program. We cannot currently estimate with any accuracy the amount of these funds because it may vary significantly depending on the results of our current sponsored research and development activities, product testing, costs of acquiring licenses, changes in the focus and direction of our research and development programs, competitive and technological advances, the cost of filing, prosecuting, defending and enforcing patent claims, the regulatory process, manufacturing, marketing and other costs associated with commercialization of products following receipt of approval from regulatory bodies and other factors.

There can be no assurances that our early stage sponsored research will be successful. The ultimate results of our ongoing research program may demonstrate that the technologies being researched by us may be ineffective, unsafe or unlikely to receive necessary regulatory approvals, if ever. If such results are obtained, we will be unable to create marketable products or generate revenues and we may have to cease operations.

We have not submitted any products or any technologies that are the subject of, or result from, our research and development activities for regulatory approval or clearance. Even if our research is successful, the process of obtaining necessary U.S. Food and Drug Administration (FDA) approvals or clearances can take years and is expensive and full of uncertainties. Additionally, approved products are subject to continuing FDA requirements relating to quality control and quality assurance, maintenance of records, reporting of adverse events and product recalls, documentation, labeling and promotion of medical products. Compliance with such continued regulatory oversight may prove to be costly and may limit our ability to attain profitable operations.

We May Not Be Granted An Exclusive License Under Our CRADA With The USDA s Agricultural Research Service.

-

We are a party to a CRADA with the USDA s Agricultural Research Service which grants us an option to negotiate an exclusive license to any invention or other intellectual property conceived or reduced to practice under the CRADA which is patentable or otherwise protectable under Title 35 of the United States Code or under the patent laws of a foreign country. There can be no assurance that such a license will be granted to us or that we can obtain a license on terms favorable to us. If we do not obtain an exclusive license, our ability to generate revenue would be materially adversely affected.

We expect to enter into additional research agreements and licenses in the future that relate to important technologies that may be necessary for the development and commercialization of related and unrelated products. These agreements and licenses may impose various commercialization, indemnification, royalty, insurance and other obligations on us, which, if we fail to comply, may result in the termination of these agreements and licenses or make the agreements and licenses non-

exclusive, which could affect our ability to exploit important technologies that are required for successful development of products, if any, derived from our ongoing sponsored research and development programs.

Our CRADA With The USDA s Agricultural Research Service May Be Terminated By Either Party At Any Time By Giving Written Notice Of Not Less Than Sixty Calendar Days Prior To The Desired Termination Date.

Our current sponsored research and development program is based entirely on our CRADA with the USDA s Agricultural Research Service. The termination date of the CRADA is September 30, 2007. However, the CRADA provides that it may be terminated unilaterally by either us or the USDA s Agricultural Research Service upon written notice of not less than sixty calendar days prior to the desired termination date. This means that the USDA s Agricultural Research Service could terminate the CRADA even if we are not in default under the terms of the Agreement. If the USDA s Agricultural Research Service were to do so, our business and future prospects would be materially adversely affected.

Currently, We Do Not Directly Conduct Any Of Our Research And Development Activities And Therefore We Will Have Minimal Control Over Such Research.

We rely primarily on the USDA s Agricultural Research Service to conduct, monitor and assess our sponsored research. We will have no control over the specifics of and possible direction that the research may take. Accordingly, there can be no assurance that the USDA s Agricultural Research Service will conduct our sponsored research in a manner that will lead to the commercial development of any products.

We are also dependent upon the services of certain key scientific personnel who are not employed by us, including the principal investigators with respect to our on going research regarding both the treatment of liver disease (and related conditions), including the development of an artificial liver device, and in-vitro toxicology testing technologies. The loss of the services provided by such persons could have a materially adverse effect on us, unless qualified replacements could be found. We have no control over whether our principal investigators or other scientific personnel will choose to remain involved with our projects. Since these individuals are not bound by contract to us nor employed by us directly, they might move on to other research or positions.

We Are Subject To Substantial Government Regulation Which Could Materially Adversely Affect Our Business.

