ALANCO TECHNOLOGIES INC
Form 10-Q
February 14, 2017
ALANCO TECHNOLOGIES, INC.
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

__X__ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2016

____TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from _____________ to ____________

Commission file number 0-9347

ALANCO TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)
Arizona
(State or other jurisdiction of incorporation or organization)

86-0220694
(I.R.S. Employer Identification No.)

7950 E. Acoma Drive, Suite 111, Scottsdale, Arizona 85260
(Address of principal executive offices) (Zip Code)

(480) 607-1010
(Registrant's telephone number)
____
(Former name, former address and former fiscal year, if changed since last report)

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 in the past 90 days. __X__ Yes ___ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). X Yes ___ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company X

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)
Yes X No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:
As of February 9, 2017 there were 4,982,400 shares of common stock outstanding.

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ALANCO TECHNOLOGIES, INC.

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ALANCO TECHNOLOGIES, INC.

Except for historical information, the statements contained herein are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts. The words "believe," "may," "estimate," "continue," "anticipate," "intend," "should," "plan," "could," "target," "potential," "is likely," "will," "expect" and similar expressions, as they relate to the Company are intended to identify forward-looking statements within the meaning of the "safe harbor" provisions of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. From time to time, the Company may publish or otherwise make available forward-looking statements of this nature. All such forward-looking statements are based on the expectations of management when made and are subject to, and are qualified by, risks and uncertainties that could cause actual results to differ materially from those expressed or implied by those statements. These risks and uncertainties include, but are not limited to, the following factors, among others, that could affect the outcome of the Company's forward-looking statements: general economic and market conditions; the inability to profitably run current operations sufficient to cover overhead; the inability to attract, hire and retain key personnel; the difficulty of integrating an acquired business; unforeseen litigation; unfavorable result of potential litigation; the ability to maintain sufficient liquidity in order to support operations; the ability to maintain satisfactory relationships with current and future suppliers; federal and/or state regulatory and legislative action; the ability to implement or adjust to new technologies and the ability to secure and maintain key contracts and relationships. New risk factors emerge from time to time and it is not possible to accurately predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any risk factor, or combination of risk factors, may cause results to differ materially from those contained in any forward-looking statements. Except as otherwise required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statements or the risk factors described in this Quarterly Report or in the documents we incorporate by reference, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Quarterly Report on Form 10-Q.

ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2016 AND JUNE 30, 2016

	December 31, 2016 (unaudited)	June 30, 2016
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$5,000	$139,600
Accounts receivable - trade, net	2,600	3,900
Other receivables - related party	-	2,800
Assets held for sale	1,653,500	1,653,500
Prepaid expenses and other current assets	47,500	47,300
Total current assets	1,708,600	1,847,100
LAND, PROPERTY AND EQUIPMENT, NET	2,020,200	2,111,000
OTHER ASSETS		
Trust account - asset retirement obligation	96,800	86,100
TOTAL ASSETS	$3,825,600	$4,044,200
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$225,900	$251,400
Accrued expenses	305,700	146,200
Total current liabilities	531,600	397,600
LONG-TERM LIABILITIES		
Note payable	640,000	200,000
Contingent payments, long-term	682,000	672,700
Asset retirement obligation	434,000	434,000
TOTAL LIABILITIES	2,287,600	1,704,300
SHAREHOLDERS' EQUITY		
Preferred Stock - no shares issued or outstanding	-	-
Common Stock		
Class A - 75,000,000 no par shares authorized, 4,982,400 shares issued and outstanding at December 31, 2016 and June 30, 2016	109,191,800	109,188,200
Accumulated Deficit	(107,653,800)	(106,848,300)
Total shareholders' equity	1,538,000	2,339,900
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$3,825,600	$4,044,200

See accompanying notes to the condensed consolidated financial statements

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ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED DECEMBER 31, (unaudited)

	2016	2015
NET REVENUES	$5,800	$57,700
Cost of revenues	84,900	132,200
GROSS LOSS	(79,100)	(74,500)
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES		
Corporate expenses	103,400	107,500
Alanco Energy Services	125,700	156,200
Stock-based compensation	-	13,900
	229,100	277,600
OPERATING LOSS	(308,200)	(352,100)
OTHER INCOME AND (EXPENSE)		
Interest income	-	7,300
Interst expense	(17,700)	-
NET LOSS	$(325,900)	$(344,800)
LOSS PER SHARE - BASIC AND DILUTED		
Net loss per share	$(0.07)	$(0.07)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - BASIC AND DILUTED	4,982,400	4,982,400

See accompanying notes to the condensed consolidated financial statements

ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED DECEMBER 31, (unaudited)

	2016	2015
NET REVENUES	$9,700	$172,000
Cost of revenues	175,400	392,600
GROSS LOSS	(165,700)	(220,600)
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES		
Corporate expenses	177,000	201,200
Alanco Energy Services	265,200	313,200
Stock-based compensation	-	27,800
	442,200	542,200
OPERATING LOSS	(607,900)	(762,800)
OTHER INCOME AND (EXPENSE)		
Interest income	4,800	14,700
Interest expense	(26,400)	-
LOSS FROM CONTINUING OPERATIONS	(629,500)	(748,100)
DISCONTINUED OPERATIONS		
Loss from discontinued operations	(176,000)	-
LOSS FROM DISCONTINUED OPERATIONS	(176,000)	-
NET LOSS	$(805,500)	$(748,100)
NET LOSS PER SHARE - BASIC AND DILUTED		
Continuing operations	$(0.12)	$(0.15)
Discontinued operations	$(0.04)	$-
Net loss per share	$(0.16)	$(0.15)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - BASIC AND DILUTED	4,982,400	4,982,400

See accompanying notes to the condensed consolidated financial statements

ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE SIX MONTHS ENDED DECEMBER 31, 2016 (unaudited)

	COMMON STOCK SHARES	AMOUNT	ACCUMULATED DEFICIT	TOTAL
Balances, June 30, 2016	4,982,400	$109,188,200	$ (106,848,300)	$2,339,900
Value of warrants	-	3,600	-	3,600
Net loss	-	-	(805,500)	(805,500)
Balances, December 31, 2016	4,982,400	$109,191,800	$ (107,653,800)	$1,538,000

See accompanying notes to the condensed consolidated financial statements

ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED DECEMBER 31, (unaudited)

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(805,500)	$(748,100)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	91,800	91,900
Accretion of fair value - contingent payments	9,300	9,400
Stock-based compensation for options	-	27,800
Exercisable warrants issued under note payable to Anderson Family Trust	3,600	-
Reserve recorded for American Citizenship Center, LLC note receivable	-	50,000
Changes in operating assets and liabilities:		
Accounts receivable - trade	1,300	23,800
Other receivables - related party	2,800	(2,900)
Prepaid expenses and other current assets	(200)	137,000
Trust account - asset retirement obligation	(10,700)	(9,400)
Accounts payable and accrued expenses	134,000	(52,400)
Net cash used in operating activities	(573,600)	(472,900)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from repayment of American Citizenship Center, LLC note receivable	-	22,400
Purchase of land, property, and equipment	(1,000)	(6,800)
Net cash (used) provided by investing activities	(1,000)	15,600
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from note payable to Anderson Family Trust	440,000	-
Net cash provided by financing activities	440,000	-
NET DECREASE IN CASH AND CASH EQUIVALENTS	(134,600)	(457,300)
CASH AND CASH EQUIVALENTS, beginning of period	139,600	788,900
CASH AND CASH EQUIVALENTS, end of period	$5,000	$331,600
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION		
Non-cash investing & financing activities:		
Value of exercisable warrants issued under note payable to Anderson Family Trust	$3,600	$-
Value of stock-based compensation for options	$-	$27,800

See accompanying notes to the condensed consolidated financial statements

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note A – Basis of Presentation, Accounting Policies and Recent Accounting Pronouncements

Nature of Operations

Alanco Technologies, Inc. (OTCQB: ALAN) was incorporated in 1969 under the laws of the State of Arizona. Unless otherwise noted, the "Company" or "Alanco" refers to Alanco Technologies, Inc. and its wholly-owned subsidiaries. The Company's subsidiary, Alanco Energy Services, Inc. ("AES"), operates a water disposal facility near Grand Junction, CO to receive and dispose of produced water generated as a byproduct from oil and natural gas production in Western Colorado. During the fiscal year 2016, the Company implemented a plan to divest of its 160 acre owned and undeveloped land and associated permits located near its water disposal facility and known as Indian Mesa. Refer to Note D – Assets Held for Sale and Discontinued Operations for further discussion.

The Company recently formed Alanco Behavioral Health, Inc. ("ABH"), a wholly-owned subsidiary incorporated in the State of Arizona with the expectation of pursuing a business plan to consolidate small cap private behavioral health companies through acquisition. The Company executed a letter of intent to purchase the operations of a behavioral health treatment facility located in California, but has since terminated said acquisition and currently has no plans to pursue acquisitions in the behavioral health market.

The Company is developing alternative business plans for investment of its resources.

Basis of Presentation

The unaudited condensed consolidated financial statements presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and in accordance with the instructions to Form 10-Q. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. In our opinion, the accompanying condensed consolidated financial statements include all adjustments necessary for a fair presentation of such condensed consolidated financial statements. Such necessary adjustments consist of normal recurring items and the elimination of all significant intercompany balances and transactions.

