PROVECTUS BIOPHARMACEUTICALS, INC.
Form 10-Q
November 09, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016

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

Commission file number 001-36457

PROVECTUS BIOPHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**90-0031917**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
7327 Oak Ridge Highway, Suite A, Knoxville, Tennessee	**37931**
(Address of principal executive offices)	**(Zip Code)**

866-594-5999

(Registrant s telephone number, including area code)

N/A

(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 for the past 90 days. 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). 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.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

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

The number of shares outstanding of the registrant s common stock, par value $0.001 per share, as of November 4, 2016 was 243,895,352.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements as defined under U.S. federal securities laws. These statements reflect management s current knowledge, assumptions, beliefs, estimates, and expectations and express management s current views of future performance, results, and trends and may be identified by their use of terms such as anticipate, believe, could, estimate, expect, intend, may, plan, predict, project, wil
terms. Forward-looking statements are subject to a number of risks and uncertainties that could cause our actual results to materially differ from those described in the forward-looking statements. Readers should not place undue reliance on forward-looking statements. Such statements are made as of the date of this Quarterly Report on Form 10-Q, and we undertake no obligation to update such statements after this date.

Risks and uncertainties that could cause our actual results to materially differ from those described in forward-looking statements include those discussed in our filings with the Securities and Exchange Commission (including those described in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015 and in this Quarterly Report on Form 10-Q for the quarter ended September 30, 2016), and the following:

our determination, based on guidance from the FDA, whether to proceed with or without a partner with the fully enrolled phase 3 trial of PV-10 to treat locally advanced cutaneous melanoma and the costs associated with such a trial if it is necessary to complete (versus interim data alone);

our determination whether to license PV-10, our investigational drug product for melanoma and other solid tumors such as cancers of the liver, if such licensure is appropriate considering the timing and structure of such a license, or to commercialize PV-10 on our own to treat melanoma and other solid tumors such as cancers of the liver;

our ability to license PH-10, our investigational drug product for dermatology, on the basis of our phase 2 atopic dermatitis and psoriasis results, which are in the process of being further developed in conjunction with mechanism of action studies;

our ability to raise additional capital if we determine to commercialize PV-10 and/or PH-10 on our own, although our expectation is to be acquired by a prospective pharmaceutical or biotech concern prior to commercialization; and

our ability to raise capital through our proposed rights offering.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PROVECTUS BIOPHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2016 (Unaudited)	December 31, 2015
Assets		
Current Assets		
Cash and cash equivalents	$ 5,178,076	$ 14,178,902
Short-term receivable - settlement	50,000	500,000
Other current assets	187,222	41,192
Total Current Assets	5,415,298	14,720,094
Equipment and furnishings, less accumulated depreciation of $460,954 and $451,028, respectively	75,219	85,145
Patents, net of amortization of $9,306,197 and $8,802,857, respectively	2,409,248	2,912,588
Long-term receivable reimbursable legal fees, net of reserve for uncollectibility	683,250	683,250
Long-term receivable settlement, net of discount	2,075,509	2,011,735
Other assets	27,000	27,000
Total Assets	$ 10,685,524	$ 20,439,812
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts payable trade	$ 1,486,240	$ 1,887,171
Accrued consulting expense	192,000	133,282
Accrued settlement expense		1,850,000
Other accrued expenses	355,232	252,418
Warrant liability	3,342,340	
Total Current Liabilities	5,375,812	4,122,871
Commitments and Contingencies Stockholders Equity		
Preferred stock; par value $0.001 per share; 25,000,000 shares authorized; 240,000 Series B Convertible Preferred shares designated; 18,100 shares and no shares issued and outstanding, respectively	18	
Common stock; par value $0.001 per share; 400,000,000 authorized; 243,895,352 and 204,979,100 shares issued and outstanding, respectively	243,895	204,979
Additional paid-in capital	205,288,577	196,908,112

Accumulated deficit		(200,222,778)		(180,796,150)
Total Stockholders Equity		5,309,712		16,316,941
Total Liabilities and Stockholders Equity	$	10,685,524	$	20,439,812

See accompanying notes to condensed consolidated financial statements.

