

VistaGen Therapeutics, Inc.  
Form 10-Q  
February 14, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2013

or

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: 000-54014

VistaGen Therapeutics, Inc.

(Exact name of registrant as specified in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

20-5093315  
(I.R.S. Employer  
Identification No.)

343 Allerton Avenue  
South San Francisco, CA 94080

(Address of principal executive offices including zip code)

(650) 577-3600

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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 x No o

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  Smaller reporting company

Edgar Filing: VistaGen Therapeutics, Inc. - Form 10-Q

(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  
o No x

As of February 10, 2014, 23,361,877 shares of the registrant's common stock, \$0.001 par value, were issued and outstanding.

---

---

---

Table of Contents

VistaGen Therapeutics, Inc.  
Quarterly Report on Form 10-Q  
for the Quarter Ended December 31, 2013

TABLE OF CONTENTS

	Page
PART I. FINANCIAL INFORMATION	
<u>Item 1. Condensed Consolidated Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets at December 31, 2013 and March 31, 2013</u>	1
<u>Condensed Consolidated Statements of Operations and Comprehensive Loss for the three and nine months ended December 31, 2013 and 2012</u>	2
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended December 31, 2013 and 2012</u>	3
<u>Notes to the Condensed Consolidated Financial Statements</u>	4
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 4. Controls and Procedures</u>	30
PART II. OTHER INFORMATION	
<u>Item 1. Legal Proceedings</u>	30
<u>Item 1A. Risk Factors</u>	30
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	31
<u>Item 3. Defaults Upon Senior Secured Securities</u>	31
<u>Item 6. Exhibits</u>	31
<u>SIGNATURES</u>	33

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements (Unaudited)

VISTAGEN THERAPEUTICS, INC.  
(a development stage company)  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Amounts in Dollars, except share amounts)

	December 31, 2013 (Unaudited)	March 31, 2013 (Note 2)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 20,700	\$ 638,100
Prepaid expenses and other current assets	70,600	33,700
Total current assets	91,300	671,800
Property and equipment, net	190,700	180,700
Security deposits and other assets	46,900	29,000
Total assets	\$ 328,900	\$ 881,500
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
Current liabilities:		
Accounts payable	\$ 2,256,600	\$ 1,353,600
Accrued expenses	532,500	342,900
Advance from officer	10,300	-
Current portion of notes payable and accrued interest	638,600	617,200
Current portion of notes payable to related parties and accrued interest	99,500	93,000
Convertible promissory notes and accrued interest, net of discount of \$423,900 at December 31, 2013	169,200	-
Capital lease obligations	5,600	7,600
Total current liabilities	3,712,300	2,414,300
Non-current liabilities:		
Senior secured convertible promissory notes, net of discount of \$2,135,800 at December 31, 2013 and \$1,963,100 at March 31, 2013 and accrued interest	1,781,200	1,425,700
Notes payable, net of discount of \$929,000 at December 31, 2013 and \$1,142,600 at March 31, 2013 and accrued interest	2,479,200	2,091,800
Notes payable to related parties, net of discount of \$115,000 at December 31, 2013 and \$147,200 at March 31, 2013 and accrued interest	1,209,700	1,106,000
Warrant liability	2,717,100	6,394,000
Deferred rent liability	97,300	-
Capital lease obligations	2,400	6,100
Total non-current liabilities	8,286,900	11,023,600
Total liabilities	11,999,200	13,437,900
Commitments and contingencies		

Stockholders' deficit:			
Preferred stock, \$0.001 par value; 10,000,000 shares, including 500,000 Series A shares, authorized at December 31, 2013 and March 31, 2013; 500,000 Series A shares issued and outstanding at December 31, 2013 and March 31, 2013, respectively		500	500
Common stock, \$0.001 par value; 200,000,000 shares authorized at December 31, 2013 and March 31, 2013; 25,295,185 and 23,480,169 shares issued at December 31, 2013 and March 31, 2013, respectively		25,300	23,500
Additional paid-in capital		61,282,400	59,266,000
Treasury stock, at cost, 2,713,308 shares of common stock held at December 31, 2013 and March 31, 2013		(3,968,100 )	(3,968,100 )
Note receivable from sale of common stock		(198,100 )	(209,100 )
Deficit accumulated during development stage		(68,812,300 )	(67,669,200 )
Total stockholders' deficit		(11,670,300 )	(12,556,400 )
Total liabilities and stockholders' deficit	\$	328,900	\$ 881,500

See accompanying notes to Condensed Consolidated Financial Statements.

Table of Contents

## VISTAGEN THERAPEUTICS, INC.

(a development stage company)

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Unaudited)

(Amounts in dollars, except share amounts)

	Three Months Ended December 31,		Nine Months Ended December 31,		May 26, 1998 (Inception) Through December 31, 2013
	2013	2012	2013	2012	
<b>Revenues:</b>					
Grant revenue	\$ -	\$ -	\$ -	\$ 200,400	\$ 12,963,100
Collaboration revenue	-	-	-	-	2,283,600
Other	-	-	-	-	1,123,500
Total revenues	-	-	-	200,400	16,370,200
<b>Operating expenses:</b>					
Research and development	551,300	1,119,600	1,916,100	3,092,200	31,471,800
Acquired in-process research and development	-	-	-	-	7,523,200
General and administrative	897,000	799,000	2,047,500	2,430,200	32,728,600
Total operating expenses	1,448,300	1,918,600	3,963,600	5,522,400	71,723,600
Loss from operations	(1,448,300 )	(1,918,600 )	(3,963,600 )	(5,322,000 )	(55,353,400)
<b>Other expenses, net:</b>					
Interest expense, net	(360,900 )	(235,400 )	(1,000,500 )	(611,700 )	(11,362,700)
Change in warrant and put and note extension option liabilities	1,940,200	357,800	3,823,700	357,800	2,606,400
Loss on early extinguishment of debt	-	(3,537,000 )	-	(3,537,000 )	(4,761,300 )
Other income	-	-	-	-	81,900
Income (loss) before income taxes	131,000	(5,333,200 )	(1,140,400 )	(9,112,900 )	(68,789,100)
Income taxes	-	(1,800 )	(2,700 )	(3,700 )	(23,200 )
Net income (loss)	131,000	(5,335,000 )	(1,143,100 )	(9,116,600 )	(68,812,300)
Deemed dividend on Series A Preferred stock	-	(10,193,200)	-	(10,193,200)	(10,193,200)
Net income (loss) attributable to common stockholders	\$ 131,000	\$ (15,528,200)	\$ (1,143,100 )	\$ (19,309,800)	\$ (79,005,500)
Basic net income (loss) attributable to common stockholders per common share	\$ 0.01	\$ (0.85 )	\$ (0.05 )	\$ (1.11 )	
Diluted net loss attributable to common stockholders per common share	\$ (0.02 )	\$ (0.85 )	\$ (0.05 )	\$ (1.11 )	

Edgar Filing: VistaGen Therapeutics, Inc. - Form 10-Q

Weighted average shares  
used in computing:

Basic net income (loss)  
attributable to common  
stockholders per common  
share

22,210,573      18,292,301      21,554,929      17,411,993

Diluted net loss attributable  
to common stockholders  
per common share

22,210,573      18,292,301      21,554,929      17,411,993

Comprehensive income  
(loss)

\$ 131,000      \$ (5,335,000 )      \$ (1,143,100 )      \$ (9,116,600 )      \$ (68,812,300)

See accompanying notes to Condensed Consolidated Financial Statements.

Table of Contents

VISTAGEN THERAPEUTICS, INC.  
(a development stage company)  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(Amounts in Dollars)

	Nine Months Ended December 31,		Period From May 26, 1998 (Inception) Through December 31, 2013
	2013	2012	
Cash flows from operating activities:			
Net loss	\$(1,143,100)	\$(9,116,600)	\$(68,812,200)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	40,200	21,000	817,700
Amortization of discounts on convertible and promissory notes	356,100	352,200	5,031,700
Change in warrant liability and put and note term extension option liabilities	(3,823,700)	(357,800 )	(2,606,500 )
Stock-based compensation	893,700	962,000	6,489,200
Expense related to modification of warrants	174,500	440,700	1,424,400
Non-cash rent and relocation expense	56,700	-	56,700
Interest income on note receivable for stock purchase	(400 )	(26,800 )	(28,000 )
Fair value of common stock granted for services following the Merger	-	340,000	846,000
Fair value of warrants granted for services and interest following the Merger	54,000	150,000	748,300
Gain on currency fluctuation	(30,100 )	(37,100 )	(83,100 )
Fair value of additional warrants granted pursuant to exercises of modified warrants	-	35,900	173,900
Loss on settlements of accounts payable	-	78,300	78,300
Acquired in-process research and development	-	-	7,523,200
Loss on early extinguishment of debt	-	3,537,000	4,761,300
Fair value of Series C preferred stock, common stock, and warrant granted for services prior to the Merger	-	-	3,150,900
Fair value of common stock issued for note term modification	-	-	22,400
Consulting services by related parties settled by issuing promissory notes	-	-	44,600
Gain on sale of assets	-	-	(16,700 )
Changes in operating assets and liabilities:			
Unbilled contract payments receivable	-	106,200	-
Prepaid expenses and other current assets	56,100	(16,500 )	97,800
Security deposits and other assets	(17,900 )	-	(46,900 )
Accounts payable and accrued expenses, including accrued interest	1,725,000	1,051,500	17,696,400
Deferred revenues	-	(13,200 )	-
Net cash used in operating activities	(1,658,900)	(2,493,200)	(22,630,600)
Cash flows from investing activities:			
Purchases of equipment, net	(9,600 )	(131,100 )	(825,800 )
Net cash used in investing activities	(9,600 )	(131,100 )	(825,800 )
Cash flows from financing activities:			



Edgar Filing: VistaGen Therapeutics, Inc. - Form 10-Q

Net proceeds from issuance of common stock and warrants, including Units	597,900	480,600	4,583,000
Proceeds from exercise of modified warrants	264,200	262,100	1,692,600
Net proceeds from issuance of Platinum notes and warrants	250,000	2,222,100	7,172,100
Advance from officer	64,000	-	64,000
Proceeds from issuance of notes under line of credit	-	-	200,000
Proceeds from issuance of 7% note payable to founding stockholder	-	-	90,000
Net proceeds from issuance of 7% convertible notes	-	-	575,000
Net proceeds from issuance of 10% convertible notes and warrants	-	-	1,655,000
Net proceeds from issuance of preferred stock and warrants	-	-	4,198,600
Net proceeds from issuance of notes and warrants from 2006 to 2010	-	-	4,851,800
Net proceeds from issuance of February 2012 12% convertible notes and warrants	-	-	466,500
Repayment of capital lease obligations	(5,700 )	(15,300 )	(123,100 )
Repayment of notes	(119,300 )	(382,000 )	(1,948,400 )
Net cash provided by financing activities	1,051,100	2,567,500	23,477,100
Net (decrease) increase in cash and cash equivalents	(617,400 )	(56,800 )	20,700
Cash and cash equivalents at beginning of period	638,100	81,000	-
Cash and cash equivalents at end of period	\$20,700	\$24,200	\$20,700

See accompanying notes to Condensed Consolidated Financial Statements.