The condensed consolidated balance sheet as of June 30, 2016 was derived from audited financial statements, but does not include all disclosures required by GAAP. These interim condensed consolidated financial statements should be read in conjunction with the Company's June 30, 2016 Annual Report filed on Form 10-K. Interim results are not necessarily indicative of results for a full year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Fair Value of Assets and Liabilities – The estimated fair value for assets and liabilities are determined at discrete points in time based on relevant information. The Accounting Standards Codification ("ASC") prioritizes inputs used in measuring fair value into a hierarchy of three levels: Level 1 – unadjusted quoted prices for identical assets or liabilities traded in active markets, Level 2 – observable inputs other than quoted prices included within Level 1 such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability; and

Level 3 – unobservable inputs in which little or no market activity exists that are significant to the fair value of the assets or liabilities, therefore requiring an entity to develop its own assumptions that market participants would use in pricing. These estimates involve uncertainties and cannot be determined with precision. The Company's policy is to recognize transfers into and out of Level 1, 2 and 3 categories as of the date of the event or change in circumstances occurs. The carrying amounts of receivables, prepaid expenses, trust account, accounts payable, accrued liabilities and note payable approximate fair value given their short-term nature or their effective interest rates, which represent Level 3 input levels.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

The following are the classes of assets and liabilities measured at fair value on a recurring basis at December 31, 2016 and June 30, 2016, using quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3):

Fair Value at December 31, 2016

	Level 1: Quoted Prices in active Markets for Identical Assets	Level 2: Significant Other Observable Inputs	Level 3: Significant Unobservable Inputs	Total at December 31, 2016
Asset Retirement Obligation	$ -	$ -	$ 434,000	$434,000
Contigent Land Payment	-	-	682,000	682,000
	$ -	$ -	$ 1,116,000	$1,116,000

Fair Value at June 30, 2016

	Level 1: Quoted Prices in active Markets for Identical Assets	Level 2: Significant Other Observable Inputs	Level 3: Significant Unobservable Inputs	Total at June 30, 2016
Asset Retirement Obligation	$ -	$ -	$ 434,000	$434,000
Contigent Land Payment	-	-	672,700	672,700
	$ -	$ -	$ 1,106,700	$1,106,700

The following is a reconciliation of the opening and closing balances for assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the six months ended December 31, 2016.

	Asset Retirement Obligation	Contingent Land Payment	Total
Opening balance	$ 434,000	$ 672,700	$ 1,106,700
Accretion expense	-	9,300	9,300
Closing balance	$ 434,000	$ 682,000	$ 1,116,000

Fair Value of Asset Retirement Obligation – The Deer Creek asset retirement obligation is the estimated cost to close the Deer Creek facility under terms of the lease, meeting environmental and State of Colorado regulatory requirements. The estimate is determined at discrete points in time based upon significant unobservable inputs in which little or no market activity exists that is significant to the fair value of the liability, therefore requiring the Company to develop its own assumptions. Management's estimate of the asset retirement obligation is based upon a cost estimate developed by a consultant knowledgeable of government closure requirements and costs incurred at similar water disposal facility operations. A present value discount has not been taken as the estimated closure costs, excluding regulatory changes and inflation adjustments, are anticipated to remain fairly consistent over the operational life of the facility. The lack of an active market to validate the estimated asset retirement obligation results in the fair value of the asset retirement obligation to be a Level 3 fair value measurement. ASC Topic 410-20: Asset Retirement Obligations requires the Company to review the asset retirement obligation on a recurring basis and record changes in the period incurred.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

Fair Value of Contingent Payments – The contingent land payment liability is also determined at discrete points in time based upon unobservable inputs in which little or no market activity exists that is significant to the fair value of the liability, therefore requiring the Company to develop its own assumptions. In calculating the estimate of fair value for the contingent land payment, management completed an estimate of the present value of the contingent liability based upon projected income, cash flows and capital expenditures for the Deer Creek facility developed under plans currently approved by the Company's board of directors. Different assumptions relative to the expansion or alternative uses of the Deer Creek and Indian Mesa facilities could result in significantly different valuations. The projected payments have been discounted at a rate of 3% per annum to determine net present value. The lack of an active market to validate the estimated contingent land liability results in the fair value of the contingent land liability to be a Level 3 fair value measurement. ASC Topic 820: Fair Value Measurement requires the Company to review the contingent land liability on a recurring basis and record changes in the period incurred.

Assets Held for Sale – The Company has implemented a plan to divest of its 160 acre owned and undeveloped land and associated permits located in Whitewater, Colorado and known as Indian Mesa. As a result, the value of the land and associated permits has been classified as Assets Held for Sale at December 31, 2016. A long-lived asset classified as held for sale shall be measured at the lower of its carrying amount or fair value less cost to sell. The value of Assets Held for Sale represents the carrying amount.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued guidance regarding revenue from contracts with customers. The guidance outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes the most current revenue recognition guidance. In August 2015, this accounting pronouncement was deferred for one year, and is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of reporting periods beginning after December 15, 2016. The Company is currently assessing the impact on its financial position and results of operations.

In January 2016, the FASB issued guidance regarding the enhancement of reporting financial instruments including aspects of recognition, measurement, presentation and disclosure. The guidance is effective for periods beginning after December 15, 2017 including interim periods within those fiscal years. While a portion of the guidance allows for early application, it does not permit complete early adoption. The Company is currently assessing the impact on its financial position and results of operations.

In February 2016, the FASB issued guidance regarding lease reporting. The guidance requires a lessee to record on the balance sheet the assets and liabilities for the rights and obligations created by leases with terms of more than 12 months. The guidance is effective for periods beginning after December 15, 2018 including interim periods within those fiscal years and early adoption is permitted. The Company is currently assessing the impact on its financial position and results of operations.

In March 2016, the FASB issued guidance under the simplification initiative regarding stock compensation. The guidance is effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted provided that all amendments are adopted in the same period. The Company is currently assessing the impact on its financial position and results of operations.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

In June 2016, the FASB issued guidance regarding credit losses on financial instruments including loans. The guidance is effective for annual periods beginning after December 15, 2019 including interim periods within those annual periods. The Company is currently assessing the impact on its financial position and results of operations.

In August 2016, the FASB issued guidance regarding the classification of certain cash receipts and cash payments in the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2017 and interim periods within those years. Early adoption is permitted provided that all amendments are adopted in the same period. The Company has adopted the guidance, which had no material impact on its financial position, results of operations or presentation of the statement of cash flows.

In October 2016, the FASB issued guidance regarding the treatment of intra-entity transfers of assets other than inventory. The guidance is effective for annual periods beginning after December 15, 2017, including interim reporting periods. Early adoption is permitted at the beginning of an annual period. The Company is currently assessing the impact on its financial position and results of operations.

In October 2016, the FASB issued guidance regarding consolidation and variable interest entities. The guidance is effective for annual reporting periods beginning after December 15, 2016 including interim periods within that reporting period and early adoption is permitted. The Company has adopted the guidance, which had no material impact on its financial position and results of operations.

In December 2016, the FASB issued technical corrections and improvements on various topics. The guidance is effective upon issuance. The Company has adopted the guidance, which had no material impact on its financial position and results of operations.

There have been no other recent accounting pronouncements or changes in accounting pronouncements during the six months ended December 31, 2016, that are of significance, or potential significance, to us.

Note B – Stock-Based Compensation and Warrants

The Company has stock-based compensation plans and reports stock-based compensation expense for all stock-based compensation awards based on the estimated grant date fair value. The value of the compensation cost is amortized on a straight-line basis over the requisite service periods of the award (generally the option vesting term).

The Company estimates fair value using the Black-Scholes valuation model. Assumptions used to estimate compensation expense are determined as follows:

- Expected term is determined under the simplified method using an average of the contractual term and vesting period of the award as appropriate statistical data required to properly estimate the expected term was not available;

- Expected volatility of award grants made under the Company's plans is estimated using the historical daily changes in the market price of the Company's common stock over the expected term of the award and contemplation of future activity;

- Risk-free interest rate is the implied yield on zero-coupon U.S. Treasury bonds with a remaining maturity equal to the expected term of the awards; and,

- Forfeitures are based on the history of cancellations of awards granted by the Company and management's analysis of potential future forfeitures.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

The Company has several employee stock option and officer and director stock option plans that have been approved by the shareholders of the Company. The plans require that options be granted at a price not less than market on the date of grant and are more fully discussed in our Form 10-K for the year ended June 30, 2016.

The following table summarizes the Company's stock option activity during the first six months of fiscal 2017:

	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (1)	Aggregate Fair Value (3)	Aggregate Instrinsic Value (2)
Outstanding July 1, 2016	1,200,000	$ 0.58	2.03	$ 273,500	$ -
Granted	-	-	-	-	-
Exercised	-	-	-	-	-
Forfeited or expired	-	-	-	-	-
Outstanding December 31, 2016	1,200,000	$ 0.58	1.53	$ 273,500	$ -
Exercisable December 31, 2016	1,200,000	$ 0.58	1.53	$ 273,500	$ -

(1) Remaining contractual term presented in years.

(2) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing price of the Company's common stock as of December 31, 2016, for those awards that have an exercise price currently below the closing price as of December 31, 2016 of $0.07.

(3) Aggregate Fair Value is calculated using the Black Scholes option pricing model to estimate fair value of stock-based compensation.

As of December 31, 2016, there was no unamortized Black Scholes value remaining to be recognized as stock-based compensation expense.

As of December 31, 2016, the Company had 140,000 outstanding warrants. The following table summarizes the Company's warrant activity during the six months ended December 31, 2016:

Warrants Outstanding		Warrants Exercisable	
	Weighted		Weighted

	Number of Shares	Average Exercise Price	Number of Shares	Average Exercise Price
Warrants Outstanding, July 1, 2016	140,000	$ 0.75	20,000	$ 0.75
Granted	-	-	-	-
Previously Granted, Vested	-	-	60,000	0.75
Exercised	-	-	-	-
Canceled/Expired	-	-	-	-
Warrants Outstanding, December 31, 2016	140,000	$ 0.75	80,000	$ 0.75

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

Note C – Note Receivable – Related Party

Note receivable at December 31, 2016 and June 30, 2016 represents a note due from American Citizenship Center, LLC ("ACC"), a related party. Note receivable at December 31, 2016 and June 30, 2016 consists of the following:

	December 31, 2016	June 30, 2016
Note receivable, gross	$295,400	$295,400
Accounting and loan fees reversed against deferred income	(29,000)	(29,000)
Less reserve	(266,400)	(266,400)
Note receivable, net	$-	$-

The gross balance of $295,400 at December 31, 2016 and June 30, 2016 represents the outstanding amount drawn by ACC on a $295,400 credit line provided by the Company. The note is secured by all assets of ACC and bears interest at the rate of 9.5% per annum. Interest of $9,400 is unpaid and fully reserved at December 31, 2016.