We have yet to develop any products for submission for regulatory approval. If any such products are submitted for approval, they must undergo rigorous preclinical and clinical testing and an extensive regulatory approval process before they can be marketed. This process makes it longer, harder and more costly to bring any products to market; moreover, we cannot guarantee that approval will be granted. The pre-marketing approval process can be particularly expensive, uncertain and lengthy. Many products for which FDA have never been approved for marketing. In addition

to testing and approval procedures, extensive regulations also govern marketing, manufacturing, distribution, labeling and record-keeping procedures. If we do not comply with applicable regulatory requirements, such violations could result in warning letters, non-approval, suspensions of regulatory approvals, civil penalties and criminal fines, product seizures and recalls, operating restrictions, injunctions and criminal prosecution.

Delays in, or rejection of, FDA or other government entity approval may also adversely affect our business. Such delays or rejection may be encountered due to, among other reasons, government or regulatory delays, lack of efficacy during clinical trials, unforeseen safety issues, slower than expected rate of patient recruitment for clinical trials, inability to follow patients after treatment in clinical trials, inconsistencies between early clinical trial results and results obtained in later clinical trials, varying interpretations of data generated by clinical trials, or changes in regulatory policy during the period of product development in the United States. In the United States more stringent FDA oversight in product clearance and enforcement activities could result in our experiencing longer approval cycles, more uncertainty, greater risk and significantly higher expenses. Even if regulatory approval for any product is granted, this approval may entail limitations on uses for which any such product may be labeled and promoted. It is possible, for example, that we may not receive FDA approval to market products based on our sponsored research and development efforts for broader or different applications or to market updated products that represent extensions of any such product. In addition, we may not receive FDA approval to export any such product in the future, and countries to which products are to be exported may not approve them for import.

Any manufacturing facilities would also be subject to continual review and inspection. The FDA has stated publicly that compliance with manufacturing regulations will be scrutinized more strictly. A governmental authority may challenge our compliance with applicable federal, state and foreign regulations. In addition, any discovery of previously unknown problems with any of our sponsored research and development efforts or products derived from such research and development, or facilities may result in marketing, sales and manufacturing restrictions, being imposed, as well as possible enforcement actions.

From time to time, legislative or regulatory proposals are introduced that could alter the review and approval process relating to our research and development programs and products, if any, derived from such research. It is possible that the FDA will issue additional regulations further restricting the sale of our products, if any, derived from our research and development efforts. Any change in legislation or regulations that govern the review and approval process relating to could make it more difficult and costly to obtain approval, or to produce, market, and distribute such products, if any, derived from our research and development efforts, even if approved.

We May Be Required To Comply With Rules Regarding Animal Testing and This May Limit the Success of Our Research and Development Program.

Our sponsored research and development efforts involve laboratory animals. We may be adversely affected by changes in laws, regulations or accepted procedures applicable to animal testing or by social pressures that would restrict the use of animals in testing or by actions against our collaborators or us by groups or individuals opposed to such testing.

Our Sponsored Research and Development Program Uses Cells Derived From Pigs, Which Could Prevent The FDA Or Other Health Regulatory Agencies From Approving Products, If Any, Derived From Our Research and Development Efforts.

Because pigs carry genetic material of the porcine endogenous retrovirus (PERV), our use of cells derived from pigs carries a risk of transmitting viruses harmless to pigs, but deadly to humans. This may result in the FDA or other health regulatory agencies not approving products, if any, derived from our sponsored research and development efforts or subsequently banning any further use of any such products should health concerns arise after any such product was approved. At this time, it is unclear whether we will be able to obtain clinical and product liability insurance that covers the PERV risk.

We May Be Liable For Contamination Or Other Harm Caused By Materials That We Handle, And Changes In Environmental Regulations Could Cause Us To Incur Additional Expense.

Our sponsored research and development programs do not generally involve the handling of potentially harmful biological materials or hazardous materials, but they may occasionally do so. The USDA s Agricultural Research Service and we are subject to federal, state and local laws and regulations governing the use, handling, storage and disposal of hazardous and biological materials. If violations of environmental, health and safety laws occur, we could be held liable for damages, penalties and costs of remedial actions. These expenses or this liability could have a significant negative impact on our business, financial condition and results of operations. We may violate environmental, health and safety laws in the future as a result of human error, equipment failure or other causes. Environmental laws could become more stringent over time, imposing greater compliance costs and increasing risks

and penalties associated with violations. We may be subject to potentially conflicting and changing regulatory agendas of political, business and environmental groups. Changes to or restrictions on permitting requirements or processes, hazardous or biological material storage or handling might require an unplanned capital investment or relocation. Failure to comply with new or existing laws or regulations could harm our business, financial condition and results of operations.