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PROVECTUS BIOPHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Operating expenses				
Research and development	$ 2,461,407	$ 2,864,331	$ 6,874,353	$ 7,537,440
General and administrative	3,315,555	2,914,375	12,454,661	7,453,401
Total operating loss	(5,776,962)	(5,778,706)	(19,329,014)	(14,990,841)
Investment income	318	1,260	1,985	3,745
Public offering issuance expense (See Note 4)	(436,248)		(436,248)	
Gain (loss) on change in fair value of warrant liability	336,649	(2,607)	336,649	136,987
Net loss	(5,876,243)	(5,780,053)	(19,426,628)	(14,850,109)
Dividend paid in-kind to preferred shareholders	(2,257,432)		(2,257,432)	
Deemed dividend	(726,989)		(726,989)	
Net loss attributable to common shareholders	$ (8,860,664)	$ (5,780,053)	$ (22,411,049)	$ (14,850,109)
Basic and diluted loss per common share	$ (0.04)	$ (0.03)	$ (0.10)	$ (0.08)
Weighted average number of common shares outstanding basic and diluted	222,959,570	204,610,080	213,722,977	192,604,128

See accompanying notes to condensed consolidated financial statements.

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PROVECTUS BIOPHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW

(Unaudited)

	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Cash Flows From Operating Activities		
Net loss	$ (19,426,628)	$ (14,850,109)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	9,926	9,669
Amortization of patents	503,340	503,340
Warrant incentive expense	2,718,407	
Issuance of stock for services	20,163	165,439
Issuance of warrants for services		79,476
Public offering issuance expense (See Note 4)	436,248	
Gain on change in fair value of warrant liability	(336,649)	(136,987)
(Increase) decrease in assets		
Settlement receivable	386,226	653,228
Other current assets	(146,030)	(87,956)
Increase (decrease) in liabilities		
Accounts payable	(400,931)	531,991
Accrued settlement expense	(1,850,000)	
Accrued expenses	161,532	685,354
Net cash used in operating activities	(17,924,396)	(12,446,555)
Cash Flows From Investing Activities		
Capital expenditures		(6,139)
Net cash used in investing activities		(6,139)
Cash Flows From Financing Activities		
Net proceeds from sales of common stock and warrants		13,653,927
Gross proceeds from sales of convertible preferred stock and warrants	6,000,000	
Payment of offering costs in connection with August 2016 financing	(711,470)	
Net proceeds from the issuance of common stock and warrants pursuant to warrant exchange offer	3,635,040	
Proceeds from exercises of warrants and stock options		290,828
Net cash provided by financing activities	8,923,570	13,944,755

Net change in cash and cash equivalents		(9,000,826)		1,492,061
Cash and cash equivalents, at beginning of period		14,178,902		17,391,601
Cash and cash equivalents, at end of period	$	5,178,076	$	18,883,662
Interest and Taxes:	$		$	

Supplemental Disclosure of Noncash Investing and Financing Activities:

		Nine Months Ended September 30, 2016		Nine Months Ended September 30, 2015
Conversion of preferred stock into common stock	$	31,066	$	
Contractual dividend on preferred stock	$	729,989	$	
Issuance in-kind of preferred stock dividends	$	2,257,432	$	

See accompanying notes to condensed consolidated financial statements.

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PROVECTUS BIOPHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information pursuant to Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements and should be reviewed in conjunction with the Company s audited consolidated financial statements included in Form 10-K for the year ended December 31, 2015 filed with the U.S. Securities and Exchange Commission (SEC) on March 30, 2016. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

2. Liquidity and Financial Condition

The Company s cash and cash equivalents were $5,178,076 at September 30, 2016, compared with $14,178,902 at December 31, 2015. The Company continues to incur significant operating losses and management expects that significant on-going operating expenditures will be necessary to successfully implement the Company s business plan and develop and market its products. These circumstances raise substantial doubt about the Company s ability to continue as a going concern. Implementation of the Company s plans and its ability to continue as a going concern will depend upon the Company s ability to develop PV-10 and raise additional capital.