ACC's business plan is based on the Executive Action, known as DAPA, issued by President Obama in November 2014. In February 2015, twenty-six states filed a lawsuit to stop the program and the court granted an injunction meaning that the U.S. Government cannot proceed with rolling out the program. The U.S. government appealed the lawsuit which went to the 5th Circuit Court of Appeals. The appeal was unsuccessful and in January 2016, the Supreme Court granted an oral hearing which was held in April 2016. In June 2016, the Supreme Court announced that the justice votes were even for and against the DAPA case, effectively a no decision. As a result, it is presumed that the case will go back to trial at the District Court in Texas. Due to the uncertainty of the court case, a change in administration and overall immigration reform, the Company has fully reserved for the amount of the note as of December 31, 2016 and June 30, 2016.

Note D – Assets Held for Sale and Discontinued Operations

During the fiscal year 2016, Alanco's Board of Directors approved a formal plan to sell its 160 acre owned and undeveloped land and associated permits known as Indian Mesa. The plan was contemplated because the Company intends to expand into other markets that are unrelated to waste disposal. The Company expects the sale to occur within one year. Accordingly, the Assets Held for Sale of $1,653,500 presented in the attached condensed consolidated balance sheet as of December 31, 2016 and June 30, 2016 represents the Indian Mesa land and associated permits. The classification of the assets to Assets Held for Sale does not affect the Consolidated Statements of Operations as the Indian Mesa land is undeveloped and has no associated discontinued operations.

During the six months ended December 31, 2016, the Company recorded a loss from discontinued operations in the amount of $176,000 which represents an accrual related to the judgment received from litigation whereby the Company is a defendant and counterclaimant involving the Company's former subsidiary known as Alanco/TSI Prism, Inc. ("TSI") and the purchaser of TSI's assets, Black Creek Systems Corp. ("Black Creek"). The Company vehemently disagrees with Black Creek's attorney's fees claim and the Court ruling and intends to vigorously pursue an appeal of the judgment. The case is more fully described in Note K – Commitments and Contingencies.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

Note E – Property and Equipment

Property and Equipment, net at December 31, 2016 and June 30, 2016 consist of the following:

	June 30, 2016	Additions	December 31, 2016
Office furniture and equipment	$51,300	$-	$51,300
Water disposal facility	2,220,900	1,000	2,221,900
Production equipment	514,400	-	514,400
	2,786,600	1,000	2,787,600
Less accumulation depreciation	(675,600)	(91,800)	(767,400)
Net book value	$2,111,000	$(90,800)	$2,020,200

Note F – Note Payable

Note payable at December 31, 2016 and June 30, 2016 consists of the following:

	December 31, 2016	June 30, 2016
Note payable	$640,000	$200,000
Less current	-	-
Note payable, long-term	$640,000	$200,000

At December 31, 2016, the Note Payable balance of $640,000 represents the amount drawn against a $750,000 line of credit with the Anderson Family Trust ("Trust") entered into on June 28, 2016 and amended on November 14, 2016 at which time the credit limit was increased to $750,000 and the maturity date was revised to January 1, 2018. As of December 31, 2016, the line of credit has an available balance of $110,000. The line of credit matures on January 1, 2018 when the full outstanding balance is due. The balance accrues interest at 7% per annum payable monthly and is collateralized by all assets of the Company. At loan inception, the Trust was paid a loan fee of $10,000 plus a warrant to purchase 140,000 shares of Alanco Common Stock of which 20,000 warrants vested immediately and 10,000 warrants vest each month thereafter. The exercise price per share for the warrants is $0.50 per share for one half of each vested group and $1.00 for the other half of each vested group with a five year term following the issuance date. The Company uses the Black-Scholes option pricing model to estimate fair value of stock-based awards.

During the six months ended December 31, 2016, the Company expensed approximately $15,200, in interest related to the note, approximately $7,600 related to amortization of deferred loan costs, and approximately $3,600 related to the value of 60,000 warrants which vested during the six month period. The line of credit has a provision allowing the lender, at the lender's option, to convert up to the full amount of the credit line into shares of a then available class of preferred stock outstanding any time prior to the full repayment of the line of credit. There is currently no such preferred stock outstanding and the rights and privileges of preferred stock have not been determined.

Note G – Earnings Per Share

Basic and diluted loss per share of common stock was computed by dividing net loss, loss from continuing operations and loss from discontinued operations by the weighted average number of shares of common stock outstanding.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

Diluted earnings per share are computed based on the weighted average number of shares of common stock and dilutive securities outstanding during the period. Dilutive securities are options, warrants, convertible debt, and preferred stock that are freely exercisable into common stock at less than the prevailing market price. Dilutive securities are not included in the weighted average number of shares when inclusion would increase the earnings per share or decrease the loss per share. For the six months ended December 31, 2016 and 2015, there were no dilutive securities included in the loss per share calculation as the effect would be antidilutive.

Considering all holders' rights, total common stock equivalents issuable under these potentially dilutive securities are approximately 1,340,000 and 1,200,000 at December 31, 2016 and 2015, respectively.

Note H – Equity

The Company did not issue any shares of Common Stock during the six months ended December 31, 2016.

During the six months ended December 31, 2016, the Company recognized the value of exercisable detachable warrants issued with debt in the amount of $3,600.

The Company has authorized 25,000,000 shares of Preferred Stock of which 5,000,000 shares have been allocated to Series A, 500,000 have been allocated to Series B, 400,000 have been allocated to Series C Junior Participating, 500,000 have been allocated to Series D, and 750,000 have been allocated to Series E. At December 31, 2016 and June 30, 2016, no Preferred Stock of any series was issued or outstanding.

Note I - Contingent Payments

Contingent payments at December 31, 2016 and June 30, 2016 are as follows:

	December 31, 2016	June 30, 2016
Contingent land payment	$682,000	$672,700
Less current portion	-	-
Contingent payments, long-term	$682,000	$672,700

Contingent land payment of $682,000 at December 31, 2016 represents the net present value of $800,000 of estimated contingent land payments due under an agreement whereby Alanco Energy Services, Inc. ("AES") acquired 160 acres of land known as Indian Mesa. The maximum total of $800,000 of contingent land payments is based upon 10% of quarterly revenues in excess of operating expenses up to $200,000 per quarter for activity at both the Deer Creek and Indian Mesa locations. The payments were projected considering current operating plans as approved by the Alanco Board of Directors, with the payments discounted at a rate of 3% per annum. Accretion expense is being imputed at 3% per annum, increasing the fair value of the contingent land payment during the six months ended December 31, 2016 by $9,300. During the six months ended December 31, 2016, no contingent land payment was earned or payable under the contingency formula. The contingent land payment is an obligation of the Company which will not be transferred to the buyer of the Indian Mesa land and associated permits discussed in Note D – Assets Held for Sale and Discontinued Operations. The Company will maintain the liability for contingent payments resulting from future revenues on the Indian Mesa land resulting from the buyer's operations.

The Company also has a contingent purchase price liability with TC Operating, LLC ("TCO") under the original agreement executed in April 2012 which transferred the Deer Creek facility land lease to the Company. TCO can earn additional purchase price payments based upon a percentage of the net cumulative EBITDA (net of all related AES capital investments) over a period of approximately 10 years (contingent purchase price), approximately the initial term of the lease. As of December 31, 2016 and June 30, 2016, the Company had no liability recorded for the contingent purchase price based on the probability of the contingent payment being realized.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

Note J – Asset Retirement Obligation

The Company has recognized estimated asset retirement obligations (closure cost) of $434,000 at December 31, 2016 to remove leasehold improvements, remediate any pollution issues and return the Deer Creek water disposal property to its natural state at the conclusion of the Company's lease. The closure process is a requirement of both the Deer Creek lease and the State of Colorado, a permitting authority for such facilities. The closure cost estimate, in current dollars, was completed by an approved independent consultant experienced in estimating closure costs for water disposal operations and the estimated amount was approved by the State of Colorado. A present value discount has not been taken as the estimated closure costs, excluding regulatory changes and inflation adjustments, are anticipated to remain fairly consistent over the operational life of the facility.

The Company reviews the asset retirement obligation quarterly and performs a formal annual assessment of its estimates to determine if an adjustment to the value of the asset retirement obligation is required.

The laws of the State of Colorado require companies to meet environmental and asset retirement obligations by selecting an approved payment method. The Company has elected to meet its obligation by making quarterly payments of approximately $4,700 into a trust that, over the expected lease period, will build liquid assets to meet the asset retirement obligation. During the six months ended December 31, 2016, the Company made the required quarterly payments. The balances in the trust account for the asset retirement obligation as of December 31, 2016 and June 30, 2016 were $96,800 and $86,100, respectively.