Table of Contents

VISTAGEN THERAPEUTICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. History and Organization

VistaGen Therapeutics, Inc., a Nevada corporation (“VistaGen” or the “Company”), is a biotechnology company with expertise in human pluripotent stem cell technology. The Company is applying and developing its stem cell technology for drug rescue, drug discovery and regenerative medicine. The Company’s primary goal is to use its stem cell technology platform, Human Clinical Trials in a Test Tube™, and its network of strategic relationships, to design and generate novel, proprietary, safer variants, which the Company refers to as Drug Rescue Variants™, of once-promising small molecule drug candidates discovered, developed and ultimately discontinued by pharmaceutical companies and others prior to market approval due to unexpected heart or liver safety concerns. The Company refers to these once-promising drug candidates that are now potentially suitable for drug rescue as Drug Rescue Candidates™. The Company’s drug rescue strategy is to leverage (i) substantial prior investment in discovery and development of Drug Rescue Candidates by others, (ii) its unique insight into heart and liver biology from its stem cell-derived bioassay systems, and (iii) medicinal chemistry to generate proprietary Drug Rescue Variants for license and sale to pharmaceutical companies and others.

In parallel with its drug rescue activities, VistaGen plans to explore, internally and/or through sponsored external programs, pilot nonclinical development opportunities relating to small molecule drug discovery and/or regenerative medicine focused on blood, bone, cartilage, heart, liver and pancreas (insulin-producing beta islet) cells. Each of these drug discovery and regenerative medicine programs would be based on the proprietary differentiation and production capabilities of the Company’s Human Clinical Trials in a Test Tube™ platform.

AV-101 is VistaGen's orally-available, small molecule prodrug candidate. AV-101 has successfully completed Phase 1 clinical development in the United States for treatment of neuropathic pain, a serious and chronic condition causing pain after an injury or disease of the peripheral or central nervous system that affects millions of people worldwide. The NIH awarded VistaGen approximately \$8.8 million for preclinical and Phase 1 clinical development of AV-101.

VistaGen is in the development stage and, since inception, has devoted substantially all of its time and efforts to human pluripotent stem cell technology research and development, including, among other things, bioassay system development, small molecule drug development, creating, protecting and patenting intellectual property, recruiting personnel and raising working capital.

VistaGen Therapeutics, Inc., a California corporation incorporated on May 26, 1998 (“VistaGen California”), is a wholly-owned subsidiary of the Company. As described more completely in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2013, pursuant to a strategic merger transaction on May 11, 2011, the Company acquired all outstanding shares of VistaGen California in exchange for 6,836,452 shares of the Company’s common stock (the “Merger”), and assumed all of VistaGen California’s pre-Merger obligations. The Condensed Consolidated Financial Statements of the Company included in this report also include the accounts of VistaGen California’s two wholly-owned subsidiaries, Artemis Neuroscience, Inc., a Maryland corporation, and VistaStem Canada, Inc., a corporation organized under the laws of Ontario, Canada.

Note 2. Basis of Presentation and Going Concern

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not contain all of the

information and footnotes required for complete consolidated financial statements. In the opinion of management, the accompanying unaudited Condensed Consolidated Financial Statements reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company's interim financial information. The accompanying Condensed Consolidated Balance Sheet at March 31, 2013 has been derived from the Company's audited consolidated financial statements at that date but does not include all disclosures required by U.S. GAAP. The operating results for the three and nine months ended December 31, 2013 are not necessarily indicative of the operating results to be expected for the Company's fiscal year ending March 31, 2014 or for any other interim period or any other future period.

The accompanying unaudited Condensed Consolidated Financial Statements and notes to Condensed Consolidated Financial Statements should be read in conjunction with the Company's audited Consolidated Financial Statements for the fiscal year ended March 31, 2013 contained in its Annual Report on Form 10-K, as filed with the United States Securities and Exchange Commission ("SEC").

-4-

---

## Table of Contents

The accompanying Condensed Consolidated Financial Statements have been prepared assuming the Company will continue as a going concern. As a development stage company without sustainable revenues, the Company has experienced recurring losses and negative cash flows from operations. From inception through December 31, 2013, the Company has a deficit accumulated during its development stage of \$68.8 million. The Company expects these conditions to continue for the foreseeable future as it expands its Human Clinical Trials in a Test Tube™ platform and executes its drug rescue programs and, potentially, regenerative medicine programs.

Since its inception in May 1998, the Company has financed its operations and technology acquisitions primarily through the issuance and sale of equity and debt securities, including convertible promissory notes and short-term promissory notes, for cash proceeds of approximately \$25.4 million, as well as from an aggregate of approximately \$16.4 million of government research grant awards, strategic collaboration payments and other revenues. Additionally, the Company has issued equity securities with an approximate value at issuance of \$12.6 million in non-cash settlements of certain liabilities, including liabilities for professional services rendered to the Company or as compensation for such services. At December 31, 2013, the Company had approximately \$20,700 in cash and cash equivalents. Such cash and cash equivalents are not sufficient to enable the Company to fund its planned operations, including expected cash expenditures of approximately \$5 million through the next twelve months. However, on April 8, 2013, the Company entered into a Securities Purchase Agreement (as amended, the “Securities Purchase Agreement”) with Autilion AG, a company organized and existing under the laws of Switzerland (“Autilion”). Under the terms of the Securities Purchase Agreement, Autilion is contractually obligated to purchase an aggregate of 72.0 million restricted shares of the Company’s common stock at a purchase price of \$0.50 per share for aggregate cash consideration of \$36.0 million (the “Autilion Financing”). At December 31, 2013, the Company had completed a nominal initial closing of \$25,000 and issued 50,000 restricted shares of its common stock under the Securities Purchase Agreement. Although there can be no assurance that an additional closing of the Autilion Financing will occur, in early January 2014, Autilion informed the Company of its expectation that the Company will receive the full \$36.0 million committed under the terms of the Securities Purchase Agreement by mid-February 2014. As of the date of this report, there has not been a subsequent closing of the Autilion Financing. To provide working capital for operations prior to any closing of the Autilion Financing, from December 31, 2013 through the date of this report, the Company completed private placements of its securities resulting in aggregate cash proceeds of \$390,000, as described in Note 11, Subsequent Events.

To the extent necessary, the Company may also seek to meet its cash needs and fund its working capital requirements through a combination of additional private placements of its securities, which may include both debt and equity securities issued to Platinum Long Term Growth Fund VII (“Platinum”), currently the Company’s largest institutional investor, and/or other investors, research and development collaborations, license fees and government grant awards. Additionally, the Company believes that its participation in strategic collaborations, including licensing transactions, may provide additional cash in support of its future working capital requirements. If the Company is unable to complete the Autilion Financing in a timely manner or to obtain sufficient financing from other sources, if required, it may be required to reduce, defer, or discontinue certain of its research and development activities or it may not be able to continue as a going concern.

### Note 3. Summary of Significant Accounting Policies

#### Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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. Significant estimates include those relating to revenue recognition, share-based compensation, and assumptions that have been used to value warrants, warrant modifications, and

previous put option and note term extension liabilities.

#### Revenue Recognition

Although the Company does not currently have any such arrangements, it has historically generated revenue principally from collaborative research and development arrangements, technology access fees and government grants. Revenue arrangements with multiple components are divided into separate units of accounting if certain criteria are met, including whether the delivered component has stand-alone value to the customer. Consideration received is allocated among the separate units of accounting based on their respective selling prices. The selling price for each unit is based on vendor-specific objective evidence, or VSOE, if available, third party evidence if VSOE is not available, or estimated selling price if neither VSOE nor third party evidence is available. The applicable revenue recognition criteria are then applied to each of the units.

-5-

---

## Table of Contents

The Company recognizes revenue when the four basic criteria of revenue recognition are met: (1) a contractual agreement exists; (2) the transfer of technology has been completed or services have been rendered; (3) the fee is fixed or determinable; and (4) collectability is reasonably assured. For each source of revenue, the Company complies with the above revenue recognition criteria in the following manner:

Collaborative arrangements typically consist of non-refundable and/or exclusive technology access fees, cost reimbursements for specific research and development spending, and various milestone and future product royalty payments. If the delivered technology does not have stand-alone value, the amount of revenue allocable to the delivered technology is deferred. Non-refundable upfront fees with stand-alone value that are not dependent on future performance under these agreements are recognized as revenue when received, and are deferred if the Company has continuing performance obligations and has no objective and reliable evidence of the fair value of those obligations. The Company recognizes non-refundable upfront technology access fees under agreements in which it has a continuing performance obligation ratably, on a straight-line basis, over the period in which the Company is obligated to provide services. Cost reimbursements for research and development spending are recognized when the related costs are incurred and when collectability is reasonably assured. Payments received related to substantive, performance-based “at-risk” milestones are recognized as revenue upon achievement of the milestone event specified in the underlying contracts, which represent the culmination of the earnings process. Amounts received in advance are recorded as deferred revenue until the technology is transferred, costs are incurred, or a milestone is reached.

Technology license agreements typically consist of non-refundable upfront license fees, annual minimum access fees and/or royalty payments. Non-refundable upfront license fees and annual minimum payments received with separable stand-alone values are recognized when the technology is transferred or accessed, provided that the technology transferred or accessed is not dependent on the outcome of the continuing research and development efforts. Otherwise, revenue is recognized over the period of the Company’s continuing involvement.

Government grants, which support the Company’s research efforts on specific projects, generally provide for reimbursement of approved costs as defined in the terms of grant awards. Grant revenue is recognized when associated project costs are incurred.

### Research and Development Expenses

Research and development expenses are composed of both internal and external costs. Internal costs include salaries and employment-related expenses of scientific personnel and direct project costs. External research and development expenses consist primarily of sponsored stem cell research and development costs, costs associated with clinical and non-clinical development of AV-101, the Company’s small molecule prodrug candidate for neuropathic pain, depression and potentially other neurological conditions, and costs related to the application and prosecution of patents related to the Company’s stem cell technology platform, Human Clinical Trials in a Test Tube™, and AV-101. All such costs are charged to expense as incurred.

### Stock-Based Compensation

The Company recognizes compensation cost for all stock-based awards to employees based on the grant date fair value of the award. Stock-based compensation expense is recognized over the period during which the employee is required to perform services in exchange for the award, which generally represents the scheduled vesting period. The Company has no awards with market or performance conditions. For equity awards to non-employees, the Company re-measures the fair value of the awards as they vest and the resulting value is recognized as an expense during the period over which the services are performed.

Edgar Filing: VistaGen Therapeutics, Inc. - Form 10-Q

The table below summarizes stock-based compensation expense included in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss for the quarter and nine months ended December 31, 2013:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2013	2012	2013	2012
Research and development expense:				
Stock option grants, including expense related to modifications	\$ 126,900	\$ 574,700	\$ 240,300	\$ 666,800
Warrants granted to officer in March 2013	33,400	-	100,300	-
	160,300	574,700	340,600	666,800
General and administrative expense:				
Stock option grants, including expense related to modifications	242,100	239,000	352,500	295,200
Warrants granted to officers and directors in March 2013	66,900	-	200,600	-
	309,000	239,000	553,100	295,200
Total stock-based compensation expense	\$ 469,300	\$ 813,700	\$ 893,700	\$ 962,000

-6-

### Table of Contents

During the nine months ended December 31, 2013, the Company granted options to purchase an aggregate of 156,000 shares of its common stock at exercise prices from \$0.40 per share to \$0.82 per share (the quoted market price on the grant dates) to certain employees and consultants. During the quarter ended December 31, 2013, the Company modified certain outstanding options granted from its 2008 Stock Incentive Plan to reduce the exercise price to \$0.40 per share or \$0.50 per share and modified certain options granted from its 1999 Stock Incentive Plan to reduce the exercise price to \$0.50 per share. The expense indicated in the table above for the three and nine months ended December 31, 2013 includes an aggregate of \$252,000 attributable to these modifications. The Company modified certain options during the quarter ended December 31, 2012 and recognized an aggregate of \$788,800 attributable to such modifications in the three and nine month periods ended December 31, 2012. At December 31, 2013, there were options outstanding to purchase 4,705,270 shares of the Company's common stock at a weighted average exercise price of \$0.59 per share.