On October 13, 2016, the Company received notice from NYSE MKT that NYSE MKT commenced delisting procedures and immediately suspended trading in the Company s common stock and class of warrants that was listed on NYSE MKT. The Company submitted a request for a review of such delisting determination and has until November 11, 2016 to make a written submission to NYSE MKT in connection with this review. The NYSE Regulation staff s delisting action has been stayed pending the outcome of this review.

Management believes that the Company has access to capital resources through possible public or private equity offerings, exchange offers, debt financings, corporate collaborations or other means. In addition, the Company continues to explore opportunities to strategically monetize its lead drug candidates, PV-10 and PH-10, through potential co-development and licensing transactions, although there can be no assurance that the Company will be successful with such plans. The Company has historically been able to raise capital through equity offerings, although no assurance can be provided that it will continue to be successful in the future. If the Company is unable to raise sufficient capital through the planned Rights Offering (see Footnote 8 to the financial statements, Subsequent Events), it may be forced to implement significant cost cutting measures as early as the first quarter of 2017.

3. Nature of Operations and Significant Accounting Policies

Nature of Operations

Provectus Biopharmaceuticals, Inc., a Delaware corporation (together with its subsidiaries, the Company), is a biopharmaceutical company that is focusing on developing minimally invasive products for the treatment of psoriasis and other topical diseases, and certain forms of cancer including melanoma, breast cancer, and cancers of the liver. To date, the Company has not generated any revenues from planned principal operations. The Company s activities are subject to significant risks and uncertainties, including failing to successfully develop and license or commercialize the Company s prescription drug candidates, or sell or license the Company s over-the-counter (OTC) products or non-core technologies.

Principles of Consolidation

Intercompany balances and transactions have been eliminated in consolidation.

Estimates

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 those estimates.

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Research and Development

Research and development costs are charged to expense when incurred. An allocation of payroll expenses to research and development is made based on a percentage estimate of time spent. The research and development costs include the following: amortization of patents, payroll, consulting and contract labor, lab supplies and pharmaceutical preparations, legal, insurance, rent and utilities, and depreciation.

Sequencing Policy

As a result of the issuance of preferred stock and warrants, for which such instruments contained a variable conversion feature with no floor until November 23, 2016, the Company has adopted a sequencing policy in accordance with Accounting Standards Codification (ASC) 815-40-35-12 whereby all future instruments may be classified as a derivative liability with the exception of instruments related to share-based compensation issued to employees or directors.

Fair Value of Financial Instruments

The carrying amounts reported in the condensed consolidated balance sheets for cash and cash equivalents, short-term settlement receivable, other current assets and accounts payable approximate their fair value because of the short-term nature of these items.

The fair value of derivative instruments is determined by management with the assistance of an independent third party valuation specialist. Certain derivatives with limited market activity are valued using Level 3 inputs with externally developed models that consider unobservable market parameters. See Note 6.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, Leases (ASU 2016-02), which amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. ASU 2016-02 will be effective beginning in the first quarter of 2019. Early adoption of ASU 2016-02 is permitted. The new standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The Company is currently evaluating the impact of adopting ASU 2016-02 on our condensed consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*. This ASU amends the principal versus agent guidance in ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which was issued in May 2014 (ASU 2014-09). Further, in April 2016, the FASB issued ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. This ASU also amends ASU 2014-09 and is related to the identification of performance obligations and accounting for licenses. The effective date and transition requirements for both of these amendments to ASU 2014-09 are the same as those of ASU 2014-09, which was deferred for one year by ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*. That is, the guidance under these standards is to be applied using a full retrospective method or a modified retrospective method, as outlined in the guidance, and is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted only for annual periods, and interim period within those annual periods, beginning after December 15, 2016. The Company is currently evaluating the provisions of each of these standards and assessing their impact on the Company s condensed consolidated financial statements and disclosures.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. This ASU makes targeted amendments to the accounting for employee share-based payments. This guidance is to be applied using various transition methods such as full retrospective, modified retrospective, and prospective based on the criteria for the specific amendments as outlined in the guidance. The guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Early adoption is permitted, as long as all of the amendments are adopted in the same period. The Company is currently evaluating the provisions of this guidance and assessing its impact on the Company s condensed consolidated financial statements and disclosures.