Note K – Commitments and Contingencies

Legal Proceedings

The Company is a defendant and counterclaimant in litigation involving its former subsidiary known as Alanco/TSI Prism, Inc. ("TSI") and the purchaser of TSI's assets, Black Creek Integrated Systems Corp. ("Black Creek"). Black Creek filed a complaint in the Maricopa County Superior Court against TSI and the Company, being Civil Case No. CV2011-014175, claiming various offsets from the purchase price, primarily concerning inventory adjustments, and TSI counterclaimed for monies due from Black Creek under the purchase agreement. Following a trial during fiscal 2014, the court awarded a net judgment in favor of Black Creek in the amount of $16,800, plus attorney's fees and accrued interest, resulting in a total judgment in the amount of $128,300. At June 30, 2014, the Company recorded an accrued liability of $128,300 for the judgment and had posted a bond with the court in conjunction with the Company's appeal of the judgment. In May 2015, the State of Arizona Division One Court of Appeals vacated the trial court's damages award and remanded to the trial court to direct the parties to follow dispute guidelines defined in the asset purchase agreement. In addition, the appellate court's decision vacated the trial court's attorney's fees award and awarded TSI approximately $21,900 of its fees on appeal. At June 30, 2015, the Company reversed the accrual of $128,300 for the prior judgment. Under the court's direction, the Company followed the dispute guidelines defined in the asset purchase agreement which resulted in an award to Black Creek of approximately $13,000. The Company has previously stipulated that it owed Black Creek approximately $9,600 for shared expenses incurred from 2010 - 2011. In October 2016, the court ruled on Black Creek's attorney's fees application and the Company's answer to said application. The court granted Black Creek a fee award which, when combined with the judgment amount of approximately $22,600 plus interest, results in a potential liability to the Company of approximately $176,000 which has been accrued at December 31, 2016 and reported as a loss from discontinued operations in the six month period. The Company vehemently disagrees with Black Creek's attorney's fees claim and the Court ruling and intends to vigorously pursue an appeal of the judgment.

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ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

The Company may from time to time be involved in litigation arising from the normal course of business. As of December 31, 2016, other than the litigation discussed above, there was no other such litigation pending deemed material by the Company.

Note L – Related Party Transactions

At December 31, 2016 and June 30, 2016, the Company had a note due from American Citizenship Center, LLC ("ACC"), a related party, with a gross balance of $295,400 which has been fully reserved. During the six months ended December 31, 2016, the Company billed ACC a total of approximately $14,200 for interest of which $9,400 is unpaid and fully reserved at December 31, 2016.

At December 31, 2016 and June 30, 2016, the Company had accrued board fees in the total amount of $41,000 and $14,000, respectively.

Effective as of December 15, 2016, the Board of Directors accepted the resignation of John Carlson, Chief Executive Officer and a Director of the Company. Mr. Carlson will remain on the Company's Board of Directors. At December 31, 2016 and June 30, 2016, the Company had accrued deferred compensation of $69,100 and $58,400, respectively, payable to John Carlson, the Company's former Chief Executive Officer and a current Director of the Company. The Company's compensation committee approved a Severance and Employment Agreement with Mr. Carlson whereby he will provide ongoing services to the Company and the deferred compensation will be repaid in addition to other incentive based compensation related to the potential sale of the Company's AES Indian Mesa and Deer Creek sites.

Also effective as of December 15, 2016, the Company's Board of Directors elected Steven Oman to serve as the interim President and Chief Executive Officer of the Company. In addition, the Board of Directors accepted the resignation of Harold Carpenter from the board and elected Steven Oman, Donald Anderson and Rebecca Anderson to the Board of Directors.

Note M – Subsequent Events

Subsequent to December 31, 2016, the Company drew an additional $75,000 from its line of credit with the Anderson Family Trust resulting in a current balance of $715,000, with $35,000 remaining available.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

Note N – Liquidity and Going Concern

During the six months ended December 31, 2016, the Company reported a net loss of ($805,500) and for fiscal year ended June 30, 2016, the Company reported a net loss of ($1,594,800). The Company's fiscal 2017 operating plan includes divestiture of the undeveloped AES Indian Mesa site which is currently classified as Assets Held for Sale. Management cannot assure that the sale of Indian Mesa will be finalized which would provide additional cash flow to the Company. The Company is continuing to analyze options to monetize current and future operations of Deer Creek. There is no assurance that the Company will be able to execute options for Deer Creek. The Company recently announced it was entering the behavioral health market and the business plan included the acquisition of behavioral health businesses. The Company has since terminated the business development activities related to behavioral health and has no plans to pursue acquisitions in that market. The Company is developing alternative business plans for investment of its resources. Future business plans may require additional capital. There is no assurance the Company will be able to raise additional financing which may be in the form of public or private debt or equity financing, or both. If adequate funds are not available or are not available on acceptable terms, the Company's business, operating results, financial condition and ability to continue operations may be materially adversely affected. Management has historically been successful in obtaining financing and has demonstrated the ability to implement a number of cost-cutting initiatives to reduce working capital needs. The accompanying condensed consolidated financial statements have been prepared assuming the Company will continue to operate and do not include any adjustment that might be necessary if the Company is unable to continue as a going concern. The Company's independent registered public accounting firm has included an explanatory paragraph in their audit opinion on the consolidated financial statements of the Company for the fiscal year ended June 30, 2016 discussing the substantial doubt of the Company's ability to continue as a going concern.

ALANCO TECHNOLOGIES, INC.

Item 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements: Except for historical information, the statements contained herein are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts. The words "believe," "may," "estimate," "continue," "anticipate," "intend," "should," "plan," "could," "target," "potential," "is likely," "will," "expect" and similar expressions, as they relate to the Company are intended to identify forward-looking statements within the meaning of the "safe harbor" provisions of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. From time to time, the Company may publish or otherwise make available forward-looking statements of this nature. All such forward-looking statements are based on the expectations of management when made and are subject to, and are qualified by, risks and uncertainties that could cause actual results to differ materially from those expressed or implied by those statements. These risks and uncertainties include, but are not limited to, the following factors, among others, that could affect the outcome of the Company's forward-looking statements: general economic and market conditions; the inability to profitably run current operations sufficient to cover overhead; the inability to attract, hire and retain key personnel; the difficulty of integrating an acquired business; unforeseen litigation; unfavorable result of potential litigation; the ability to maintain sufficient liquidity in order to support operations; the ability to maintain satisfactory relationships with current and future suppliers; federal and/or state regulatory and legislative action; the ability to implement or adjust to new technologies and the ability to secure and maintain key contracts and relationships. New risk factors emerge from time to time and it is not possible to accurately predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any risk factor, or combination of risk factors, may cause results to differ materially from those contained in any forward-looking statements. Except as otherwise required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statements or the risk factors described in this Quarterly Report or in the documents we incorporate by reference, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Quarterly Report on Form 10-Q.

Current Status of Deer Creek facility

The Deer Creek produced water disposal facility, located near Grand Junction, CO, became operational in August 2012 with annual evaporative capacity of approximately 300,000 barrels without using enhanced evaporation methods, providing some Piceance Basin producers with significant transportation cost savings compared to alternative water disposal sites. Water deliveries have been negatively impacted by the falling market prices of oil and gas which significantly reduced drilling activities and fracking in the region and resulted in the temporary closing of many of the producing oil and gas wells in the area. The Company is continuing to analyze options to monetize current and future operations of Deer Creek.

Current Status of Indian Mesa facility

The permitting process for the Indian Mesa facility, located approximately 4 miles North West of the Deer Creek site, has been in process for a number of years with an initial County Use Permit issued in 2010 covering, among other things, evaporation ponds and land farming. In December 2013, in response to an AES request to amend its County User Permit ("CUP"), the Mesa County Board of Commissioners unanimously approved a new CUP for AES to construct and operate on its 160 acre Indian Mesa site evaporation ponds and/or landfill for disposal of solid oil and gas (O&G) waste, such as drill cuttings, tank bottoms, sock filters, etc. The county approval also allows for solid and produced water disposal of Naturally-Occurring Radioactive Materials (NORM) and Technically Enhanced Naturally-Occurring Radioactive Materials (TENORM), and is in the permitting process with the State of Colorado. In June 2014 AES received final construction approval from the Colorado Department of Public Health and Environment (CDPHE) for twelve produced water disposal ponds.

The capacity of Indian Mesa is dependent on its type of development. If 80 acres is developed as 12 ponds the annual capacity at Indian Mesa for produced water, not considering enhanced evaporation, would be approximately 1 million barrels. If the remaining 80 acres were developed into landfills, the capacity would be approximately 3 million cubic yards. If the entire 160 acres were developed into landfill, the solid waste capacity would increase to approximately 8 million cubic yards. Complete build-out of its Indian Mesa facility, including both landfill and evaporative ponds, would result in a unique Western Colorado "one stop shop" for all O&G waste products, including NORM and TENORM contaminated waste streams. During fiscal year 2016, Alanco's Board of Directors approved a formal plan to sell Indian Mesa, consisting of land and associated permits. Accordingly, the land and associated permit costs are being presented as "Assets Held for Sale" in the attached condensed consolidated balance sheet as of December 31, 2016 and June 30, 2016.

Alanco Behavioral Health, Inc.

The Company recently formed Alanco Behavioral Health, Inc. ("ABH"), a wholly-owned subsidiary incorporated in the State of Arizona with the expectation of pursuing a business plan to consolidate small cap private behavioral health companies through acquisition. The Company executed a letter of intent to purchase the operations of a behavioral health treatment facility located in California, but has since terminated said acquisition and currently has no plans to pursue acquisitions in the behavioral health market.

The Company is developing alternative business plans for investment of its resources.

Critical Accounting Policies and Estimates

Management's discussion and analysis of financial condition and results of operations are based upon the condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the United States Securities and Exchange Commission. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. On an on-going basis, we evaluate our estimates and assumptions concerning the estimated fair value of stock-based compensation and detachable warrants, realization of deferred tax assets, collectability of accounts and notes receivable, estimated useful lives and carrying value of fixed assets, the recorded values of accruals and contingencies, the estimated fair values of the Company's asset retirement obligation and the contingent land and purchase price liabilities, and the Company's ability to continue as a going concern. We base our estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. The result of these estimates and judgments form the basis for making conclusions about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may materially differ from these estimates under different assumptions or conditions.