Even If We Were To Secure Regulatory Approval In The Future For Any Product Derived From Our Sponsored Ongoing Research Efforts, We Lack Sales and Marketing Experience and Will Likely Rely On Third Parties For Such Services.

Our ability to achieve profitability is dependent in part on ultimately obtaining regulatory approvals for products, if any, which are derived from our sponsored research and development efforts, and then entering into agreements for the commercialization of any such products. There can be no assurance that such regulatory approvals will be obtained or such agreements will be entered into. The failure to obtain any such necessary regulatory approvals or to enter into any such necessary agreements could delay or prevent us from achieving profitability and would have a material adverse effect on the business, financial position and results of our operations. Further, there can be no assurance that our operations will become profitable even if products, if any, which are derived from our sponsored research and development efforts, are commercialized.

If FDA and other approvals are ultimately obtained with respect to any product submitted by us in the future for approval, we expect to market and sell any such product through distribution, co-marketing, co-promotion or sublicensing arrangements with third parties. We have no experience in sales, marketing or distribution of biotechnology products and our current management and staff is not trained in these areas. To date, we have no such agreements. To the extent that we enter into distribution, co-marketing, co-promotion or sublicensing arrangements for the marketing and sale of any such products, any revenues received by us will be dependent on the efforts of third parties. If any of such parties were to breach or terminate their agreement with us or otherwise fail to conduct marketing activities successfully, and in a timely manner, the commercialization of products, if any, derived from our research and development efforts would be delayed or terminated.

We May Not Be Able To Attract And Retain Qualified Personnel Either As Employees Or As Consultants; Without Such Personnel, We May Not Be Successful In Commercializing The Results Of Our Ongoing Research And Development Efforts.

Competition for qualified employees among companies in the biotechnology industry is intense. Our future success depends upon our ability to attract, retain and motivate highly skilled employees. Our present management has no clinical or other experience in the development of biotechnology products. Attracting desirable employees will require us to offer competitive compensation packages, including possible stock options. In order to successfully commercialize the results of our ongoing research and development efforts or products, if any, derived from our research program we must substantially expand our personnel, particularly in the areas of clinical trial management, regulatory affairs, business development and marketing. There can be no assurance that we will be successful in hiring or retaining qualified personnel. Managing the integration of new personnel and our growth generally could pose significant risks to our development and progress. The addition of such personnel may result in significant changes in our utilization of cash resources and our development schedule.

We Expect To Operate In A Highly Competitive Market; We May Face Competition From Large, Well-Established Companies With Significant Resources; And, We May Not Be Able To Compete Effectively.

Our commercial success will depend on our ability and the ability of our sublicensees, if any, to compete effectively in product development areas such as, but not limited to, safety, efficacy, ease of use, patient or customer compliance, price, and marketing and distribution. There can be no assurance that competitors will not succeed in developing products that are more effective than any products derived from our research and development efforts or that would render such products obsolete and non-competitive.

The biotechnology industry is characterized by intense competition, rapid product development and technological change. Most of the competition that we encounter will come from companies, research institutions and universities who are researching and developing technologies and potential products similar to or competitive with our own.

These companies enjoy numerous competitive advantages over us, including:

- significantly greater name recognition;
- established relations with healthcare professionals, customers and third-party payors;
- established distribution networks;

- additional lines of products, and the ability to offer rebates, higher discounts or incentives to gain a competitive advantage;

- greater experience in conducting research and development, manufacturing, clinical trials, obtaining regulatory approval for products, and marketing approved products; and

- greater financial and human resources for product development, sales and marketing, and patent litigation.

As a result, we may not be able to compete effectively against these companies or their products.