In March 2016, the FASB issued ASU 2016-03, *Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments*, which clarifies the requirements for assessing whether contingent call or put options that can accelerate the repayment of principal on debt instruments are clearly and closely related to their debt hosts. This guidance will be effective for annual reporting periods beginning after December 15, 2016, including interim periods within those annual reporting periods, and early adoption is permitted. The Company is currently evaluating the provisions of this guidance and assessing its impact on the Company s condensed consolidated financial statements and disclosures.

In September 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,* which clarifies whether the following items should be categorized as operating, investing or financing in the statement of cash flows: (i) debt prepayments and extinguishment costs, (ii) settlement of zero-coupon debt, (iii) settlement of contingent consideration, (iv) insurance proceeds, (v) settlement of corporate-owned life insurance (COLI) and bank-owned life insurance (BOLI) policies, (vi) distributions from equity method investees, (vii) beneficial interests in securitization transactions, and

(viii) receipts and payments with aspects of more than one class of cash flows. The new standard takes effect in 2018 for public companies. If an entity elects early adoption, it must adopt all of the amendments in the same period. The Company is currently evaluating the provisions of this guidance and assessing its impact on the Company s condensed consolidated financial statements and disclosures.

Reclassifications

Certain prior period amounts have been reclassified for comparative purposes to conform to the fiscal 2016 presentation. These reclassifications have no impact on the previously reported net loss.

Basic and Diluted Loss Per Common Share

Basic loss per share is computed by dividing the net loss by the weighted average number of shares of common stock outstanding during the period. Diluted loss per share is computed using the weighted average number of common shares and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of the incremental common shares issuable upon the exercise of warrants and stock options (using the treasury stock method). Diluted loss per share excludes the shares issuable upon the conversion of the exercise of stock options and warrants from the calculation of net loss per share as their effect would be anti-dilutive. Loss per share excludes the impact of outstanding options and warrants as they are antidilutive. Potential common shares excluded from the calculation at September 30, 2016 and 2015, respectively, relate to 101,821,186 and 78,607,893 from warrants, 5,000,000 and 9,545,214 from options and 1,810,000 and 0 from convertible preferred stock.

4. Equity Transactions

Common Stock Issued for Services

During the three months ended March 31, 2016, the Company issued 51,745 shares of common stock to consultants in exchange for services. Consulting costs charged to operations were $20,163. During the three months ended March 31, 2015, the Company issued 75,000 shares of common stock to consultants in exchange for services. Consulting costs charged to operations were $64,000.

During the three months ended June 30, 2015, the Company issued 75,000 shares of common stock to consultants in exchange for services. Consulting costs charged to operations were $63,000.

During the three months ended September 30, 2015, the Company issued 78,877 shares of common stock to consultants in exchange for services. Consulting costs charged to operations were $38,439.

Warrant Activity

During the three months ended March 31, 2016, 1,048,494 warrants expired. During the three months ended March 31, 2015, the Company issued 3,000 fully vested warrants to consultants in exchange for services. Consulting costs charged to operations were $1,632. During the three months ended March 31, 2015, 3,693,898 warrants expired.