The SEC suggests that all registrants discuss their most "critical accounting policies" in Management's Discussion and Analysis. A critical accounting policy is one which is both important to the portrayal of the Company's financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Management has identified the critical accounting policies as those accounting policies that affect its more significant judgments and estimates in the preparation of its consolidated financial statements. The Company's Audit Committee has reviewed and approved the critical accounting policies identified. These policies include, but are not limited to, revenue recognition, estimated useful lives and carrying value of fixed assets, classification of assets held for sale, the recorded values of accruals and fair values of assets and liabilities including the Company's contingent liabilities.

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a) Options to employees and directors: (Cont.)

On April 13, 2010, the Company, Abraham Israeli and Hadasit Medical Research Services and Development Ltd. ("Hadasit") entered into an Agreement (the "Agreement") pursuant to which Mr. Israeli agreed, during the term of the Agreement, to serve as (i) the Company's Clinical Trials Advisor and (ii) a member of the Company's Board of Directors. In consideration of the services to be provided by Mr. Israeli to the Company under the Agreement, the Company agreed to grant options annually during the term of the Agreement for the purchase of its Common Stock, as follows:

- An option for the purchase of 166,666 shares of Common Stock at an exercise price equal to $0.00005 per share to Mr. Israeli; and
- An option for the purchase of 33,334 shares of Common Stock at an exercise price equal to $0.00005 per share to Hadasit,
- * Such options will vest and become exercisable in twelve (12) consecutive equal monthly amounts.

In April 2010, the Company granted to Mr. Israeli an option to purchase 166,666 shares of Common Stock at an exercise price equal to $0.00005 per share. The total compensation related to the option was $50, which is amortized over the vesting period as general and administrative expense.

On January 30, 2011 the Company signed an agreement with a new COO and acting CEO. According to the employment agreement, the new COO received 450,000 options to purchase Common Stock of the Company at $0.20.

On June 27 2011, the Company granted to Mr. Israeli an option to purchase 166,666 shares of Common Stock at an exercise price equal to $0.00005 per share. The total compensation related to the option was $48, which is amortized over the vesting period as general and administrative expense.

On June 27 2011, the Company granted to four of its directors an option to purchase 634,999 shares of Common Stock of the Company at $0.15. The total compensation related to the option was $287, which is amortized over the vesting period as general and administrative expense.

On August 10 2011, the Company granted to its CEO, an option to purchase 70,000 shares of Common Stock of the Company at $0.20. The total compensation related to the option was $26, which was amortized as general and administrative expense.

In the three months ended March 31 2012, 167,849 options were exercised by former CEO of the Company for $20.

After the balance sheet date, the Company granted to Mr. Israeli an option to purchase 166,666 shares of Common Stock at an exercise price equal to $0.00005 per share.

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BRAINSTORM CELL THERAPEUTICS INC. AND SUBSIDIARY

(A development stage company)

Notes to the financial statements

NOTE 8 - STOCK CAPITAL (Cont.)

B. Issuance of shares, warrants and options: (Cont.)

2. Share-based compensation to employees and to directors: (Cont.)

b) Restricted shares to directors (Cont.):

A summary of the Company's option activity related to options to employees and directors, and related information is as follows:

	For the period ended March 31, 2012		
	Amount of options	Weighted average exercise price $	Aggregate intrinsic value $
Outstanding at beginning of period	4,938,821	0.168	
Granted	-		
Exercised	167,849	0.150	
Reclassified	13,784	0.067	
Outstanding at end of period	4,784,756	0.169	807,430
Vested and expected-to-vest at end of period	3,784,617	0.166	627,162

On May 2, 2006, the Company issued to two of its directors 200,000 restricted shares of common stock (100,000 each). The restrictions on the shares have fully lapsed. The compensation related to the stocks issued amounted to $104, which was amortized over the vesting period as general and administrative expenses.

On April 20, 2007, based on a board resolution dated March 21, 2007, the Company issued to a director 100,000 restricted shares of Common Stock. The restrictions on the shares have fully lapsed. The compensation related to the shares issued amounted to $47, which was amortized over the vesting period as general and administrative expenses.

In addition, on April 20, 2007, based on a board resolution dated March 21, 2007, the Company issued to another director 100,000 restricted shares of Common Stock. The restricted shares are not subject to any right to repurchase, and the compensation related to the shares issued amounted to $47 was recorded as prepaid general and administrative expenses in the three months ended March 31, 2007.

On August 27, 2008, the Company issued to one of its directors 960,000 shares of Common Stock upon a cashless exercise by a shareholder of a warrant to purchase 1,000,000 shares of Common Stock at an exercise price of $.01 per share that was acquired by the shareholder from Ramot. The shares were allocated to the director by the shareholder.

BRAINSTORM CELL THERAPEUTICS INC. AND SUBSIDIARY

(A development stage company)

Notes to the financial statements

NOTE 8 - STOCK CAPITAL (Cont.)

B. Issuance of shares, warrants and options: (Cont.)

2. Share-based compensation to employees and to directors: (Cont.)

b) Restricted shares to directors (Cont.):

In May 2010, based on a board resolution dated June 29, 2009, the Company issued to three of its directors 300,000 restricted shares of Common Stock. The restrictions of the shares shall lapse in three annual and equal portions commencing with the grant date.

In May and in June 2010, based on a board resolution dated June 29, 2009, the Company issued to three of its Scientific Advisory Board members and two of its Advisory Board members 500,000 restricted shares of common stock. The restrictions of the shares shall lapse in three annual and equal portions commencing with the grant date.

On April 6, 2010, Prof. Melamed fully exercised his warrant to purchase 1,097,215 shares of the Company's Common Stock; the warrant was issued to him pursuant to the agreement with the Consultants effective as of November 4, 2004.

3. Shares and warrants to investors and service providers:

The Company accounts for shares and warrants issued to non-employees using the guidance of ASC 718-10 (formerly "SFAS" 123(R)), "Accounting for Stock-Based Compensation" and ASC 505-50-30 (formerly "EITF" 96-18), "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," whereby the fair value of such option and warrant grants is determined using a Black-Scholes options pricing model at the earlier of the date at which the non-employee's performance is completed or a performance commitment is reached.

BRAINSTORM CELL THERAPEUTICS INC. AND SUBSIDIARY

(A development stage company)

Notes to the financial statements

NOTE 8 - STOCK CAPITAL (Cont.)

B. Issuance of shares, warrants and options: (Cont.)

3. Shares and warrants to investors and service providers: (Cont.)

a) Warrants to investors and service providers and investors:

Issuance date	Number of warrants issued	Exercised	Forfeited	Outstanding	Exercise Price $	Warrants exercisable	Exercisable through
November 2004	12,800,845	11,761,281	151,803	887,761	0.01	887,761	April 2012
December 2004	1,800,000	1,800,000		-	0.00005	–	-
February 2005	1,894,808		1,894,808	-	2.5	-	-
May 2005	47,500		47,500	-	1.62	-	-
June 2005	30,000			30,000	0.75	30,000	June 2015
August 2005	70,000		70,000	-	0.15	-	-
September 2005	3,000	3,000		-	0.15	-	-
September 2005	36,000		36,000	-	0.75	-	-
September-December 2005	500,000		500,000	-	1	-	-
December 2005	20,000	20,000		-	0.15	-	-
December 2005	457,163	150,000		307,163	0.15	307,163	December 2015
February 2006	230,000			230,000	0.65	230,000	February 2016
February 2006	40,000		40,000	-	1.5	-	
February 2006	8,000		8,000	-	0.15	-	
February 2006	189,000	97,696	91,304	-	0. 5	-	-
May 2006	50,000			50,000	0.0005	50,000	May 2016
May -December 2006	48,000		48,000	-	0.35	-	-
May -December 2006	48,000		48,000	-	0.75	-	-
May 2006	200,000			200,000	1	200,000	May 2011
June 2006	24,000		24,000	-	0.15	-	-
May 2006	19,355		19,355	-	0.15	-	-

October 2006	630,000	630,000		-	0.3	-	-
December 2006	200,000		200,000	-	0.45	-	-
March 2007	200,000		200,000	-	0.47	-	-
March 2007	500,000			500,000	0.47	500,000	March 2017
March 2007	50,000		50,000	-	0.15	-	-
March 2007	15,000		15,000	-	0.15	-	-
February 2007	50,000		50,000	-	0.45	-	-
March 2007	225,000		225,000	-	0.45	-	-
March 2007	50,000		50,000	-	0.45	-	-
April 2007	33,300		33,300	-	0.45	-	-
May 2007	250,000		250,000	-	0.45	-	-
July 2007	500,000			500,000	0.39	500,000	July 2017
September 2007	500,000			500,000	0.15	500,000	August 2017
August 2007	7,562,500			7,562,500	0.2	7,562,500	November 2013
July 2007	30,000		30,000	-	0.45	-	-
July 2007	100,000		100,000	-	0.45	-	-
October 2007	200,000			200,000	0.15	200,000	August-October 2017
November 2007	2,520,833			2,520,833	0.20	2,520,833	November 2013
November 2007	2,016,667			2,016,667	0.29	2,016,667	November 2013
April 2008	4,537,500			4,537,500	0.29	4,537,500	November 2013
August 2008	3,529,166			3,529,166	0.29	3,529,166	November 2013
August 2008	1,008,334			1,008,334	0.29	1,008,333	November 2013
November 2008	100,000			100,000	0.15	100,000	September 2018
April 2009	200,000			200,000	0.1	200,000	April 2019
October 2009	200,000	100,000		100,000	0.067	66,667	October 2019
October 2009	4,537,500			4,537,500	0.29	4,537,500	November 2013
January 2010	1,250,000		1,250,000	-	0.5	-	-
February 2010	125,000	125,000		-	0.01	-	-
February 2010	3,000,000		3,000,000	-	0.5	-	-
January 2011	4,537,500			4,537,500	0.29	4,537,500	November 2013
February 2011	641,026		641,026	-	0.39	-	-
February 2011	6,407,500	946,834	5,460,666	-	0.28	-	-
February 2011	12,815,000			12,815,000	0.5	12,815,000	February 2013
April 2010	33,334			33,334	0.00005	33,334	April 2020
April 2011	33,334			33,334		33,334	April 2021
February 2010	1,500,000			1,500,000		500,000	February 2020
	78,604,165	15,633,811	14,533,762	48,436,590		47,403,257	

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BRAINSTORM CELL THERAPEUTICS INC. AND SUBSIDIARY

(A development stage company)

Notes to the financial statements

NOTE 8 - STOCK CAPITAL (Cont.)