### Warrant Liability

The Company has issued certain warrants to Platinum and, subject to Platinum's exercise of its rights to exchange shares of the Company's Series A preferred stock that it holds, the Company is also obligated to issue an additional warrant to Platinum, that contain an exercise price adjustment feature in the event the Company subsequently issues additional equity instruments at a price lower than the exercise price of the warrants. The Company accounts for these warrants as non-cash liabilities and estimates their fair value as described in Note 4, Fair Value Measurements; Note 7, Convertible Promissory Notes and Other Notes Payable, and Note 9, Capital Stock. The Company computes the fair value of the warrant liability at each reporting period and the change in the fair value is recorded as non-cash expense or non-cash income. The key component in determining the fair value of the warrant and the related liability is the Company's stock price, which is subject to significant fluctuation and is not under the Company's control. The resulting change in the fair value of the warrant liability on the Company's net income or loss is therefore also subject to significant fluctuation and will continue to be so until all of the warrants are issued and exercised, amended or expire. Assuming all other fair value inputs remain generally constant, the Company will record an increase in the warrant liability and non-cash expense when its stock price increases and a decrease in the warrant liability and non-cash income when its stock price decreases.

### Comprehensive Loss

The Company has no components of other comprehensive loss other than net loss, and accordingly the Company's comprehensive loss is equivalent to its net loss for the periods presented.

### Income (Loss) per Common Share

Basic income (loss) per share of common stock excludes the effect of dilution and is computed by dividing net income (loss) by the weighted-average number of shares of common stock outstanding for the period. Diluted income (loss) per share of common stock reflects the potential dilution that could occur if securities or other contracts to issue shares of common stock were exercised or converted into shares of common stock. In calculating diluted net income (loss) per share, the numerator is adjusted for the change in the fair value of the warrant liability attributable to outstanding warrants, only if dilutive, and the denominator is increased to include the number of potentially dilutive common shares assumed to be outstanding during the period using the treasury stock method. Based on the market price of the Company's common stock for the quarter ended December 31, 2013, no potentially dilutive securities were assumed to be converted into common shares and outstanding during the period for purposes of calculating diluted earnings per share. For all loss periods presented, potentially dilutive securities have been excluded from the computation as their effect would be antidilutive.

Basic net income (loss) and diluted net loss attributable to common stockholders per share was computed as follows:



Edgar Filing: VistaGen Therapeutics, Inc. - Form 10-Q

	Quarters Ended December 31,		Nine Months Ended December 31,	
	2013	2012	2013	2012
Numerator:				
Net income (loss) attributable to common stockholders for basic earnings per share	\$131,100	\$(15,528,200)	\$(1,143,100)	\$(19,309,800)
less: change in fair value of warrant liability attributable to Exchange, Investment and Bridge Warrants issued to Platinum	(620,900 )	-	-	-
Net loss for diluted earnings per share attributable to common stockholders	\$(489,800 )	\$(15,528,200)	\$(1,143,100)	\$(19,309,800)
Denominator:				
Weighted average basic common shares outstanding	22,210,573	18,292,301	21,554,929	17,411,993
Assumed conversion of dilutive securities:				
Warrants to purchase common stock	-	-	-	-
Potentially dilutive common shares assumed converted	-	-	-	-
Denominator for diluted earnings per share - adjusted weighted average shares	22,210,573	18,292,301	21,554,929	17,411,993
Basic net income (loss) attributable to common stockholders per common share	\$0.01	\$(0.85 )	\$(0.05 )	\$(1.11 )
Diluted net loss attributable to common stockholders per common share	\$(0.02 )	\$(0.85 )	\$(0.05 )	\$(1.11 )

-7-

Table of Contents

Potentially dilutive securities excluded in determining diluted net loss per common share are as follows:

	December 31,	
	2013	2012
Series A preferred stock issued and outstanding (1)	15,000,000	15,000,000
Warrant shares issuable to Platinum upon exercise of common stock warrants by Platinum upon exchange of Series A preferred stock under the terms of the October 11, 2012 Note Purchase and Exchange Agreement	7,500,000	7,500,000
Outstanding options under the 2008 and 1999 Stock Incentive Plans	4,705,270	4,966,771
Outstanding warrants to purchase common stock	15,710,885	9,873,034
10% convertible Exchange Note and Investment Notes issued to Platinum in October 2012, February 2013 and March 2013, including accrued interest through December 31, 2013 (2)	7,271,640	4,645,198
10% Convertible note issued to Platinum on July 26, 2013, including accrued interest through December 31, 2013	522,339	-
10% Convertible notes issued as a component of Unit Offering, including accrued interest through December 31, 2013	1,186,097	-
Total	51,896,231	41,985,003

(1) assumes exchange under the terms of the October 11, 2012 Note Exchange and Purchase Agreement with Platinum

(2) assumes conversion under the terms of the October 11, 2012 Note Exchange and Purchase Agreement with Platinum and the terms of the individual notes

#### Recent Accounting Pronouncements

There have been no recent accounting pronouncements or changes in accounting pronouncements during the nine months ended December 31, 2013, as compared to the recent accounting pronouncements described in the Company's Form 10-K for the fiscal year ended March 31, 2013, that are of significance or potential significance to the Company.

#### Note 4. Fair Value Measurements

The Company follows the principles of fair value accounting as they relate to its financial assets and financial liabilities. Fair value is defined as the estimated exit price received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, rather than an entry price that represents the purchase price of an asset or liability. Where available, fair value is based on observable market prices or parameters, or derived from such prices or parameters. Where observable prices or inputs are not available, valuation models are applied. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on several factors, including the instrument's complexity. The required fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels is described as follows:

**Level 1** — Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

**Level 2** — Inputs other than Level 1 that are observable, either directly or indirectly, 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 assets or liabilities.

Level 3 — Unobservable inputs (i.e., inputs that reflect the reporting entity's own assumptions about the assumptions that market participants would use in estimating the fair value of an asset or liability) are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

Table of Contents

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Where quoted prices are available in an active market, securities are classified as Level 1 of the valuation hierarchy. If quoted market prices are not available for the specific financial instrument, then the Company estimates fair value by using pricing models, quoted prices of financial instruments with similar characteristics or discounted cash flows. In certain cases where there is limited activity or less transparency around inputs to valuation, financial assets or liabilities are classified as Level 3 within the valuation hierarchy.

The Company does not use derivative instruments for hedging of market risks or for trading or speculative purposes. In conjunction with the issuance of the Senior Secured Convertible Promissory Notes and related Exchange Warrant and Investment Warrants to Platinum in October 2012, February 2013, March 2013, and the potential issuance of the Series A Exchange Warrant (see Note 9, Capital Stock), all pursuant to the Note Exchange and Purchase Agreement of October 2012 between the Company and Platinum (see Note 7, Convertible Promissory Notes and Other Notes Payable), and the issuance of the warrant related to the Senior Secured Convertible Promissory Note issued to Platinum in July 2013, the Company determined that the warrants included certain exercise price adjustment features requiring the warrants to be treated as liabilities, which were recorded at their estimated fair value. The Company determined the initial fair value of the warrant liability using a Monte Carlo simulation model with Level 3 inputs or the Black-Scholes Option Pricing model. Inputs used to determine fair value include the remaining contractual term of the warrants, risk-free interest rates, expected volatility of the price of the underlying common stock, and the probability of a financing transaction that would trigger a reset in the warrant exercise price, and, in the case of the Series A Exchange Warrant, the probability of Platinum's exchange of the shares of Series A preferred stock it holds into shares of common stock. Changes in the fair value of these warrant liabilities since March 31, 2013 have been recognized as a non-cash component of other expense, net in the Condensed Consolidated Statements of Operations and Comprehensive Loss for the quarter and nine months ended December 31, 2013.

The fair value hierarchy for the warrant liability measured at fair value on a recurring basis is as follows:

	Total Carrying Value	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2013:				
Warrant liability	\$2,717,100	\$ -	\$ -	\$ 2,717,100
March 31, 2013:				
Warrant liability	\$6,394,000	\$ -	\$ -	\$ 6,394,000

During the nine month period ended December 31, 2013, there was no significant change to the valuation models used for purposes of determining the fair value of the Level 3 warrant liability. The decline in the market price of the Company's common stock since March 31, 2013 and the reduction in the exercise price of the warrants as described in Note 9, Capital Stock, are the primary factors resulting in the reduction in the warrant liability.

Table of Contents

The changes in Level 3 liabilities measured at fair value on a recurring basis are as follows:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
Balance at March 31, 2013	\$ 6,394,000
Recognition of warrant liability upon issuance of Senior Secured Convertible Promissory Note and warrant to Platinum on July 26, 2013	146,800
Mark to market gain included in net loss	(3,823,700 )
Balance at December 31, 2013	\$ 2,717,100

No assets or other liabilities were carried at fair value at December 31, 2013 or March 31, 2013.

## Note 5. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets is composed of the following at December 31, 2013 and March 31, 2013:

	December 31, 2013	March 31, 2013
Insurance	\$48,100	\$19,700
Legal fees	3,400	3,400
Interest receivable on note receivable from sale of common stock	400	1,600
Technology license fees and all other	18,700	9,000
	\$70,600	\$33,700

## Note 6. Accrued Expenses

Accrued expenses is composed of the following at December 31, 2013 and March 31, 2013:

	December 31, 2013	March 31, 2013
Accrued professional services	\$104,800	\$67,800
Accrued compensation	427,700	219,300
Accrued royalties and license fees	-	25,000
All other	-	30,800
	\$532,500	\$342,900

Table of Contents

## Note 7. Convertible Promissory Notes and Other Notes Payable

The following table summarizes the Company's secured and unsecured promissory notes and other notes payable at December 31, 2013 and March 31, 2013.