We May Become Subject To Claims Of Infringement Or Misappropriation Of The Intellectual Property Rights Of Others, Which Could Prohibit Us From Commercializing Products Based On Our Sponsored Research And Development Program, Require Us To Obtain Licenses From Third Parties Or To Develop Non-Infringing Alternatives, And Subject Us To Substantial Monetary Damages And Injunctive Relief.

We do not have any patents regarding any of our sponsored research and development activities. We may not be able to assert any rights, under our CRADA, to any patents held by the USDA s Agriculture Research Service. Third parties could, in the future, assert infringement or misappropriation claims against us with respect to our current sponsored research and development program or future products, if any, derived from our sponsored research and development program. Whether a product infringes a patent involves complex legal and factual issues, the determination of which is often uncertain. Therefore, we cannot be certain that we have not infringed the intellectual property rights of such third parties.

Any infringement or misappropriation claim could cause us to incur significant costs, could place significant strain on our financial resources, divert management s attention from our business and harm our reputation. If the relevant patents were upheld as valid and enforceable and we were found to infringe, we could be prohibited from continuing our research and development activities and from marketing or selling products, if any, derived from our sponsored research and development efforts unless we could obtain licenses to use the technology covered by the patent or are able to design around the patent. We may be unable to obtain a license on terms acceptable to us, if at all, and we may not be able to commercialize any products. A court could also order us to pay compensatory damages for such infringement, plus prejudgment interest and could, in addition, treble the compensatory damages and award attorney fees. These damages could be substantial and could

harm our reputation, business, financial condition and operating results. Depending on the nature of the relief ordered by the court, we could become liable for additional damages to third parties.

We May Be Exposed To Product Liability Claims For Which We Do Not Have Any Insurance Coverage.

Because our activities involve the researching, developing and testing of new technologies; and in the future we may be involved either directly or indirectly in the manufacturing and distribution of products, if any, derived from our sponsored research and development efforts, we may be exposed to the financial risk of liability claims in the event that the use of any such product results in personal injury, misdiagnosis or death. We may be subject to claims against us even if the apparent injury is due to the actions of others. There can be no assurance that we will not experience losses due to product liability claims in the future, or that adequate insurance will be available in sufficient amounts, at an acceptable cost, or at all. A product liability claim, product recall or other claim, or claims for uninsured liabilities or in excess of insured liabilities, may have a material adverse effect on our business, financial condition and results of operations. These liabilities could prevent or interfere with our product commercialization efforts. Defending a suit, regardless of merit, could be costly, could divert management attention and might result in adverse publicity, which could result in the withdrawal of, or inability to recruit, clinical trial volunteers, or result in reduced acceptance of products derived from our sponsored research and development activities in the market.

We do not currently carry any insurance. If a claim against us results in a large monetary judgment, which we cannot pay, we may have to cease operations.

Failure To Obtain Third Party Reimbursement For Products Derived From Our Sponsored Research and Development Efforts Could Limit Our Revenue.

In the United States, success in obtaining payment for a new product from third parties, such as insurers, depends greatly on the ability to present data which demonstrates positive outcomes and reduced utilization of other products or services, as well as cost data which shows that treatment costs using the new product are equal to or less than what is currently covered for other products. If we are unable to obtain favorable third party reimbursement and patients are unwilling or unable to pay for such products or services out-of-pocket, it could limit our revenue and harm our business.

Mr. Harmel S. Rayat, Our President, Chief Executive Officer, Chief Financial Officer, Principal Accounting Officer And Director, Is Able To Substantially Influence All Matters Requiring Approval By Our Stockholders, Including The Election Of Directors.

As of July 31, 2006, Mr. Rayat beneficially owned approximately 69% of our outstanding common stock. Accordingly, he is able to substantially influence virtually all matters requiring approval by our stockholders,

including the election of directors. Our Articles of Incorporation do not provide for cumulative voting in the election of directors and, therefore, although they are able to vote, our other stockholders should not expect to be able to elect any directors to our board of directors.

We Rely On Our Management, The Loss Of Whose Services Could Have A Material Adverse Affect On Our Business.