B. Issuance of shares, warrants and options: (Cont.)

3. Shares and warrants to service providers: (Cont.)

a) Warrants: (Cont.)

The fair value for the warrants to service providers was estimated on the date of grant using a Black-Scholes option pricing model, with the following weighted-average assumptions for the 3 month activity ended on March 31, 2011; weighted average volatility of 134%-141%, risk free interest rates of 2.26%-3.47% dividend yields of 0% and a weighted average life of the options of 6-10 years.

b) Shares:

On June 1 and June 4, 2004, the Company issued 40,000 and 150,000 shares of Common Stock for 12 months of filing services and legal and due-diligence services, respectively, with respect to a private placement. Compensation expense related to filing services, totaling $26, was amortized over a 12-month period. Compensation related to legal services, totaling $105 was recorded as equity issuance cost and had no effect on the statement of operations.

On July 1 and September 22, 2004, the Company issued 20,000 and 15,000 shares to a former director for financial services for the first and second quarters of 2004, respectively. Related compensation in the amount of $39 was recorded as general and administrative expense.

On February 10, 2005, the Company signed an agreement with one of its service providers under which the Company issued the service provider 100,000 restricted shares at a purchase price of $0.00005 par value under the U.S. Stock Option and Incentive Plan of the Company. All restrictions on these shares have lapsed.

In March and April 2005, the Company signed an agreement with four members of its Scientific Advisory Board under which the Company issued to the members of the Scientific Advisory Board 400,000 restricted shares at a purchase price of $0.00005 par value under the U.S. Stock Option and Incentive Plan (100,000 each). All restrictions on these shares have lapsed.

In July 2005, the Company issued to its legal advisors 50,000 shares for legal services for 12 months. The compensation related to the shares in the amount of $37.5 was recorded as general and administrative expense.

In January 2006, the Company issued to two service providers 350,000 restricted shares at a purchase price of $0.00005 par value under the U.S. Stock Option and Incentive Plan of the Company. All restrictions on these shares have lapsed. Related compensation in the amount of $23 was recorded as general and administrative expense.

On March 6, 2006, the Company issued to its legal advisor 34,904 shares of Common Stock. The shares are in lieu of $18.5 payable to the legal advisor. Related compensation in the amount of $18.5 was recorded as general and administrative expense.

On April 13, 2006, the Company issued to service providers 60,000 shares of Common Stock at a purchase price of $0.00005 par value under the U.S. Stock Option and Incentive Plan of the Company. Related compensation in the amount of $25.8 was recorded as general and administrative expense.

BRAINSTORM CELL THERAPEUTICS INC. AND SUBSIDIARY

(A development stage company)

Notes to the financial statements

On May 9, 2006, the Company issued to its legal advisor 65,374 shares of Common Stock in lieu of payment for legal services. Related compensation in the amount of $33 was recorded as general and administrative expense.

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BRAINSTORM CELL THERAPEUTICS INC. AND SUBSIDIARY

(A development stage company)

Notes to the financial statements

NOTE 8 - STOCK CAPITAL (Cont.)

B. Issuance of shares, warrants and options: (Cont.)

3. Shares and warrants to service providers: (Cont.)

b) Shares: (Cont.)

On June 7, 2006, the Company issued to a service provider 50,000 shares of Common Stock for filing services for 12 months. Related compensation in the amount of $24.5 was recorded as general and administrative expense.

On May 5, 2006, the Company issued 200,000 shares of Common Stock to a finance consultant for his services. Related compensation in the amount of $102 was recorded as general and administrative expense.

On August 14, 2006, the Company issued 200,000 shares of Common Stock to a service provider. Related compensation in the amount of $68 was recorded as general and administrative expense.

On August 17, 2006, the Company issued 100,000 shares of Common Stock to a service provider. Related compensation in the amount of $35 was recorded as general and administrative expense.

On September 17, 2006, the Company issued to its legal advisor 231,851 shares of Common Stock in lieu of $63 payable to the legal advisor. [Related compensation in the amount of $63 was recorded as general and administrative expense.]

On April 1 and September 30, 2006, the Company issued to its business development advisor, based on an agreement, 240,000 shares of Common Stock. Related compensation in the amount of $74 was recorded as general and administrative expense.

On January 3, 2007, the Company issued to its legal advisor 176,327 shares of Common Stock in lieu of $45 payable to the legal advisor. Related compensation in the amount of $49 was recorded as general and administrative expense.

On April 12, 2007, the Company issued to its filing and printing service providers 80,000 shares of Common Stock in lieu of $15 payable to the service provider. Related compensation in the amount of $30 was recorded as general and administrative expense. In addition, the Company was obligated to issue the filing and printing service providers additional shares, in the event that the total value of the shares previously issued (as quoted on the Over-the-Counter Bulletin Board or such other exchange where the Common Stock is quoted or listed) was less than $0.20 on March 20, 2008. As a result, the Company recorded a liability in the amount of $20.

On April 12, 2007, the Company issued to its legal advisor 108,511 shares of Common Stock in lieu of $29 payable to the legal advisor. Related compensation in the amount of $40 was recorded as general and administrative expense.

On May 18, 2007, the Company issued to its legal advisor 99,257 shares of Common Stock in lieu of $33 payable to the legal advisor. Related compensation in the amount of $33 was recorded as general and administrative expense.

BRAINSTORM CELL THERAPEUTICS INC. AND SUBSIDIARY

(A development stage company)

Notes to the financial statements

NOTE 8 - STOCK CAPITAL (Cont.)

B. Issuance of shares, warrants and options: (Cont.)

3. Shares and warrants to service providers: (Cont.)

b) Shares: (Cont.)

On October 29, 2007, the Company issued to a scientific advisory board member 80,000 shares of the Company’s Common Stock for scientific services. Compensation of $67 was recorded as research and development expense.

On May 20, 2008, the Company issued to its financial advisor 90,000 shares of the Company's Common Stock. The shares were for $35 payable to the financial advisor for introduction fee of past convertible loans. Related compensation in the amount of $36 was recorded as financial expenses.

On April 5, 2009, the Company issued to its Chief Technology Advisor 1,800,000 shares of Common Stock. The shares were for $180 payable to the advisor. Related compensation in the amount of $144 was recorded as research and development expense.

On June 24, 2009, the Company issued to its public relations advisor 250,000 shares of Common Stock. The shares were for $25 payable to the advisor. Related compensation in the amount of $18 was recorded as general and administrative expense.

On July 8, 2009, the Company issued to its financial consultant 285,714 shares of the Company's Common Stock. The shares were for $20 payable to the financial consultant for valuation of options and warrants. Related compensation in the amount of $20 was recorded as general and administrative expense.

On July 15, 2009, the Company issued to a service provider 357,142 shares of the Company's Common Stock. The shares were for $25 payable to the service provider for filing services. Related compensation in the amount of $21 was recorded as general and administrative expense.

On August 10, 2009, the Company issued to a service provider 71,428 shares of the Company's Common Stock. The shares were for $5 payable to the service provider for IT services. Related compensation in the amount of $4 was recorded as general and administrative expense.

On January 5, 2010, the Company issued to its public relations advisor 50,000 shares of the Company's Common Stock for six months service. The issuance of the shares is part of the agreement with the public relations advisor that entitled them to a monthly grant of 8,333 shares of the Company's Common Stock. Related compensation in the amount of $12 was recorded as general and administrative expense.

On January 6, 2010, the Company issued to a service provider 60,000 shares of the Company's Common Stock. The shares were for $15 payable to the service provider for insurance and risk management consulting and agency services for three years. Related compensation in the amount of $16 was recorded as general and administrative expense.

On March 5, 2007, the Company issued a $150 Convertible Promissory Note to a third party. Interest on the note accrued at the rate of 8% per annum for the first year and 10% per annum after the first year. On January 27, 2010, the third party converted the entire accrued principle and interest outstanding under the note, amounting to $189, into 1,016,109 shares of Common Stock.

BRAINSTORM CELL THERAPEUTICS INC. AND SUBSIDIARY

(A development stage company)

Notes to the financial statements

NOTE 8 - STOCK CAPITAL (Cont.)

B. Issuance of shares, warrants and options: (Cont.)

3. Shares and warrants to service providers: (Cont.)

b) Shares: (Cont.)

On December 13, 2009, the Company issued a $135 Convertible Promissory Note to it legal advisor for $217 in legal fees accrued through October 31, 2009. Interest on the note accrued at the rate of 4%. On February 19, 2010, the Company’s legal advisor converted the entire accrued principal and interest of outstanding under the note into 402,385 shares of Common Stock.

In May 2010, based on a board resolution dated June 29, 2009 the Company issued to one of its public relations advisors 100,000 restricted shares of Common Stock. The restrictions of the shares shall lapse in three annual and equal portions commencing with the grant date.

On December 16, 2010, the Company issued to a service provider 83,333 shares of the Company's Common Stock. The shares were for public relations services. Related compensation in the amount of $40 is recorded as general and administrative expense.