	December 31, 2013			March 31, 2013		
	Principal Balance	Accrued Interest	Total	Principal Balance	Accrued Interest	Total
Senior Secured 10% Convertible Promissory Notes issued to Platinum:						
Exchange Note issued on October 11, 2012	\$ 1,272,600	\$ 167,100	\$ 1,439,700	\$ 1,272,600	\$ 61,700	\$ 1,334,300
Investment Note issued on October 11, 2012	500,000	65,700	565,700	500,000	24,200	524,200
Investment Note issued on October 19, 2012	500,000	64,400	564,400	500,000	23,000	523,000
Investment Note issued on February 22, 2013	250,000	22,500	272,500	250,000	2,600	252,600
Investment Note issued on March 12, 2013	750,000	63,500	813,500	750,000	4,700	754,700
	3,272,600	383,200	3,655,800	3,272,600	116,200	3,388,800
Convertible promissory note issued on July 26, 2013	250,000	11,200	261,200	-	-	-
Total Senior notes	3,522,600	394,400	3,917,000	3,272,600	116,200	3,388,800
Aggregate note discount	(2,135,800)	-	(2,135,800)	(1,963,100)	-	(1,963,100)
Net Senior notes (non-current)	\$ 1,386,800	\$ 394,400	\$ 1,781,200	\$ 1,309,500	\$ 116,200	\$ 1,425,700
10% Convertible Promissory Notes (2013 Unit Notes)	\$ 580,000	\$ 13,100	\$ 593,100	\$ -	\$ -	\$ -
Note discount	(423,900)	-	(423,900)	-	-	-
Net convertible notes (all current)	\$ 156,100	\$ 13,100	\$ 169,200	\$ -	\$ -	\$ -

Edgar Filing: VistaGen Therapeutics, Inc. - Form 10-Q

Notes Payable to  
unrelated parties:

7.5% Notes payable to service

providers for

accounts payable converted to notes

payable:

Burr, Pilger,

Mayer	\$ 90,400	\$ 5,100	\$ 95,500	\$ 90,400	\$ -	\$ 90,400
-------	-----------	----------	-----------	-----------	------	-----------

Desjardins	184,800	11,200	196,000	194,100	800	194,900
------------	---------	--------	---------	---------	-----	---------

McCarthy

Tetrault	373,300	18,800	392,100	403,100	1,700	404,800
----------	---------	--------	---------	---------	-------	---------

August 2012

Morrison & Foerster

Note A	918,200	63,500	981,700	937,400	-	937,400
--------	---------	--------	---------	---------	---	---------

August 2012

Morrison & Foerster

Note B (1)	1,379,400	161,100	1,540,500	1,379,400	60,100	1,439,500
------------	-----------	---------	-----------	-----------	--------	-----------

University Health

Network (1)	549,500	50,500	600,000	549,500	19,400	568,900
-------------	---------	--------	---------	---------	--------	---------

	3,495,600	310,200	3,805,800	3,553,900	82,000	3,635,900
--	-----------	---------	-----------	-----------	--------	-----------

Note discount	(929,000 )	-	(929,000 )	(1,142,600)	-	(1,142,600)
---------------	------------	---	------------	-------------	---	-------------

	2,566,600	310,200	2,876,800	2,411,300	82,000	2,493,300
--	-----------	---------	-----------	-----------	--------	-----------

less: current portion	(352,800 )	(98,600 )	(451,400 )	(450,300 )	(2,500 )	(452,800 )
-----------------------	------------	-----------	------------	------------	----------	------------

non-current

portion and discount	\$ 2,213,800	\$ 211,600	\$ 2,425,400	\$ 1,961,000	\$ 79,500	\$ 2,040,500
----------------------	--------------	------------	--------------	--------------	-----------	--------------

5.75% and 10.25% Notes payable to  
insurance

premium financing

company (current)	\$ 28,400	\$ -	\$ 28,400	\$ 4,200	\$ -	\$ 4,200
-------------------	-----------	------	-----------	----------	------	----------

10% Notes payable to vendors for

accounts

payable converted to

notes payable	\$ 119,400	\$ 31,700	\$ 151,100	\$ 128,800	\$ 23,300	\$ 152,100
---------------	------------	-----------	------------	------------	-----------	------------

less: current portion	(119,400 )	(31,700 )	(151,100 )	(128,800 )	(23,300 )	(152,100 )
-----------------------	------------	-----------	------------	------------	-----------	------------

non-current

portion	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
---------	------	------	------	------	------	------

7.0% Note payable

(August 2012)	\$ 58,800	\$ 2,700	\$ 61,500	\$ 59,400	\$ -	\$ 59,400
---------------	-----------	----------	-----------	-----------	------	-----------

less: current portion	(5,000 )	(2,700 )	(7,700 )	(8,100 )	-	(8,100 )
-----------------------	----------	----------	----------	----------	---	----------

7.0% Notes payable

- non-current portion	\$ 53,800	\$ -	\$ 53,800	\$ 51,300	\$ -	\$ 51,300
-----------------------	-----------	------	-----------	-----------	------	-----------

Total notes payable

to unrelated parties	\$ 3,702,200	\$ 344,600	\$ 4,046,800	\$ 3,746,300	\$ 105,300	\$ 3,851,600
----------------------	--------------	------------	--------------	--------------	------------	--------------

less: current portion	(505,600 )	(133,000)	(638,600 )	(591,400 )	(25,800 )	(617,200 )
-----------------------	------------	-----------	------------	------------	-----------	------------

non-current

portion	3,196,600	211,600	3,408,200	3,154,900	79,500	3,234,400
---------	-----------	---------	-----------	-----------	--------	-----------

less: discount	(929,000 )	-	(929,000 )	(1,142,600)	-	(1,142,600)
----------------	------------	---	------------	-------------	---	-------------

Edgar Filing: VistaGen Therapeutics, Inc. - Form 10-Q

	\$ 2,267,600	\$ 211,600	\$ 2,479,200	\$ 2,012,300	\$ 79,500	\$ 2,091,800
Notes payable to related parties:						
October 2012 7.5%						
Note to Cato Holding Co.	\$ 293,600	\$ 24,800	\$ 318,400	\$ 293,600	\$ 7,400	\$ 301,000
October 2012 7.5%						
Note to Cato Research Ltd. (1)	1,009,000	96,800	1,105,800	1,009,000	36,200	1,045,200
	1,302,600	121,600	1,424,200	1,302,600	43,600	1,346,200
Note discount	(115,000 )	-	(115,000 )	(147,200 )	-	(147,200 )
Total notes payable to related parties	1,187,600	121,600	1,309,200	1,155,400	43,600	1,199,000
less: current portion	(74,700 )	(24,800 )	(99,500 )	(85,600 )	(7,400 )	(93,000 )
non-current portion and discount	\$ 1,112,900	\$ 96,800	\$ 1,209,700	\$ 1,069,800	\$ 36,200	\$ 1,106,000

(1) Note and interest payable solely in restricted shares of the Company's common stock.



Table of Contents

Senior Secured Convertible Promissory Notes Issued to Platinum

On July 2, 2012 and on August 31, 2012, the Company issued to Platinum senior secured convertible promissory notes in the principal amount of \$500,000 (the "July 2012 Platinum Note") and \$750,000 (the "August 2012 Platinum Note"), respectively. The July 2012 Platinum Note and the August 2012 Platinum Note each accrued interest at the rate of 10% per annum and were due and payable on July 2, 2015. The July 2012 Platinum Note and the August 2012 Platinum Note were each mandatorily convertible into securities that may be issued by the Company in an equity, equity-based, or debt financing, or series of financings, subsequent to the issuance of the note resulting in gross proceeds to the Company of at least \$3,000,000, excluding any additional investment by Platinum.

On October 11, 2012, the Company and Platinum entered into a Note Exchange and Purchase Agreement (the "October 2012 Agreement") in which the July 2012 Platinum Note and the August 2012 Platinum Note (together, the "Existing Notes"), as well as the related accrued interest, were consolidated into and exchanged for a single senior secured convertible note in the amount of \$1,272,600 (the "Exchange Note") and Platinum agreed to purchase four additional 10% senior secured convertible promissory notes in the aggregate principal amount of \$2.0 million (the "Investment Notes"), issuable over four separate \$500,000 tranches between October 2012 and December 2012. The first and second \$500,000 Investment Notes, in the aggregate principal amount of \$1.0 million, were purchased by Platinum on October 11, 2012 and October 19, 2012, respectively.

On November 14, 2012 and January 31, 2013, the Company and Platinum entered into amendments to the October 2012 Agreement (the "NEPA Amendments"), pursuant to which the final two \$500,000 tranches contemplated by the October 2012 Agreement were combined into a single Investment Note in the aggregate principal amount of \$1.0 million (the "\$1.0 Million Note"). Under the terms and conditions of the NEPA Amendment, Platinum agreed to purchase the \$1.0 Million Note within five business days of the Company's notice to Platinum of the consummation of a debt or equity financing, or combination of financings, prior to February 15, 2013, resulting in gross proceeds to the Company of at least \$1.0 million (the "Additional Financing Requirement"). The Company satisfied the Additional Financing Requirement on February 12, 2013. Effective February 22, 2013, the Company and Platinum entered into an additional amendment to the October 2012 Agreement pursuant to which Platinum agreed to purchase an Investment Note in the face amount of \$250,000 on February 22, 2013 and an additional Investment Note in the face amount of \$750,000 on or before March 12, 2013, which Investment Note was issued by the Company and purchased by Platinum on March 12, 2013.

The Exchange Note and each Investment Note (together, the "Notes") accrue interest at a rate of 10% per annum and, subject to certain limitations and exceptions set forth in the Notes, unless converted earlier and voluntarily by Platinum, will be due and payable in restricted shares of the Company's common stock on October 11, 2015, or three years from the date of issuance, as determined by the terms of the respective Investment Notes. At maturity, all principal and accrued interest under the Notes will be payable by the Company through the issuance of restricted shares of common stock to Platinum. Subject to certain potential adjustments set forth in the Notes, the number of restricted shares of common stock issuable as payment in full for each of the Notes at maturity will be calculated by dividing the outstanding Note balance plus accrued interest by \$0.50 per share. Prior to maturity, the outstanding principal and any accrued interest on the Exchange Note and each of the Investment Notes is convertible, in whole or in part, at Platinum's option into shares of the Company's common stock at a conversion price of \$0.50 per share, subject to certain adjustments. The conversion feature in each of the Notes constituted a beneficial conversion feature at the date of issuance.

As additional consideration for the purchase of the Investment Notes, the Company agreed to issue to Platinum warrants to purchase an aggregate of 2,000,000 shares of the Company's common stock, issuable in separate tranches together with each Investment Note, of which a warrant to purchase 500,000 shares was issued to Platinum on October 11, 2012 and on October 19, 2012, a warrant to purchase 250,000 shares was issued to Platinum on February

22, 2013 and a warrant to purchase 750,000 shares was issued to Platinum on March 12, 2013 (each an “Investment Warrant”). In addition, the Company issued Platinum a warrant to purchase 1,272,577 shares of the Company’s common stock in connection with the issuance of the Exchange Note (the “Exchange Warrant”). At issuance, the Platinum Exchange Warrant and each Investment Warrant had a term of 5 years and an exercise price of \$1.50 per share, subject to certain adjustments. See Note 9, Capital Stock, regarding a modification of the exercise price of the Exchange Warrant and the Investment Warrants made in May 2013. In connection with the October 2012 Agreement, the Company and Platinum also executed and subsequently amended a security agreement to secure repayment of all obligations due and payable under the terms of the Exchange Note and all of the Investment Notes.

Table of Contents

On July 26, 2013, the Company issued an additional senior secured convertible promissory note in the principal amount of \$250,000 to Platinum (the “July 2013 Note”). The July 2013 Note matures on July 26, 2016 and accrues interest at a rate of 10% per annum. Subject to certain terms and conditions, all principal and accrued interest under the July 2013 Note will be payable by the Company through the issuance of restricted shares of common stock to Platinum. Subject to certain potential adjustments set forth in the July 2013 Note, the number of restricted shares of common stock issuable as payment in full for the July 2013 Note at maturity will be calculated by dividing the outstanding balance plus accrued interest of the July 2013 Note by \$0.50 per share. In the same manner as the earlier Notes, prior to maturity, the outstanding principal and any accrued interest on the July 2013 Note is convertible, in whole or in part, at Platinum’s option into shares of the Company’s restricted common stock at a conversion price of \$0.50 per share, subject to certain adjustments. The conversion feature in the July 2013 Note constituted a beneficial conversion feature at the date of issuance. As additional consideration for the purchase of the July 2013 Note, the Company issued to Platinum a five-year warrant to purchase 250,000 shares of the Company’s common stock at an exercise price of \$0.50 per share (the “July 2013 Warrant”). In addition, the Company granted Platinum the right to exchange all amounts due under the terms of the July 2013 Note into the 2013 Unit Private Placement securities (see Note 9, Capital Stock) offered by the Company to third party investors to finance its short-term working capital needs (the “Exchange Securities”). Upon the Company’s receipt of gross proceeds of at least \$10.0 million from the Autilion Financing, the Company expects the July 2013 Note to be converted into the Exchange Securities.