During the three months ended June 30, 2016, 1,757,253 warrants expired. During the three months ended June 30, 2016, employees of the Company forfeited 3,830,000 stock options. During the three months ended June 30, 2015, the Company issued 100,000 fully vested warrants to consultants in exchange for services, and charged to consulting costs $53,582. During the three months ended June 30, 2015, 1,161,790 warrants expired.

During the three months ended September 30, 2016, 53,500 warrants were forfeited. During the three months ended September 30, 2015, the Company issued 79,500 fully vested warrants to consultants in exchange for services. Consulting costs charged to operations were $24,262. During the three months ended September 30, 2015, 1,152,135 warrants were forfeited.

Warrant Exchange Programs

As of December 28, 2015, the Company had outstanding warrants to purchase an aggregate of 59,861,601 shares of common stock, which were issued between January 6, 2011 and November 1, 2015 in transactions exempt from registration under the Securities Act (the Existing Warrants). Each Existing Warrant has an exercise price of between $1.00 and $3.00 per share, and expires between January 6, 2016 and November 1, 2020. On December 31, 2015, the Company offered pursuant to an Offer Letter/Prospectus 59,861,601 shares of its common stock for issuance upon exercise of the Existing Warrants. The shares issued upon exercise of the Existing Warrants are unrestricted and freely transferable. The Offer was to temporarily modify the terms of the Existing Warrants so that each holder who tendered Existing Warrants during the Offer Period for early exercise were able to do so at a discounted exercise price of $0.50 per share. Each Existing Warrant holder who tendered Existing Warrants for early exercise during the Offer Period received, in addition to the shares of Common Stock purchased upon exercise, an equal number of new warrants to purchase common stock, with an exercise price of $0.85 per share, expiring June 19, 2020 (the Replacement Warrants). The modification of the exercise price of the Existing Warrants and the Replacement Warrants are treated as an inducement to enter into the exchange offer and were accounted for as of the closing date. The exchange offer expired at 4:00 p.m., Eastern Time, on March 28, 2016. The Company accepted for purchase approximately 7,798,507 Existing Warrants properly tendered, resulting in the issuance of approximately 7,798,507 shares of common stock upon exercise of Existing Warrants and the issuance of approximately 7,798,507 Replacement Warrants, resulting in gross proceeds of $3,899,254 upon closing of the exchange offer. Maxim Group LLC and Network 1 Financial Securities, Inc. received a total of $264,214 in placement agent fees and 467,910 warrants with a cash exercise price of $0.85 per share which expire on June 19, 2020, unless sooner exercised. In connection with the exchange offer, a warrant incentive expense totaling $2,718,407 was recorded. The value was determined using the Black-Scholes option-pricing model between the Existing Warrants exchanged and the common stock and Replacement Warrants received.

On May 13, 2016, the Company offered pursuant to an Offer Letter/Prospectus 51,149,594 shares of its common stock for issuance upon exercise of the Existing Warrants. The Offer was to temporarily modify the terms of the Existing Warrants so that each holder who tendered Existing Warrants during the Offer Period for early exercise were able to do so at a discounted exercise price of $0.75 per share. Each Existing Warrant holder who tendered Existing Warrants for early exercise during the Offer Period were to receive, in addition to the shares of Common Stock purchased upon exercise, an equal number of new warrants to purchase common stock, with an exercise price of $0.85 per share, expiring June 19, 2020 (the Replacement Warrants). The exchange offer expired at 4:00 p.m., Eastern Time, on July 28, 2016 with no warrants tendered.

August 2016 Public Offering

On August 25, 2016, the Company filed the Certificate of Designation of Preferences, Rights and Limitations of the Series B Convertible Preferred Stock with the Delaware Secretary of State (the Certificate of Designation). The Certificate of Designation provides for the issuance of the Series B Convertible Preferred Stock, par value $0.001 per share (the Preferred Stock). In the event of the Company s liquidation, dissolution, or winding up, holders of Preferred Stock will be entitled to receive the amount of cash, securities or other property to which such holder would be entitled to receive with respect to such shares of Preferred Stock if such shares had been converted to Common Stock immediately prior to such event (without giving effect for such purposes to any beneficial ownership limitation), subject to the preferential rights of holders of any class or series of the Company s capital stock specifically ranking by its terms senior to the Preferred Stock as to distributions of assets upon such event, whether voluntarily or involuntarily. The Preferred Stock has no voting rights.