On December 16, 2010, the Company granted to its Chief Medical Advisor 900,000 shares of the Company's Common Stock for services rendered through December 31 2010. Related compensation in the amount of $180 is recorded as research and development expense (see Note 5B).

On December 16, 2010 the Company granted to its Chief Scientist 200,000 shares of the Company's Common Stock for services rendered through December 31 2010. Related compensation in the amount of $40 is recorded as research and development expense (see Note 5B).

On February 16, 2011 one of the Company's consultants exercised 100,000 warrants to Common Stock for $33.

On February 18, 2011, the Company's legal advisor converted the entire accrued principal and interest of the Convertible Promissory Note granted on September 15, 2010, totaling $137, into 445,617 shares of Common Stock.

The total stock-based compensation expense, related to shares, options and warrants granted to employee’s directors and service providers, was comprised, at each period, as follows:

	Three months ended March 31		Period from September 22, 2000 (inception date) through March 31,
	2012	2011	2012
	Unaudited		Unaudited
Research and development	13	9	17,556
General and administrative	168	-2	10,281
Financial expenses, net	-	-	248
Total stock-based compensation expense	181	7	28,098

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BRAINSTORM CELL THERAPEUTICS INC. AND SUBSIDIARY

(A development stage company)

Notes to the financial statements

NOTE 9 - SUBSEQUENT EVENTS

A. In April 2012, the former CEO exercised 1,014,757 options to shares of Common Stock of the Company. An exercise fee of $112 was paid to the Company. (See note 8 B 2 (a))

B. In April 2012, the Company granted to Mr. Israeli an option to purchase 166,666 shares of Common Stock at an exercise price equal to $0.00005 per share. (See note 8 B 2 (a))

C. In April 2012, the Company granted to Hadasit a warrant to purchase 33,334 shares of Common Stock at an exercise price equal to $0.00005 per share. (See note 8 B 2 (a))

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report contains numerous statements, descriptions, forecasts and projections, regarding Brainstorm Cell Therapeutics Inc. and its potential future business operations and performance. These statements, descriptions, forecasts and projections constitute "forward-looking statements," and as such involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance and achievements to be materially different from any results, levels of activity, performance and achievements expressed or implied by any such "forward-looking statements." Some of these are described under "Risk Factors" in this report and in our annual report on Form 10-K for the fiscal year ended December 31, 2011. In some cases you can identify such "forward-looking statements" by the use of words like "may," "will," "should," "could," "expects," "hopes," "anticipates," "believes," "intends," "plans," "estimates," "predicts," "likely," "potential," or "continue" or the negative of any of these terms or similar words. These "forward-looking statements" are based on certain assumptions that we have made as of the date hereof. To the extent these assumptions are not valid, the associated "forward-looking statements" and projections will not be correct. Although we believe that the expectations reflected in these "forward-looking statements" are reasonable, we cannot guarantee any future results, levels of activity, performance or achievements. It is routine for our internal projections and expectations to change as the year or each quarter in the year progresses, and therefore it should be clearly understood that the internal projections and beliefs upon which we base our expectations may change prior to the end of each quarter or the year. Although these expectations may change, we may not inform you if they do and we undertake no obligation to do so. We caution investors that our business and financial performance are subject to substantial risks and uncertainties. In evaluating our business, prospective investors should carefully consider the information set forth under the caption "Risk Factors" in addition to the other information set forth herein and elsewhere in our other public filings with the Securities and Exchange Commission.

Company Overview

Brainstorm Cell Therapeutics Inc. ("Brainstorm" or the "Company") is a biotechnology company developing innovative adults stem cell therapies for highly debilitating neurodegenerative disorders such as Amyotrophic Lateral Sclerosis (ALS, also known as Lou Gehrig's disease), Multiple Sclerosis, and Parkinson's disease (PD). These devastating diseases have limited treatment options and as such represent highly unmet medical needs.

BrainStorm's proprietary process for propagation of Mesenchymal Stem Cells (MSC), and their differentiation into NeuroTrophic factor-(NTF) secreting cells (MSC-NTF), and their transplantation at, or near, the site of damage, offers the hope of repairing degenerated tissues and curing the underlying pathology, rather than simply treating its symptoms.

BrainStorm's approach has a high safety profile based on its use of autologous cells, which are free of the risk of rejection, tumor formation, controversy or ethical issues.

Our core technology was developed in collaboration with prominent neurologist Prof. Eldad Melamed, former head of Neurology of the Rabin Medical Center and member of the Scientific Committee of the Michael J. Fox Foundation for Parkinson's Research, and expert cell biologist Prof. Daniel Offen of the Felsenstein Medical Research Center of Tel Aviv University.

The Company holds exclusive worldwide rights to commercialize the technology, through a licensing agreement with Ramot, the technology transfer company of Tel Aviv University, Israel.

As a result of limited cash resources and the desire to take a faster path to clinical trials, since the fourth quarter of 2008 the Company has focused all of its efforts on ALS. However, the company intends to begin pre-clinical testing of Multiple Sclerosis during 2012.

In February 2011, the U.S. Food and Drug Administration (“FDA”) granted Orphan Drug designation to NurOwn, the Company’s autologous adult stem cell product candidate for the treatment of ALS. Orphan Drug status entitles BrainStorm to seven years of marketing exclusivity for NurOwn upon regulatory approval, as well as the opportunity to apply for grant funding from the US government of up to $400,000 per year for four years to defray costs of clinical trial expenses, tax credits for clinical research expenses and potential exemption from the FDA's application user fee.

In June 2011, BrainStorm initiated a Phase I/II clinical trial for the treatment of ALS with NurOwn at the Hadassah University Medical Center’s in Jerusalem, after receiving approval from the Israeli Ministry of Health (“MoH”). BrainStorm is the first company to receive clearance from the MoH to carry out a differentiated stem-cell based therapeutic clinical trial in Israel. The Company’s production process for manufacturing clinical grade MSC-NTF cells is in full compliance with Good Manufacturing Practice (“GMP”) requirements.

In January 2012, BrainStorm announced interim results of its Phase I/II clinical trial. The one month follow-up of the first four ALS patients treated with the Company's NurOwn therapy indicated that the therapy was safe, did not cause any adverse side effects, and showed some initial positive clinical indications.

Our efforts are currently directed at:

- Completing a Phase I/II clinical trial in Israel;
- Initiating a Phase II clinical trial in the USA;
- Initiating pre-clinical studies on Multiple Sclerosis; and
- Submitting an IND to the FDA.

Our Approach

The Company's approach to treatment of neurodegenerative diseases with autologous adult stem cells includes a multi-step process beginning with harvesting of undifferentiated stem cells from the patient's own bone marrow, and concluding with transplantation of differentiated, neurotrophic factor-secreting mesenchymal stem cells (MSC-NTF) into the same patient – intrathecally (IT) and/or intramuscularly (IM). This approach is based on pre-clinical data documented by our research team, led by Prof. Melamed and Prof. Offen.

Melamed and Offen's group has shown that human bone marrow mesenchymal stem cells can be expanded and induced to differentiate into two types of brain cells, neuron-like and astrocyte-like, each having different therapeutic potential, as follows:

In-vitro differentiation of the expanded human bone marrow derived mesenchymal stem cells in a proprietary medium led to the generation of neurotrophic-factors secreting cells. The in-vitro differentiated cells were shown to express and secrete GDNF, as well as other NTFs, into the growth medium. GDNF is a neurotrophic-factor, previously shown to protect, preserve and even restore neuronal function, particularly dopaminergic cells in PD, but also neuron function in other neurodegenerative pathologies such as ALS and Huntington’s disease. Unfortunately, therapeutic application of GDNF is hampered by its poor brain penetration and stability. Attempting to infuse the protein directly to the brain is impractical and the alternative, using GDNF gene therapy, suffers from the limitations and risks of using viral vectors. Our preliminary results show that our NTF secreting cells, when transplanted into a 6-OHDA lesion PD rat model, show significant efficacy. Within weeks of the transplantation, there was an improvement of more than 50% in the animals’ characteristic disease symptoms.

We have optimized the proprietary processes for induction of differentiation of human bone marrow derived mesenchymal stem cells into differentiated cells that produce NTF (MSC-NTF). The optimization and process development is conducted in Good Manufacturing Practice ("GMP") compliance.

NurOwn program one (current) – Based on the above pre-clinical results, the Company initiated a Phase I/II clinical trial at the Hadassah Medical Center in June 2011 for treatment of ALS patients with MSC-NTF cells. An interim report of this ongoing clinical trial will be submitted to the Ministry of Health in Q3 2012.

NurOwn program two (future) – Based on positive proof-of-concept results with MSC-NTF cells for Multiple Sclerosis (MS), the Company plans to initiate a pre-clinical study for this disease in Q2 2012.

Our approach comprises the following steps:

- Bone marrow aspiration from patient;
- Isolation and expansion of the mesenchymal stem cells;
- Differentiation of the expanded stem cells into neurotrophic-factor secreting (MSC-NTF) cells; and
- Autologous transplantation into the patient at the site of damage.

Results of Operations

The Company has been a development stage company since its inception. For the period from inception (September 22, 2000) until March 31, 2012, the Company has not generated any revenues from operations. The Company does not expect to generate revenues from operations until 2014 at the earliest. In addition, the Company has incurred operating costs and other expenses of approximately $879,000 during the three months ended March 31, 2012, and approximately $42,301,000 for the period from inception (September 22, 2000) until March 31, 2012. Operating expenses incurred since inception were approximately $17,513,000 for general and administrative expenses and $24,788,000 for research and development costs.

Research and Development, net:

Research and development expenses, net for the three months ended March 31, 2012 and 2011 were $369,000 and $270,000, respectively. In addition, our grant from The Office of the Chief Scientist increased by $140,000 to $240,000 for the three months ended March 31, 2012 from $100,000 for the three months ended March 31, 2011.