Subject to limited exceptions, the Exchange Warrant, each of the Investment Warrants, and the July 2013 Warrant include certain exercise price reset and anti-dilution protection features in the event that the Company issues other shares of common stock during the five-year term of the warrants at a price less than their initial \$1.50 per share exercise price (subsequently modified to \$0.50 per share exercise price as described in Note 9, Capital Stock), or \$0.50 per share exercise price in the case of the July 2013 Warrant. As a result of these provisions, the Exchange Warrant, the Investment Warrants and the July 2013 Warrant do not meet the criteria set forth in ASC 815, Derivatives and Hedging, to be considered indexed to the Company’s own stock and treated as equity instruments. Consequently, the Company recorded the Exchange Warrant, each of the Investment Warrants and the July 2013 Warrant as liabilities at their fair value, which was estimated at the issuance date using a Monte Carlo simulation model or the Black-Scholes Option Pricing model. The fair value of the Exchange Warrant at the date of issuance was recorded as a liability and as a corresponding charge to loss on early extinguishment of debt in the Statement of Operations and Comprehensive Income in the third quarter of the fiscal year ended March 31, 2013. The fair value of each Investment Warrant at the date of issuance was recorded as a liability and as a corresponding discount to the respective Investment Note. Subject to limitations of the absolute amount of discount attributable to each Investment Note and the July 2013 Note, the Company treated the issuance-date intrinsic value of the beneficial conversion feature embedded in each note as an additional component of the discount attributable to each note and recorded a discount attributable to the beneficial conversion feature for each note.

The fair value of the July 2013 Warrant at inception was determined to be \$146,800 using the Black-Scholes Option Pricing Model and the following assumptions: market price per share: \$0.75; exercise price per share: \$0.50; risk-free interest rate: 1.36%; contractual term: 5.0 years; volatility: 96.9%; expected dividend rate: 0%. The fair value was recorded as a liability and as a corresponding discount to the July 2013 Note. The table below summarizes the components of the discount and the effective interest rate at inception for the July 2013 Note.

Face value	\$250,000
Discount attributable to:	
Fair value of warrant	(146,800 )
Beneficial conversion feature	(100,700 )
Inception date carrying value	\$2,500
Effective Interest Rate	159.05 %

Edgar Filing: VistaGen Therapeutics, Inc. - Form 10-Q

The Company amortizes the aggregate discount attributable to each of the Investment Notes and the July 2013 Note using the interest method over the respective term of each note. The effective interest rate attributable to the July 2013 Note is 159.05%

The fair value of the Exchange Warrant, Investment Warrants and the July 2013 Warrant was re-measured as of December 31, 2013 at an aggregate fair value of \$780,400. The accompanying Condensed Consolidated Statement of Operations and Comprehensive Loss reflects the \$620,900 and \$1,354,400 decrease in fair value of these warrants for the quarter and nine months ended December 31, 2013, respectively.

-13-

---

Table of Contents

10% Convertible Notes Issued in Connection with 2013 Unit Private Placement

As described more completely in the section entitled 2013 Unit Private Placement in Note 9, Capital Stock, between August and December 2013, the Company issued to accredited investors 10% convertible notes (the "Unit Notes") in an aggregate face amount of \$580,000 in connection with its private placement offering of Units. The Unit Notes mature on July 30, 2014 and each Unit Note and its related accrued interest is convertible into shares of the Company's common stock at a fixed conversion price of \$0.50 per share at or prior to maturity, at the option of the investor. The Company has the right to prepay the Unit Notes and accrued interest in cash prior to maturity without penalty.

The Company allocated the proceeds from the sale of the Units to the Unit Notes, the common stock and the warrants comprising the Units based on the relative fair values of the individual securities on the dates of the Unit sales. Based on the short-duration of the Unit Notes and their other terms, the Company determined that the fair value of the Unit Notes at the date of issuance was equal to their face value. Accordingly, the Company recorded an initial discount attributable to each Unit Note for an amount representing the difference between the face value of the Unit Note and its relative value. Additionally, the Unit Notes contain an embedded conversion feature, certain of which have an intrinsic value at the issuance date, which value the Company treated as an additional discount attributable to those Unit Notes, subject to limitations on the absolute amount of discount attributable to each Unit Note. The Company recorded a corresponding credit to additional paid-in capital, an equity account in the Condensed Consolidated Balance Sheet, attributable to the beneficial conversion feature. The Company amortizes the aggregate discount attributable to each of the Unit Notes using the interest method over the respective term of each Unit Note. Based on their respective discounts, the effective interest rates attributable to the Unit Notes range from 72.8% to 701.9%

Notes Payable to Morrison & Foerster

On May 5, 2011, the Company and Morrison & Foerster LLP ("Morrison & Foerster"), the Company's legal and intellectual property counsel, amended a previously outstanding note (the "Original Note") issued by the Company in payment of legal services (the "Amended Note"). Under the Amended Note, the principal balance of the Original Note was increased to \$2,200,000, interest accrued at the rate of 7.5% per annum, and the Company was required to make an additional payment of \$100,000 within three business days of the date of the Amended Note, which the Company made in a timely manner.

On August 31, 2012, the Company restructured the Amended Note (the "Restructuring Agreement"). Pursuant to the Restructuring Agreement, the Company issued to Morrison & Foerster two new unsecured promissory notes to replace the Amended Note, one in the principal amount of \$1,000,000 ("Replacement Note A") and the other in the principal amount of \$1,379,400 ("Replacement Note B") (together, the "Replacement Notes"); amended an outstanding warrant to purchase 425,000 restricted shares of the Company's common stock (the "Amended M&F Warrant"); and issued a new warrant to purchase 1,379,376 restricted shares of the Company's common stock (the "New M&F Warrant"). Under the terms of the Restructuring Agreement, the Amended Note was cancelled and all of the Company's past due payment obligations under the Amended Note were satisfied. The Company made a payment of \$155,000 to Morrison & Foerster on August 31, 2012 pursuant to the terms of the Amended Note, and issued the Replacement Notes, each dated as of August 31, 2012. Both Replacement Notes accrue interest at the rate of 7.5% per annum and are due and payable on March 31, 2016. Replacement Note A required monthly payments of \$15,000 per month through March 31, 2013, and \$25,000 per month thereafter until maturity. For strategic purposes, the Company has not made the payments required on Replacement Note A since April 2013 and accordingly, the interest rate on the Replacement Notes has increased to 10.0 % per annum from May 2013 until payments resume. Payment of the principal and interest on Replacement Note B will be made solely in shares of the Company's common stock pursuant to Morrison & Foerster's surrender from time to time of all or a portion of the principal and interest balance due on Replacement Note B in connection with its exercise of the New M&F Warrant, at an exercise price of \$1.00 per share, and concurrent cancellation of indebtedness and surrender of Replacement Note B; provided, however, that

Morrison & Foerster will have the option to require payment of Replacement Note B in cash upon the occurrence of a change in control of the Company or an event of default, and only in such circumstances.

The Company treated the aggregate of the incremental value of the Amended M&F Warrant and the fair value of the New M&F Warrant as a discount to the Replacement Notes. Through December 31, 2013, the Company has adjusted the New M&F Warrant to increase the number of restricted shares available for purchase by 161,179 shares, based on interest accrued on Replacement Note B through that date. The Company has recorded the fair value of the additional warrant shares as a charge to interest expense and a corresponding credit to additional paid-in capital.

Table of Contents

Note Payable to University Health Network (“UHN”)

On October 10, 2012, the Company issued to UHN: (i) an unsecured promissory note in the principal amount of \$549,500, which is payable solely in restricted shares of the Company’s common stock and which accrues interest at the rate of 7.5% per annum, as payment in full for all sponsored stem cell research and development activities by UHN and Gordon Keller, Ph.D. under the Sponsored Research Collaboration Agreement (“SRCA”, described in Note 8, Licensing and Collaborative Agreements) through September 30, 2012 (the “UHN Note”), and (ii) a five-year warrant to purchase, at a price of \$1.00 per share, 549,500 restricted shares of the Company’s common stock, the amount equal to the sum of the principal amount of the UHN Note, plus all accrued interest thereon, divided by \$1.00 per share (the “UHN Warrant”). The UHN Note is due and payable on March 31, 2016 and is payable solely by UHN's surrender from time to time of all or a portion of the principal and interest balance due on the UHN Note in connection with its concurrent exercise of the UHN Warrant, provided, however, that UHN will have the option to require payment of the UHN Note in cash upon the occurrence of a change in control of the Company or an event of default, and only in such circumstances.

The difference between the face value of the UHN Note and its issuance-date fair value has been treated as a discount to the note and is being amortized over the term of the note using the interest method. Through December 31, 2013, the Company has adjusted the UHN Warrant to increase the number of shares available for purchase by 50,471 shares, based on interest accrued on the UHN Note through that date. The Company has recorded the fair value of the additional warrant shares as a charge to interest expense and a corresponding credit to additional paid-in capital.

Notes Payable for Cancellation of Amounts Payable

On February 25, 2011, the Company issued to Burr, Pilger, and Mayer, LLC (“BPM”) an unsecured promissory note in the principal amount of \$98,674 for amounts payable in connection with valuation services provided to the Company by BPM. The BPM note bears interest at the rate of 7.5% per annum and has payment terms of \$1,000 per month, beginning March 1, 2011 and continuing until all principal and interest are paid in full. In addition, a payment of \$25,000 shall be due upon the sale of the Company or upon the Company completing a financing transaction of at least \$5.0 million during any three-month period, with the payment increasing to \$50,000 (or the amount then owed under the note, if less) upon the Company completing a financing of over \$10.0 million.

On April 29, 2011, the Company issued to Desjardins Securities, Inc. (“Desjardins”) an unsecured promissory note in the principal amount of CDN \$236,000 for amounts payable for legal fees incurred by Desjardins in connection with investment banking services provided to the Company by Desjardins. The Desjardins note bears interest at 7.5% and will be due, along with all accrued but unpaid interest on the earliest of (i) June 30, 2014, (ii) the consummation of a Change of Control, as defined in the Desjardins note, and (iii) any failure to pay principal or interest when due. The Company was required to make payments of CDN \$4,000 per month beginning May 31, 2011, increasing to CDN \$6,000 per month on January 31, 2012. Beginning on January 1, 2012, the Company shall also make payments equal to one-half percent (0.5%) of the net proceeds of all private or public equity financings closed during the term of the note.

On May 5, 2011, the Company issued to McCarthy Tetrault LLP (“McCarthy”) an unsecured promissory note in the principal amount of CDN \$502,797 for the amounts payable in connection with Canadian legal services provided to the Company. The McCarthy note bears interest at 7.5% and will be due, along with all accrued but unpaid interest on the earliest of (i) June 30, 2014, (ii) the consummation of a Change of Control, as defined in the McCarthy note, and (iii) any failure to pay principal or interest when due. The Company was required to make payments of CDN \$10,000 per month beginning May 31, 2011, which payment amounts increased to CDN \$15,000 per month on January 31, 2012. Beginning on January 1, 2012, the Company is also required to make payments equal to one percent (1%) of the net proceeds of all private or public equity financings closed during the term of the note. At September 30, 2012, the

Company had not made the monthly payments required for February through September 2012. In October 2012, the Company and McCarthy agreed to extend the term of the note through March 2015.