We rely upon the services of our board of directors and management, in particular those of Mr. Harmel S. Rayat, the loss of which could have a material adverse affect on our business and prospects. Competition for qualified personnel to serve in a senior management position is intense. If we are not able to retain our directors and management, or attract other qualified personnel, we may not be able to fully implement our business strategy; failure to do so would have a materially adverse impact on our future prospects.

We currently have no employment agreements with any of our officers and directors imposing any specific condition on our officers and directors regarding their continued employment by us. Our officers and directors are also officers, directors and employees of other companies, and we may have to compete with such other companies for their time, attention and efforts. Except for Mr. Rayat, none of our officers and directors is expected to spend more than approximately five (5%) of his time on our business affairs. Mr. Rayat will not be spending his full time and effort on our business affairs because he is engaged in other business activities. We do not expect Mr. Rayat to spend more than twenty (20%) of his time on our business affairs. If Mr. Rayat s other business activities, from time to time, require more of Mr. Rayat s time, he may have less time to spend on our business affairs and our operations could suffer as a result. We do not maintain key man insurance on any of our directors or officers.

Future Sales Of Our Common Stock May Decrease Our Stock Price.

We have previously issued a total of 71,768,388, shares of common stock, of which 55,039,683 are eligible for resale under Rule 144 of the Securities Act. In addition, we have also registered a substantial number of shares of common stock that are issuable upon the exercise of options. If holders of options choose to exercise their purchase rights and sell shares of common stock in the public market all at once or in a short time period, the prevailing market price for our common stock may decline. Future public sales of shares of common stock may adversely affect the market price of our common stock or our future ability to raise capital by offering equity securities.

Our Stock Price Historically Has Been Volatile And May Continue To Be Volatile.

The market price of our common stock has been and is expected to continue to be highly volatile. Factors, many of which are beyond our control, include, in addition to other risk factors described in this section, the announcements of technological innovations by us or other companies, regulatory matters, new or existing products or procedures, concerns about our financial position, operating results, litigation, government regulation, developments or disputes relating to agreements, patents or proprietary rights, and general economic, industry and market conditions may have a significant impact on the market price of our stock. In addition, potential dilutive effects of future sales of shares of common stock by our stockholders and by us, including Fusion Capital pursuant to this prospectus and subsequent sale of common stock by the holders options could have an adverse effect on the market price of our shares.

Volatility in the market price for particular companies has often been unrelated or disproportionate to the operating performance of those companies. Broad market factors may seriously harm the market price of our common stock, regardless of our operating performance. In addition, securities class action litigation has often been initiated following periods of volatility in the market price of a company's securities. A securities class action suit against us could result in substantial costs, potential liabilities, and the diversion of management's attention and resources. To the extent our stock price fluctuates and/or remains low, it could cause you to lose some or all of your investment and impair our ability to raise capital through the offering of additional equity securities.

Our Common Is A "Penny Stock" And Because "Penny Stock Rules Will Apply, You May Find It Difficult To Sell The Shares Of Our Common Stock You Acquired In This Offering.

Our common stock is a penny stock as that term is defined under Rule 3a51-1 of the Securities Exchange Act of 1934. Generally, a "penny stock" is a common stock that is not listed on a securities exchange and trades for less than $5.00 a share. Prices often are not available to buyers and sellers and the market may be very limited. Penny stocks in start-up companies are among the riskiest equity investments. Broker-dealers who sell penny stocks must provide purchasers of these stocks with a standardized risk-disclosure document prepared by the U.S. Securities & Exchange Commission. The document provides information about penny stocks and the nature and level of risks involved in investing in the penny stock market. A broker must also give a purchaser, orally or in writing, bid and offer quotations and information regarding broker and salesperson compensation, make a written determination that the penny stock is

a suitable investment for the purchaser, and obtain the purchaser's written agreement to the purchase. Many brokers choose not to participate in penny stock transactions. Because of the penny stock rules, there is less trading activity in penny stock and you are likely to have difficulty selling your shares.

Our Common Shares Are Thinly Traded, So You May Be Unable To Sell At Or Near Ask Prices Or At All If You Need To Sell Your Shares To Raise Money Or Otherwise Desire To Liquidate Your Shares.