The increase in research and development expenses for the three months ended March 31, 2012 is primarily due to: (i) in June 2011, the Company began clinical trials in ALS patients, in Hadassah, under which the Company paid $340,000 in the three months ended March 31, 2012; (ii) an increase of $65,000 in payroll costs due to recruitment of four additional employees to conduct the clinical trials.

General and Administrative:

General and administrative expenses for the three months ended March 31, 2012 and 2011 were $510,000 and $258,000, respectively.

The increase in general and administrative expenses for the three month period ended March 31, 2012 from the three month period ended March 31, 2011 is primarily due to: (i) an increase of $170,000 in compensation expenses for stock granted to directors and employees; (ii) an increase of $70,000 in legal, audit and public relations activity.

Financial Expenses:

Financial income for the three months ended March 31, 2012 was $11,000, compared to a financial expense of $177,000 for the three months ended March 31, 2011.

The financial income for the three months ended March 31, 2012 is mainly from conversion exchange rate and income on deposits in banks. The financial expense for the three months ended March 31, 2011 is primarily attributable to $192,000 financial expense from conversion of debt to a subcontractor to our common stock, balanced by financial income of $15,000 due to the conversion exchange rate.

Net Loss:

Net loss for the three months ended on March 31, 2012 was $872,000, as compared to a net loss of $705,000 for the three months ended March 31, 2011. Net loss per share for the three months ended March 31, 2012 was $0.01, as it also was for the three months ended March 31, 2011.

The weighted average number of shares of common stock used in computing basic and diluted net loss per share for the three months ended March 31, 2012 was 126,591,262, compared to 108,895,199 for the three months ended March 31, 2011.

The increase in the weighted average number of shares of common stock used in computing basic and diluted net loss per share for the three months ended March 31, 2012 was due to (i) the issuance of shares in a private placement, (ii) the exercise of options and warrants and (iii) the issuance of shares to service providers.

Liquidity and Capital Resources

The Company has financed its operations since inception primarily through private sales of its common stock and warrants and the issuance of convertible promissory notes. At March 31, 2012, we had $1,775,000 in total current assets and $1,290,000 in total current liabilities.

Net cash used in operating activities was $746,000 for the three months ended March 31, 2012. Cash used for operating activities in the three months ended March 31, 2012 was primarily attributed to clinical trial costs, payroll costs, rent, outside legal and audit fee expenses and public relations expenses.

Net cash used in investing activities was $52,000 for the three months ended March 31, 2012.

Net cash provided by financing activities was $20,000 for the three months ended March 31, 2012 is primarily attributable to exercise of options to common stock.

Our material cash needs for the next 12 months include the payments due under an agreement with Hadassah to conduct clinical trials in ALS patients, under which we must pay to Hadassah an amount of (i) up to $32,225 per patient (up to $773,400 in the aggregate) and (ii) $65,000 per month for rent and operation of the GMP facilities in anticipation of Hadassah's clinical trials.

Our other material cash needs for the next 12 months will include payments of (i) employee salaries, (ii) patents, (iii) construction fees for facilities to be used in our research and development and (iv) fees to our consultants and legal advisors.

We will need to raise substantial additional capital in order to meet our anticipated expenses. If we are not able to raise substantial additional capital, we may not be able to continue to function as a going concern and we may have to cease operations. Even if we obtain funding sufficient to continue functioning as a going concern, we will be required to raise a substantial amount of capital in the future in order to reach profitability and to complete the commercialization of our products. Our ability to fund these future capital requirements will depend on many factors, including the following:

- our ability to obtain funding from third parties, including any future collaborative partners;
- the scope, rate of progress and cost of our clinical trials and other research and development programs;
- the time and costs required to gain regulatory approvals;
- the terms and timing of any collaborative, licensing and other arrangements that we may establish;
- the costs of filing, prosecuting, defending and enforcing patents, patent applications, patent claims, trademarks and other intellectual property rights;
- the effect of competition and market developments; and
- future pre-clinical and clinical trial results.

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 U.S. The preparation of these financial statements requires us to make judgments, estimates, and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported revenue and expenses during the reporting periods. We continually evaluate our judgments, estimates and assumptions. We base our estimates on the terms of underlying agreements, our expected course of development, historical experience and other factors we believe are reasonable based on the circumstances, the results of which form our management's basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

There were no significant changes to our critical accounting policies during the quarter ended March 31, 2012. For information about critical accounting policies, see the discussion of critical accounting policies in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

Off Balance Sheet Arrangements

We have no off balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

This information has been omitted as the Company qualifies as a smaller reporting company.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this quarterly report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as a result of the material weakness in our internal control over financial reporting described below, our disclosure controls and procedures were not effective, as of the end of the period covered by this report, to ensure that information required to be disclosed by us in the reports we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that the information required to be disclosed by us in such reports is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Internal Control Over Financial Reporting

Management identified the following material weakness in its assessment of the effectiveness of internal control over financial reporting as of December 31, 2011, which continued to exist as of March 31, 2012:

- The Company did not maintain effective controls over certain aspects of the financial reporting process because we lacked a sufficient complement of personnel with a level of accounting expertise and an adequate supervisory review structure that is commensurate with the Company's financial reporting requirements.

Nevertheless, based on a number of factors, including the performance of additional procedures performed by management designed to ensure the reliability of our financial reporting, our Chief Executive Officer and Chief Financial Officer believe that the consolidated financial statements included with this quarterly report fairly present, in all material respects, our financial position, results of operations, and cash flows as of the dates, and for the periods, presented, in conformity with U.S. GAAP.

Management's Remediation Initiatives

We plan to develop policies and procedures for training of personnel or external advisers to verify that we have a sufficient number of personnel with knowledge, experience and training in the application of generally accepted accounting principles commensurate with our financial reporting and U.S. GAAP requirements. Where necessary, we will supplement personnel with qualified external advisors. Additionally, where appropriate, we plan to identify training courses on accounting principles and procedures that would benefit our accounting and finance personnel.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal controls over financial reporting that occurred during the quarter ended March 31, 2012 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings.

For a description of legal proceedings affecting the Company refer to Part I, Item 3, “Legal Proceedings” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. There were no additional material developments to the legal proceedings affecting the Company in the fiscal quarter ended March 31, 2012.

From time to time, we may become involved in litigation relating to claims arising out of operations in the normal course of business, which we consider routine and incidental to our business. We currently are not a party to any material legal proceedings, other than as described in Part I, Item 3, “Legal Proceedings” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, the adverse outcome of which, in management’s opinion, would have a material adverse effect on our business, results of operation or financial condition.

Item 1A. Risk Factors.

There have not been any material changes from the risk factors previously disclosed in the “Risk Factors” section of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the risk factors discussed below and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

On April 13, 2012, pursuant to the Hadasit Agreement, we issued a warrant to purchase up to 33,334 shares of our common stock at an exercise price of $0.00005 per share, exercisable for a period of 10 years, to Hadasit Medical Research Services and Development Ltd. The issuance of these securities was effected without registration in reliance upon Regulation D promulgated under the Securities Act. No underwriters were involved with the issuance of such securities and no commissions were paid in connection with such transactions.

On April 22, 2012, we issued 834,729 shares of our common stock to Yossef Levy in connection with his exercise of a warrant to purchase common stock previously issued. The exercise price paid upon exercise of the warrant was $0.01 per share for a total of $8,347, which has been received by us. The issuance of these securities was effected without registration in reliance on Section 4(2) of the Securities Act as a sale by the Company not involving a public offering. No underwriters were involved with the issuance of such securities.

Item 5. Other Information.

On May 10, 2012, the Company entered into a Warrant Amendment Agreement (the “Amendment”) with ACCBT Corp. (the “Investor”), a company under the control of Mr. Chaim Lebovits, the President of the Company, pursuant to which the Company and the Investor agreed to amend each warrant previously issued by the Company to the Investor.

Pursuant to the Amendment, upon effectiveness of a six month lock-up agreement entered into by the Investor in connection with a proposed offering of common stock by the Company, the then current expiration date for each warrant held by the Investor shall be automatically extended by an additional 18 months. If the proposed offering is not completed by October 31, 2012, the Amendment will automatically terminate and be of no further force or effect.

As previously disclosed, pursuant to the terms of a certain Subscription Agreement, the Company agreed to sell to the Investor up to 27,500,000 shares (the “Subscription Shares”) of the Company’s common stock for an aggregate subscription price of up to $5.0 million and for no additional consideration, if the Investor purchased the Subscription Shares, warrants to purchase up to 30,250,000 shares of common stock . Per the terms of the Subscription Agreement, as amended to date, the current expiration date for each warrant held by the Investor is November 5, 2013.

The foregoing description is subject to, and qualified in its entirety by, the Amendment filed as an exhibit hereto and incorporated herein by reference.

During the quarter ended March 31, 2012, we made no material changes to the procedures by which stockholders may recommend nominees to our Board of Directors, as described in our most recent proxy statement.

Item 6. Exhibits.

The Exhibits listed in the Exhibit Index immediately preceding such Exhibits are filed with or incorporated by reference in this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BRAINSTORM CELL THERAPEUTICS INC.

May 11, 2012 By: /s/ Adrian Harel
Name: Adrian Harel
Title: Acting Chief Executive Officer (Principal Executive Officer)

May 11, 2012 By: /s/ Liat Sossover
Name: Liat Sossover
Title: Chief Financial Officer (Principal Financial Officer)

EXHIBIT INDEX

Exhibit Number	Description
10.1	Warrant Amendment Agreement, dated as of May 10, 2012, by and between Brainstorm Cell Therapeutics Inc. and ACCBT Corp.
31.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Label Linkbase Document
101.PRE*	XBRL Taxonomy Presentation Linkbase Document

* Pursuant to Rule 406T of Regulation S-T, the interactive files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.