-15-

---



Table of Contents

On August 30, 2012, the Company issued a promissory note in the principal amount of \$60,000 and 15,000 restricted shares of its common stock valued at a market price of \$0.94 per share to Progressive Medical Research in settlement of past due obligations for clinical research services in the amount of \$79,900. Under the terms of the settlement, the company also agreed to make monthly cash payments of \$5,000 in August 2012 through December 2012. The promissory note bears interest at 7% per annum and requires payments of \$1,000 per month beginning January 15, 2013 until all principal and interest is paid in full. The note requires payment in full upon the sale of all or substantially all of the Company's assets or upon the Company completing a financing transaction, or series of transactions, resulting in gross proceeds to the Company of at least \$4.0 million in any three-month period, excluding proceeds from stock option or warrant exercises. The Company charged the loss on the settlement to interest expense during the second quarter of the fiscal year ended March 31, 2013.

Note Payable to Cato Holding Company

In April 2011, all amounts owed by the Company to Cato Holding Company ("CHC"), a related party, and its affiliates, were consolidated into a single note, in the principal amount of \$352,300 (the "2011 CHC Note"). Concurrently, CHC released all of its security interests in certain of the Company's personal property. The 2011 CHC note was to bear interest at 7% per annum, compounded monthly. Under the terms of the note, the Company was to make six monthly payments of \$10,000 each beginning June 1, 2011, and thereafter to make payments of \$12,500 monthly until the note was repaid in full. The Company had the option to prepay the outstanding balance under this note in full or in part at any time during its term without penalty.

On October 10, 2012, the Company and CHC restructured the 2011 CHC Note by cancelling the 2011 CHC Note and exchanging it for a new unsecured promissory note in the principal amount of \$310,400 (the "2012 CHC Note") and a five-year warrant to purchase 250,000 shares of the Company's common stock at a price of \$1.50 per share (the "CHC Warrant"). The 2012 CHC Note accrues interest at a rate of 7.5% per annum and is due and payable in monthly installments of \$10,000, beginning November 1, 2012 and continuing until the outstanding balance is paid in full.

The Company determined that the cancellation of the 2011 CHC Note and the issuance of the 2012 CHC Note should be accounted for as an extinguishment of debt. Accordingly, the Company recorded the 2012 CHC Note at its fair value of \$291,100 based on the present value of its scheduled cash flows and assumptions regarding market interest rates for unsecured debt of similar quality. The Company determined the fair value of the CHC Warrant to be \$0.48 per share, or \$120,500. The Company recognized the difference between the sum of the fair values of the 2012 CHC Note and the CHC Warrant less the carrying value of the 2011 CHC Note, \$119,100, as a non-cash loss on early extinguishment of debt in the Consolidated Statements of Operations and Comprehensive Income for the third quarter of the fiscal year ended March 31, 2013. The fair value of the warrant, \$120,500, which is treated as an equity instrument, was credited to additional paid in capital at the issuance date. The difference between the face value of the 2012 CHC Note and its fair value, \$19,300, has been treated as a discount to the note and is being amortized over the term of the note using the interest method.

Note Payable to Cato Research Ltd.

On October 10, 2012, the Company issued to Cato Research Ltd. ("CRL"), a related party: (i) an unsecured promissory note in the initial principal amount of \$1,009,000, which is payable solely in restricted shares of the Company's common stock and which accrues interest at the rate of 7.5% per annum, compounded monthly (the "CRL Note"), as payment in full for all contract research and development services and regulatory advice ("CRO Services") rendered by CRL to the Company and its affiliates through December 31, 2012 with respect to the preclinical and clinical development of AV-101, and (ii) a five-year warrant to purchase, at a price of \$1.00 per share, 1,009,000 restricted shares of the Company's common stock, the amount equal to the sum of the principal amount of the CRL Note, plus all accrued interest thereon, divided by \$1.00 per share (the "CRL Warrant"). The principal amount of the CRL Note may,

at the Company's option, be automatically increased as a result of future CRO Services rendered by CRL to the Company and its affiliates from January 1, 2013 to June 30, 2013. The CRL Note is due and payable on March 31, 2016 and is payable solely by CRL's surrender from time to time of all or a portion of the principal and interest balance due on the CRL Note in connection with its concurrent exercise of the CRL Warrant, provided, however, that CRL will have the option to require payment of the CRL Note in cash upon the occurrence of a change in control of the Company or an event of default, and only in such circumstances.

-16-

---

Table of Contents

The Company determined that the cancellation of the accounts payable to CRL for CRO Services and the related issuance of the CRL Note should be accounted for as an extinguishment of debt. Accordingly, the Company recorded the CRL Note at its fair value of \$857,900 based on the present value of its scheduled cash flows and assumptions regarding market interest rates for unsecured debt of similar quality. The Company determined the fair value of the CRL Warrant to be \$0.48 per share, or \$486,200. The Company recognized the difference between the sum of the fair values of the CRL Note and the CRL Warrant less the accounts payable balance due to CRL, \$335,100, as a non-cash loss on early extinguishment of debt in the Consolidated Statements of Operations and Comprehensive Income for the third quarter of the fiscal year ended March 31, 2013. The fair value of the warrant, \$486,200, which is treated as an equity instrument, was credited to additional paid in capital at the issuance date. The difference between the face value of the CRL Note and its fair value, \$151,100, has been treated as a discount to the note and is being amortized over the term of the note using the interest method. Through December 31, 2013, the Company has adjusted the CRL Warrant to increase the number of restricted shares available for purchase by 96,754 shares, based on interest accrued on the CRL Note through that date. The Company has recorded the fair value of the additional warrant shares as a charge to interest expense and a corresponding credit to additional paid-in capital.

Note 8. Licensing and Collaborative Agreements

University Health Network

On September 17, 2007, the Company and UHN entered into a Sponsored Research Collaboration Agreement (“SRCA”) to develop certain stem cell technologies for drug discovery and drug rescue technologies. The SRCA was amended on April 19, 2010 to extend the term to five years and give the Company various options to extend the term for an additional three years. On December 15, 2010, the Company and UHN entered into a second amendment to expand the scope of work to include induced pluripotent stem cell technology and to further expand the scope of research and term extension options. On April 25, 2011, the Company and UHN amended the SRCA a third time to expand the scope to include therapeutic and stem cell therapy applications of induced pluripotent cells and to extend the date during which the Company may elect to fund additional projects to April 30, 2012. On October 24, 2011, the Company and UHN amended the SRCA a fourth time to identify five key programs that will further support the Company’s core drug rescue initiatives and potential cell therapy applications. Under the terms of the fourth amendment, the Company committed to making monthly payments of \$50,000 per month from October 2011 through September 2012 to fund these programs. As disclosed in Note 7, Convertible Notes and Other Notes Payable, in October 2012, the Company issued a promissory note in the principal amount of \$549,500 and a warrant to UHN as payment in full for services rendered under the fourth amendment. Additionally, the Company and UHN entered into Amendment No. 5 to the SRCA establishing the sponsored research projects and the sponsored research budgets under the SRCA from October 1, 2012 to September 30, 2013, as well as a schedule of the Company’s sponsored research payments for such period totaling \$309,000.

Concurrent with the execution of the fourth amendment to the SRCA, the Company and UHN entered into a License Agreement under the terms of which UHN granted the Company exclusive rights to the use of a novel molecule that can be employed in the identification and isolation of mature and immature human cardiomyocytes from pluripotent stem cells, as well as methods for the production of cardiomyocytes from pluripotent stem cells that express this marker. In consideration for the grant of the license, the Company has agreed to make payments to UHN totaling \$3.9 million, if, and when, it achieves certain commercial milestones set forth in the License Agreement, and to pay UHN royalties based on the receipt of revenue by the Company attributable to the licensed patents.

U.S. National Institutes of Health

During fiscal years 2006 through 2008, the U.S. National Institutes of Health (“NIH”) awarded the Company a \$4.2 million grant to support preclinical development of AV-101, the Company’s lead drug candidate for treatment of

neuropathic pain and other neurodegenerative diseases such as Huntington's and Parkinson's diseases. In June 2009, the NIH awarded the Company a \$4.2 million grant to support the Phase I clinical development of AV-101, which amount was subsequently increased to a total of \$4.6 million in July 2010. The Company recognized NIH grant revenue related to AV-101 in the amount of \$187,000 in the quarter ended June 30, 2012. The grant expired in the ordinary course on June 30, 2012.

-17-

---

Table of Contents

Cato Research Ltd.

The Company has built a strategic development relationship with Cato Research Ltd. (“CRL”), a global contract research and development organization, or CRO, and an affiliate of one of the Company’s largest stockholders. CRL has provided the Company with access to essential CRO services and regulatory expertise supporting its AV-101 preclinical and clinical development programs and other projects. The Company recorded research and development expenses for CRO services provided by CRL in the amounts of \$7,500 and \$45,000 for the three and nine month periods ended December 31, 2013, respectively, and \$124,700 and \$639,300 for the three and nine month periods ended December 31, 2012, respectively. As described in Note 7, Convertible Promissory Notes and Other Notes Payable, in October 2012, the Company issued an unsecured promissory note in the principal amount of \$1,009,000, and a warrant exercisable for 1,009,000 shares of the Company’s common stock, as payment in full of all amounts owed to CRL for CRO services rendered to the Company through December 31, 2012.

Note 9. Capital Stock

Autilion AG Securities Purchase Agreement

On April 8, 2013, the Company entered into a Securities Purchase Agreement (as amended, the “Securities Purchase Agreement”) with Autilion AG, a company organized and existing under the laws of Switzerland (“Autilion”). On April 12, 2013, Autilion assigned the Purchase Agreement to its affiliate, Bergamo Acquisition Corp. PTE LTD, a corporation organized and existing under the laws of Singapore (“Bergamo Singapore”). On April 30, 2013, the Company and Bergamo Singapore amended the Securities Purchase Agreement to modify the investment dates. On June 27, 2013, the Company, Autilion and Bergamo Singapore further amended the Securities Purchase Agreement to vacate Autilion’s April 2013 assignment of the Securities Purchase Agreement to Bergamo Singapore, provide for an initial closing under the Securities Purchase Agreement, and amend certain of the investment dates under the Securities Purchase Agreement. Under the terms of the Securities Purchase Agreement, Autilion is contractually obligated to purchase an aggregate of 72.0 million restricted shares of the Company’s common stock at a purchase price of \$0.50 per share for aggregate cash consideration of \$36.0 million, in a series of closings scheduled to have occurred by September 30, 2013 (the “Autilion Financing”). At December 31, 2013, the Company had completed a nominal initial closing of the Autilion Financing in the amount of \$25,000 and issued 50,000 restricted shares of common stock. Although there can be no assurance that an additional closing of the Autilion Financing will occur, in early January 2014, Autilion informed the Company of its expectation that the Company will receive the full \$36.0 million committed under the terms of the Securities Purchase Agreement by mid-February 2014. As of the date of this report, there has not been a subsequent closing of the Autilion Financing. The Securities Purchase Agreement also provides for the election to the Company’s Board of Directors of a designee of Autilion upon completion of the Autilion Financing.