Our common shares have historically been sporadically or "thinly-traded" on the OTCBB, meaning that the number of persons interested in purchasing our common shares at or near ask prices at any given time may be relatively small or non-existent. As of July 31, 2006, our average trading volume per day for the past three months was approximately 74,523 shares a day with a high of 826,800 shares traded and a low of 11,500 shares traded. This situation is attributable to a number of factors, including the fact that we are a small company which is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community that generate or influence sales volume, and that even if we came to the attention of such persons, they tend to be risk-averse and would be reluctant to follow an unproven company such as ours or purchase or recommend the purchase of our shares until such time as we became more seasoned and viable. As a consequence, there may be periods of several days or more when trading activity in our shares is minimal or non-existent, as compared to a seasoned issuer which has a large and steady volume of trading activity that will generally support continuous sales without an adverse effect on share price. We cannot give you any assurance that a broader or more active public trading market for our common shares will develop or be sustained, or that current trading levels will be sustained.

Compliance With Changing Regulation Of Corporate Governance And Public Disclosure May Result In Additional Expenses.

Keeping abreast of, and in compliance with, changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and, in the event we are ever approved for listing on either NASDAQ or a registered exchange, NASDAQ and stock exchange rules, will require an increased amount of management attention and external resources. We intend to continue to invest all reasonably necessary resources to comply with evolving standards, which may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

We Do Not Intend To Pay Dividends For The Foreseeable Future.

We currently intend to retain future earnings, if any, to support the development and expansion of our business and do not anticipate paying cash dividends in the foreseeable future. Our payment of any future dividends will be at the discretion of our board of directors after taking into account various factors, including but not limited to our financial condition, operating results, cash needs, growth plans and the terms of any credit agreements that we may be a party to at the time. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize their investment. Investors seeking cash dividends should not purchase the units offered by us pursuant to this prospectus.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

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

ITEM 4. Controls and Procedures

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the

transactions and disposition of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

An evaluation was performed under the supervision of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Securities Exchange Act of 1934 (the Exchange Act) Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

Notwithstanding the foregoing, there can be no assurance that our disclosure controls and procedures will detect or uncover all failures of persons associated with us to disclose material information otherwise required to be set forth in our periodic reports. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Accordingly, even effective disclosure controls and procedures can only provide reasonable, not absolute, assurance of achieving their control objectives.

There have been no significant changes in internal controls, or in factors that could significantly affect internal controls, subsequent to the date that management, including the Chief Executive Officer and the Chief Financial Officer, completed their evaluation.

PART II Other Information

Item 1. Legal Proceedings

None

Item 1A.

Risk Factors

None

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

None

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

31.1

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

31.2

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

32.1

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

32.2

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

(b) Reports on Form 8-K

April 27, 2006: At a Board of Directors meeting held on April 24, 2006, the Company s Board of Directors agreed to enter into 10 year NonStatutory Stock Option Agreements with certain employees for 6,000,000 common shares reserved for issuance under the Company s 2001 Stock Option Plan.

May 25, 2006: On May 22, 2006, HepaLife Technologies, Inc. issued a news release to announce that the National Institutes of Health (NIH) has launched a $71 million research initiative to actively study rare diseases

June 7, 2006: On May 30, 2006, HepaLife Technologies, Inc. issued a news release to announce that the Company s patented liver stem cells have demonstrated the ability to survive and function without feeder cell support.

June 19, 2006: On June 13, 2006, HepaLife Technologies, Inc. issued a news release to announce that its PICM-19 embryonic liver stem cells have successfully demonstrated acetaminophen toxicity.

June 21, 2006: On June 15, 2006, HepaLife Technologies, Inc., through its wholly owned subsidiary, Phoenix BioSystems, Inc. entered into an exclusive worldwide license agreement with Michigan State University (MSU) for the development of new cell-culture based flu vaccines to protect against the spread of influenza viruses.

SIGNATURES

Pursuant to the requirements of Sections 13 or 15 (d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 31st day of July, 2006.

HepaLife Technologies, Inc.

(Registrant)

Date

Signature

Title

July 31, 2006

/s/ Harmel S. Rayat

Director, President, CEO,

Harmel S. Rayat

Principal Financial Officer