The holders of Preferred Stock will be entitled to receive cumulative dividends at the rate per share of 8% per annum of the stated value per share, until the fifth anniversary of the date of issuance of the Preferred Stock. The dividends become payable, at the Company s option in either cash or in shares of Common Stock, (i) upon any conversion of the Preferred Stock, (ii) on each such other date as the Board may determine, subject to written consent of the holders of Preferred Stock holding a majority of the then issued and outstanding Preferred Stock, (iii) upon the Company s liquidation, dissolution or winding up, and (iv) upon occurrence of a fundamental transaction, which includes any merger or consolidation, sale of all or substantially all of the Company s assets, exchange or conversion of all of the Common Stock by tender offer, exchange offer or reclassification; provided, however, that if Preferred Stock is converted into shares of Common Stock at any time prior to the fifth anniversary of the date of issuance of the Preferred Stock, the holder will receive a make-whole payment in an amount equal to all of the dividends that, but for the early conversion, would have otherwise accrued on the applicable shares of Preferred Stock being converted for the period commencing on the conversion date and ending on the fifth anniversary of the date of issuance, less the amount of all prior dividends paid on such converted Preferred Stock before the date of conversion. Make-whole payments are payable at the Company s option in either cash or in shares of Common Stock. With respect to any dividend payments and make-whole payments paid in shares of Common Stock, the number of shares of Common Stock to be issued to a holder of Preferred Stock will be an amount equal to the quotient of (i) the amount of the dividend payable to such holder divided by (ii) the conversion price then in effect. The dividends related to preferred stock that was not converted during the three months ended September 30, 2016 of $38,432 represent an in-kind dividend.

On August 30, 2016, the Company closed a public offering of 240,000 shares of its Preferred Stock (which are initially convertible into an aggregate of 24,000,000 shares of the Company s common stock) and warrants initially exercisable to purchase an aggregate of 24,000,000 shares of common stock at an exercise price of $0.275 per share of common stock (the August 2016 Warrants). The Preferred Stock and August 2016 Warrants were sold together at a price of $25.00 for a combination of one share of Preferred Stock and 100 August 2016 Warrants to purchase one share of common stock each, resulting in aggregate net proceeds of $5,288,530 (gross proceeds of $6,000,000 less issuance costs of $711,470) to the Company. Maxim Group LLC served as placement agent for the transaction.

The conversion feature embedded within the Preferred Stock is subject to anti-dilution price protection upon the issuance of equity or equity-linked securities within 60 trading days from the date of issuance of the Preferred Stock at an effective common stock purchase price of less than the conversion price of the Preferred Stock then in effect, subject to certain exceptions as provided in the Certificate of Designation. In addition, if the conversion price in effect on the 60th trading day following the date of issuance of the Preferred Stock exceeds 85% of the average of the 45 lowest volume weighted average trading prices of the common stock during the period commencing on the date of issuance of the Preferred Stock and ending on the 60th trading day following the date of issuance of the Preferred Stock (as adjusted for stock splits, stock dividends, recapitalizations, reorganizations, reclassification, combinations, reverse stock splits or other similar events during such period) (the Adjusted Conversion Price), then the conversion price shall be reset to the Adjusted Conversion Price and shall be further subject to adjustment as provided in the Certificate of Designation. In either case, if a holder of Preferred Stock converts its shares of Preferred Stock prior to any such price reset event, then such holder will receive additional shares of common stock equal to the number of shares of common stock that would have been issued assuming for such purposes the Adjusted Conversion Price were in effect at such time less the shares issued at the then Conversion Price (subject to being held in abeyance based on beneficial ownership limitations); provided, however, that only the initial purchaser of Preferred Stock and August 2016 Warrants in the Offering will receive the benefit of such price protection and such issuance of shares of common stock upon a price reset event. During the three months ended September 30, 2016, investors converted 221,900 shares of Preferred Stock and Preferred Stock dividends (including make-whole payments) into 31,066,000 shares of Common Stock.