The Company and Autilion also entered into a Voting Agreement, pursuant to which Autilion has agreed to vote all shares of capital stock of the Company held by Autilion consistent with the recommendation of a majority of the members of the Company’s Board of Directors. In addition, in the event of a Change in Control of the Company, as defined in the Voting Agreement, or an extraordinary transaction outside of the ordinary course of the Company’s business, in each case approved by a majority of the Company’s Board of Directors, including Autilion’s designee, as well as by the holders of a majority of the outstanding shares of Common Stock held by stockholders unaffiliated with Autilion (an “Approved Transaction”), Autilion is required to vote all shares of capital stock of the Company held by it for such Approved Transaction.

2013 Unit Private Placement

Between August and December 2013, the Company entered into securities purchase agreements with accredited investors pursuant to which it sold to such investors 116 Units, each Unit consisting of (i) a 10% convertible note in the face amount of \$5,000 maturing on July 30, 2014 (the “Unit Note”); (ii) 10,000 shares of the Company’s restricted common stock (the “Unit Stock”); and (iii) a warrant exercisable through July 30, 2016 to purchase 10,000 restricted shares of the Company’s common stock at an exercise price of \$1.00 per share (the “Unit Warrant”). Accordingly, the Company issued Unit Notes in the aggregate face amount of \$580,000; an aggregate of 1,160,000 shares of Unit Stock, and warrants to purchase an aggregate of 1,160,000 shares of the Company’s restricted common stock pursuant to the Unit Warrants, and received cash proceeds of \$580,000, including \$50,000 in lieu of repayment of previous advances to the Company made by one of its executive officers. The Unit Notes and related accrued interest are convertible into shares of the Company’s common stock at a conversion price of \$0.50 per share at or prior to maturity, at the option of each investor. The Units also represent the Exchange Securities into which Platinum may convert the July 2013 Note.

Table of Contents

The Company allocated the proceeds from the sale of the Units to the various securities based on their relative fair values on the dates of the sales. As described in Note 7, Convertible Promissory Notes and Other Notes Payable, based on the short-term nature of the Unit Notes, the Company determined that fair value of the Unit Notes was equal to their face value. The Company determined the fair value of the Unit Stock based on the quoted market price of its stock on the date of the Unit sale. The Company calculated the fair value of the Unit Warrants using the Black Scholes Option Pricing Model and the weighted average assumptions indicated in the table below. The table below also presents the aggregate allocation of the Unit sales proceeds based on the relative fair values of the Unit Stock, Unit Warrants and Unit Notes at the Unit sales date.

Warrant	Unit Warrants						Per Share	Aggregate	Aggregate	Proceeds	Aggregate Allocation of Proceeds Based on Relative Fair Value of:	
	Weighted Average	Issuance Date	Valuation	Assumptions	Risk	free					Fair Value	Fair Value
Shares	Market Price	Exercise Price	Term (Years)	Interest Rate	Volatility	Dividend Rate	of Warrant	of Unit Warrants	of Unit Sales	Unit Stock	Unit Warrant	Unit Note
1,160,000	\$0.47	\$1.00	2.80	0.57%	76.85%	0.0%	\$0.14	\$166,400	\$580,000	\$238,200	\$69,300	\$272,500

Modification of Warrants held by Platinum

Effective on May 24, 2013, the Company and Platinum entered into an Amendment and Waiver Agreement (the “Amendment and Waiver”) pursuant to which the Company agreed to reduce the exercise price of the Exchange Warrant and the Investment Warrants issued to Platinum in October 2012 and February 2013 and March 2013 (collectively, the “Warrants”) from \$1.50 per share to \$0.50 per share in consideration for Platinum’s agreement to waive its rights for any increase in the number of shares of common stock issuable under the adjustment provisions of the Exchange Warrant and the Investment Warrants that would otherwise occur from (i) the Company’s sale of shares of its common stock at a price of \$0.50 per share in connection with the Autilion Financing; (ii) the March 2013 grant of warrants to certain of the Company’s officers and independent directors to purchase an aggregate of 3.0 million restricted shares of common stock at an exercise price of \$0.64 per share; and (iii) the Company’s issuance of restricted shares of its common stock resulting in gross proceeds not to exceed \$1.5 million in connection with the exercise by warrant holders, by no later than June 30, 2013, subsequently extended to July 30, 2013, of previously outstanding warrants for which the Company may reduce the exercise price to not less than \$0.50 per share. (See “Other Warrant Modifications and Exercises” below.)

As described in Note 4, Fair Value Measurements and in Note 7, Convertible Promissory Notes and Other Notes Payable, the Company re-measures the fair value of the Exchange Warrant, the Investment Warrants and the July 2013 Warrant at the end of each quarterly reporting period. The fair value re-measurement at June 30, 2013 incorporated the modification of the exercise price resulting from the Amendment and Waiver and the corresponding adjustment was reflected as a component of the Warrant Liability at that date. At December 31, 2013, the Company determined the fair values of the Exchange Warrant, the Investment Warrants and the July 2013 Warrant to be a weighted average of \$0.22 per share, or an aggregate of \$780,400, recorded as a component of Warrant Liability in the accompanying Condensed Consolidated Balance Sheet at December 31, 2013, using the Black Scholes Option Pricing Model and the following assumptions: market price per share: \$0.42; exercise price per share: \$0.50; risk-free interest rate: 1.16% to 1.54%; remaining contractual term: 3.78 years to 4.56 years; volatility: 76.1% to 81.5%; and expected dividend rate: 0%. At December 31, 2013, the Company also re-measured the fair value of the Series A Exchange Warrant which is contingently issuable to Platinum upon the exchange of its shares of the Company’s Series A

Preferred Stock into shares of the Company's restricted common stock. The Company determined the fair value of the Series A Exchange Warrant, also recorded as a component of Warrant Liability in the accompanying Condensed Consolidated Balance Sheets at December 31, 2013, to be \$0.27 per share, or \$1,936,700, using the Black Scholes Option Pricing Model and the following assumptions: market price per share: \$0.42; exercise price per share: \$0.50; risk-free interest rate: 1.75%; contractual term: 5.00 years; volatility: 85.7%; expected dividend rate: 0%; and assumed probability of issuance of 95%.



Table of Contents

## Other Warrant Modifications and Exercises

During the months of June and July 2013, the Company offered certain long-term warrant holders the opportunity to exercise warrants having an exercise price of \$1.50 per share to purchase shares of the Company's restricted common stock at a reduced exercise price of \$0.50 per share through July 30, 2013. Warrant holders exercised warrants to purchase an aggregate of 528,370 restricted shares of the Company's common stock and the Company received cash proceeds of \$264,200. In addition, certain warrant holders exercised modified warrants to purchase 16,646 shares of the Company's restricted common stock in lieu of payment by the Company in satisfaction of amounts due for professional services in the aggregate amount of \$8,300.

The Company calculated the fair value of the warrants exercised immediately before and after the modifications and determined that the fair value of the warrants exercised decreased by \$32,900, which is reflected in general and administrative expense in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss. The warrants subject to the exercise price modifications were valued using the Black-Scholes Option Pricing Model and the following assumptions:

Assumption:	Pre-modification	Post-modification
Market price per share (weighted average)	\$ 0.74	\$ 0.74
Exercise price per share (weighted average)	\$ 1.50	\$ 0.50
Risk-free interest rate (weighted average)	0.82%	0.03%
Contractual term in years (weighted average)	3.47	0.06
Volatility (weighted average)	84.6%	73.3%
Dividend rate	0.0%	0.0%
Weighted Average Fair Value per share	\$ 0.30	\$ 0.24

In October 2013 the Company modified certain outstanding warrants held by its long-term investors and consultants to purchase an aggregate of 1,292,778 shares of the Company's restricted common stock to reduce the exercise price of the warrants to \$0.50 per share and, for warrants scheduled to expire on December 31, 2013, extend the exercise term of the warrants until January 31, 2015, generally without modifying the exercise price. The Company calculated the fair value of the warrants immediately before and after the modifications and determined that the fair value of the warrants increased by \$77,800, which is reflected in general and administrative expense in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss. The warrants subject to the exercise price modifications and term extensions were valued using the Black-Scholes Option Pricing Model and the following assumptions:

Assumption:	Pre-modification	Post-modification
Market price per share at modification date	\$ 0.50	\$ 0.50
Exercise price per share (weighted average)	\$ 1.50	\$ 1.23
Risk-free interest rate (weighted average)	0.33%	0.44%
Contractual term in years (weighted average)	1.40	2.10
Volatility (weighted average)	74.4%	75.8%
Dividend rate	0.0%	0.0%
Weighted Average Fair Value per share	\$ 0.05	\$ 0.11

Table of Contents

Additionally, in October 2013, the Company issued new warrants to purchase an aggregate of 237,500 shares of its restricted common stock to certain former warrant holders whose warrants to purchase an equivalent number of shares of the Company's restricted common stock at an exercise price of \$1.50 per share had recently expired. The Company calculated the fair value of the new warrants as \$0.03 per share, using the Black-Scholes Option Pricing Model and the following assumptions. market price per share: \$0.50; exercise price per share: \$1.50; risk-free interest rate: 0.20%; contractual term: 1.32 years; volatility: 73.5%; and expected dividend rate: 0%. The Company recorded the aggregate fair value of \$7,400 for the new warrants in general and administrative expense in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss, with a corresponding credit to additional paid-in capital, an equity account.

In December 2013, the Company modified additional outstanding warrants held by certain of its long-term investors, consultants, and members of management and its Board of Directors to purchase an aggregate of 1,260,251 shares of its restricted common stock to reduce the exercise price of the warrants to \$0.50 per share and, in limited cases, extend the exercise term of the warrants. The Company calculated the fair value of the warrants immediately before and after the modifications and determined that the fair value of the warrants increased by \$344,000, which is reflected in general and administrative expense in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss. The warrants subject to the exercise price modifications and term extensions were valued using the Black-Scholes Option Pricing Model and the following assumptions:

Assumption:	Pre-modification	Post-modification
Market price per share at modification date	\$ 0.40	\$ 0.40
Exercise price per share (weighted average)	\$ 1.67	\$ 0.50
Risk-free interest rate (weighted average)	0.51%	0.57%
Contractual term in years (weighted average)	2.06	2.34
Volatility (weighted average)	73.6%	74.4%
Dividend rate	0.0%	0.0%
Weighted Average Fair Value per share	\$ 0.05	\$ 0.14

In making its fair value determinations for both warrant modifications and new grants using the Black Scholes Option Pricing Model, the Company utilizes the following principles in selecting its input assumptions. The market price per share is based on the quoted market price of the Company's common stock on the Over-the-Counter Bulletin Board on the date of the modification or grant. Because of its short history as a public company, the Company estimates volatility based on the historical volatilities of a peer group of public companies over the contractual or remaining contractual term of the warrant. The contractual term of the warrant is determined based on the grant or modification date and the latest date on which the warrant can be exercised under its terms or under the terms of the discounted exercise price offer. The risk-free rate of interest is based on the quoted constant maturity rate for U.S Treasury Bills on the date of the modification for the term corresponding with the contractual term of the warrant. The dividend rate is zero as the Company has not paid and does not expect to pay dividends in the near future.

On June 27, 2013, the Company's Chief Executive Officer exercised an outstanding warrant to purchase 50,000 restricted shares of the Company's common stock at an exercise price of \$0.64 per share and the Company received cash proceeds of \$32,000 from his exercise.