The August 2016 Warrants expire on August 30, 2021. The exercise price of the August 2016 Warrants is subject to appropriate adjustment in the event of certain stock dividends and distributions, stock splits, stock combinations, reclassifications or similar events affecting the common stock. In addition, if the exercise price in effect on the 60th trading day following the date of issuance of the August 2016 Warrants exceeds 85% of the average of the 45 lowest volume weighted average trading prices of the common stock during the period commencing on the date of issuance of the August 2016 Warrants and ending on the 60th trading day following the date of issuance of the August 2016 Warrants (as adjusted for stock splits, stock dividends, recapitalizations, reorganizations, reclassification, combinations, reverse stock splits or other similar events during such period) (the Adjusted Exercise Price), then (i) the exercise price shall be reset to the Adjusted Exercise Price (and without giving effect to any prior conversions) and shall be further subject to adjustment as provided in the August 2016 Warrants, and (ii) the number of shares of common stock issuable upon exercise of the August 2016 Warrants will be reset to equal the number of shares of common stock issuable upon conversion of Preferred Stock after giving effect to the adjusted conversion price or adjusted exercise price, as applicable. If a holder of August 2016 Warrants exercises its August 2016 Warrants prior to such repricing, then such holder will receive shares of common stock equal to the difference between the exercise price and the Adjusted Exercise Price; provided, however, that only the initial purchaser of Preferred Stock and August 2016 Warrants in the Offering will receive the benefit of such price protection and such issuance of shares of common stock upon a price reset event.

The Series B Preferred Stock does not contain a redemption provision and an overall analysis of its features performed by the Company determined that it is more akin to equity and therefore, has been classified within stockholders equity on the condensed consolidated balance sheet. While the embedded conversion option (ECO) is subject to an anti-dilution price adjustment, since the ECO is clearly and closely related to the equity host, it is not required to be bifurcated and accounted for as a derivative liability under ASC 815. To analyze whether the Preferred Stock included a beneficial conversion feature (BCF), the Company allocated the $6,000,000 of the gross proceeds between the August 2016 Warrants and the Preferred Stock. The Company allocated the commitment date fair value of $3,678,989 to the August 2016 Warrants (which is allocated at fair value because the August 2016 Warrants were determined to be derivative liabilities as discussed in Note 6) resulting in an amount allocated to the Preferred Stock of $2,321,011. Next, the Company computed the number of shares of Common Stock issuable at the commitment date to be 24,000,000 in order to arrive at an effective conversion price of $0.097 per share. When compared to the market price of the Company s Common Stock of $0.127 per share as of the commitment date, it was determined that a BCF did exist and, as a result, the Company recorded a contractual dividend in net loss available to common stockholders of $726,989.

During the three months ended September 30, 2016, a number of investors converted their Preferred Stock such that they were entitled to dividends, including a make-whole payment, that the Company elected to pay in shares of Common Stock. As a result, the Company issued 8,876,000 shares of Common Stock related to the Preferred Stock dividends during the three months ended September 30, 2016. Since the investors did not pay any additional consideration for such shares (and the impact of the time-based dividend was immaterial due to the majority of conversions occurring on the date of issuance), the Company recognized dividend paid in kind to preferred shareholders of $2,219,000 associated with the make-whole payment which was equal to the number of shares multiplied by the market price of the Company s Common Stock of $0.127 per share as of the commitment date. The net carrying value of the Preferred Stock is $2,045,789 (gross proceeds of $6,000,000 less preferred stock discount associated with August 20