Table of Contents

Following the warrant issuances, modifications and exercises described above, at December 31, 2013, the Company had outstanding warrants to purchase shares of its restricted common stock at a weighted average exercise price of \$0.89 per share as follows:

Exercise Price per Share	Expiration Date	Shares Subject to Purchase at December 31, 2013
\$0.50	5/11/2014 to 7/26/2018	5,254,019
\$0.64	3/3/2023	2,940,000
\$0.88	5/11/2014	15,428
\$1.00	7/30/2016 to 9/30/2017	4,406,281
\$1.25	5/11/2014 to 12/31/2014	50,280
\$1.50	5/11/2014 to 3/14/2018	2,491,016
\$2.00	9/15/2017	425,000
\$2.50	5/11/2014	42,443
\$2.625	1/31/2015	61,418
\$3.00	2/13/2016	25,000
		15,710,885

## Deemed Dividend

Pursuant to the October 2012 Agreement described in Note 7, Convertible Promissory Notes and Other Notes Payable, Platinum's exchange rights in the Company's Series A Preferred were modified such that Platinum currently has the right and option to exchange 500,000 restricted shares of the Company's Series A Preferred that it holds for (i) a total of 15,000,000 restricted shares of the Company's common stock (increased from 5,000,000 shares), and (ii) a five-year warrant to purchase 7,500,000 restricted shares of the Company's common stock at an initial exercise price of \$1.50 per share (the "Series A Exchange Warrant"). The modification of the exchange ratio and the contingent grant of the Series A Exchange Warrant pursuant to the October 2012 Agreement resulted in a deemed dividend on the Series A Preferred in the aggregate amount of \$10,193,200 for accounting purposes, which has been reflected in the accompanying Condensed Consolidated Statement of Operations and Comprehensive Loss for the three and nine month periods ended December 31, 2012. The aggregate amount of the deemed dividend was determined based on (i) the fair value of the 10 million incremental shares to which Platinum is entitled pursuant to the October 2012 Agreement valued at the \$0.75 per share quoted market price for the Company's common stock on the date of the agreement, an aggregate of \$7.5 million, adjusted for an expected 95% probability of exercise of the exchange rights by Platinum, or \$7,125,000, plus (ii) the fair value of the Series A Exchange Warrant, determined to be \$0.43 per share, on the date of the agreement using the Black Scholes Option Pricing Model and the following assumptions: market price per share: \$0.75; exercise price per share: \$1.50; risk-free interest rate: 0.67%; contractual term: 5 years; volatility: 89.9%; expected dividend rate: 0%; further adjusted for an expected 95% probability of exercise of the exchange rights by Platinum, for a fair value of \$3,068,200. The fair value of the Series A Exchange Warrant was also recognized as a liability at the date of the October 2012 Agreement, with a corresponding charge to additional paid-in capital, an equity account.

## Note 10. Related Party Transactions

Between September and December 2013, one of the Company's executive officers provided short-term cash advances aggregating \$64,000 to meet the Company's short-term working capital requirements. In lieu of cash repayment of the

advances by the Company, in December 2013, the officer elected to invest \$50,000 in the 2013 Unit Private Placement. The Company has partially repaid the remaining balance of the advances.

Cato Holding Company, doing business as Cato BioVentures ("CBV"), the parent of CRL, is one of the Company's largest institutional stockholders at December 31, 2013. As described in Note 7, Convertible Promissory Notes and Other Notes Payable, in October 2012, the 2011 CHC Note was cancelled and exchanged for the 2012 CHC Note and the CHC Warrant. The 2012 CHC Note bears interest at the rate of 7.5% compounded monthly and is payable in monthly installments of \$10,000 beginning November 1, 2012 until the balance is paid in full, with the final monthly payment to be made in the amount equal to the then current outstanding balance of principal and interest due under the 2012 Cato Note. Total interest expense, including amortization of note discount, on notes payable to CHC was \$7,900 and \$24,000 in the three and nine month periods ended December 31, 2013, respectively, and \$34,700 and \$51,400 in the three and nine month periods ended December 31, 2012, respectively.

Table of Contents

During fiscal year 2007, the Company entered into a contract research organization arrangement with CRL related to the development of its lead drug candidate, AV-101, and subsequent other projects under which the Company incurred expenses of \$7,500 and \$124,700 in the three month periods ended December 31, 2013 and 2012, respectively, and \$45,000 and \$639,300 in the nine month periods ended December 31, 2013 and 2012, respectively.

As described in Note 7, Convertible Promissory Notes and Other Notes Payable, in October 2012, the Company issued to CRL (i) the CRL Note as payment in full for all contract research and development services and regulatory advice (“CRO Services”) rendered by CRL to the Company and its affiliates through December 31, 2012 with respect to the preclinical and clinical development of AV-101, and (ii) the CRL Warrant. The principal amount of the CRL Note may, at the Company’s option, be automatically increased as a result of future CRO Services rendered by CRL to the Company and its affiliates from January 1, 2013 to June 30, 2013. The CRL Note accrues interest at a rate of 7.5% compounded monthly, is due and payable on March 31, 2016 and is payable solely by CRL's surrender from time to time of all or a portion of the principal and interest balance due on the CRL Note in connection with its concurrent exercise of the CRL Warrant. Total interest expense, including amortization of the note discount, on the CRL Note for the three and nine month periods ended December 31, 2013 was \$32,000 and \$103,500, respectively, and \$26,300 for both the three and nine month periods ended December 31, 2012.

Note 11. Subsequent Events

2014 Unit Private Placement

Through February 10, 2014, the Company entered into additional securities purchase agreements with accredited investors pursuant to which it sold to such investors aggregate Units consisting of (i) one-year 10% convertible Unit Notes in the aggregate face amount of \$390,000; (ii) an aggregate of 780,000 shares of the Company’s restricted common stock; and (iii) warrants exercisable through July 30, 2016 to purchase an aggregate of 780,000 restricted shares of the Company’s common stock at an exercise price of \$1.00 per share. The Company received cash proceeds of \$390,000 from the sales of the Units.

Table of Contents

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

Cautionary Note Regarding Forward-Looking Statements

The following discussion contains forward-looking statements that are based on the current beliefs of our management, as well as current assumptions made by, and information currently available to, our management. All statements contained in the discussion below, other than statements that are purely historical, are forward-looking statements. These forward-looking statements are subject to risks and uncertainties that could cause our future actual results, performance or achievements to differ materially from those expressed in, or implied by, any such forward-looking statements as a result of certain factors, including, but not limited to, those risks and uncertainties discussed in this section, as well as elsewhere in our other filings with the Securities and Exchange Commission ("SEC"). Forward-looking statements are based on estimates and assumptions we make in light of our experience and perception of historical trends, current conditions and expected future developments, as well as other factors that we believe are appropriate and reasonable in the circumstances.

Our business is subject to significant risks including, but not limited to, our ability to obtain additional financing, the results of our research and development efforts, the results of non-clinical and clinical testing, the effect of regulation by the United States Food and Drug Administration ("FDA") and other agencies, the impact of competitive products, product development, commercialization and technological difficulties, the effect of our accounting policies, and other risks as detailed in the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended March 31, 2013 and in our other filings with the SEC. Further, even if our product candidates appear promising at various stages of development, our share price may decrease such that we are unable to raise additional capital without significant dilution or other terms that may be unacceptable to our management, Board of Directors and stockholders.

Investors are cautioned not to place undue reliance on the forward-looking statements contained herein. Additionally, unless otherwise stated, the forward-looking statements contained in this report are made as of the date of this report, and we have no intention and undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law. The forward-looking statements contained in this report are expressly qualified by this cautionary statement. New factors emerge from time to time, and it is not possible for us to predict which factors may arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause our actual results to differ materially from those contained in any forward-looking statements.

Business Overview

We are a biotechnology company with expertise applying human pluripotent stem cell technology for drug rescue, drug discovery and regenerative medicine.

Our Human Clinical Trials in a Test Tubetm platform is based on a combination of proprietary and exclusively licensed stem cell technologies focused on understanding and controlling stem cell differentiation (development) and production of multiple types of mature, functional, human cells from human pluripotent stem cells, including human heart cells and liver cells used in our novel bioassay systems.

Table of Contents

With mature heart cells produced from stem cells, we have developed CardioSafe 3D™, a novel bioassay system for assessing cardiotoxicity. We believe CardioSafe 3D™ is capable of predicting the in vivo cardiac effects, both toxic and non-toxic, of small molecule drug candidates before they are ever tested in animals or humans. We are developing LiverSafe 3D™, a human liver cell-based bioassay system, for assessing potential liver toxicity and adverse drug-drug interactions early in development. We believe our human pluripotent stem cell-derived bioassay systems will allow us to assess the heart and liver safety profile of new drug candidates with greater speed and precision than nonclinical surrogate safety testing models currently used in drug development.

Drug rescue involves the combination of human pluripotent stem cell technology with medicinal chemistry. The primary goal of drug rescue is to generate new, safer proprietary variants of once-promising small molecule drug candidates that pharmaceutical companies and others have discovered, developed and ultimately discontinued prior to market approval due to unexpected heart or liver safety concerns. We refer to once-promising drug candidates now suitable for drug rescue as Drug Rescue Candidates™. And we refer to new, safer proprietary variants generated in drug rescue campaigns as Drug Rescue Variants™. Our drug rescue strategy is to leverage (i) prior R&D investment in Drug Rescue Candidates™ by pharmaceutical companies and others, (ii) our unique insight into heart and liver biology from CardioSafe 3D™ and LiverSafe 3D™, and (iii) medicinal chemistry to generate Drug Rescue Variants for license and sale to pharmaceutical companies and others.

We are utilizing the vast amount of information available in the public domain to identify and assess potential Drug Rescue Candidates. We may also seek to acquire rights to certain Drug Rescue Candidates from third-parties, including academic research institutions and biotechnology, medicinal chemistry and pharmaceutical companies. We plan to have a range of economic participation rights in each lead Drug Rescue Variant we license or sell, including up-front payments, milestone payments and, if approved for commercial sale, royalties on net sales.

In parallel with our drug rescue activities, we plan to explore, internally and/or through sponsored external programs, pilot nonclinical development opportunities relating to small molecule drug discovery and/or regenerative medicine focused on blood, bone, cartilage, heart, liver and pancreas (insulin-producing beta islet) cells. Each of these drug discovery and regenerative medicine programs would be based on the proprietary differentiation and production capabilities of our Human Clinical Trials in a Test Tubetm platform.

With grant funding from the U.S. National Institutes of Health (“NIH”), we have successfully completed Phase 1 development of AV-101. AV-101 is an orally available small molecule prodrug candidate aimed at the multi-billion dollar neurological disease and disorders market, including neuropathic pain, a serious and chronic condition causing pain after an injury or disease of the peripheral or central nervous system, and depression. We were awarded over \$8.8 million of grant funding from the NIH to support our nonclinical and Phase I clinical development of AV-101 for neuropathic pain. We intend to explore potential strategic partnering alternatives for further development of AV-101 for neuropathic pain, depression or other neurological conditions and diseases.

Table of Contents

Financial Operations Overview and Results of Operations

Our critical accounting policies and estimates and recent accounting pronouncements are disclosed in our Form 10-K for the fiscal year ended March 31, 2013, as filed with the United States Securities and Exchange Commission, and in Note 3 to the accompanying unaudited Condensed Consolidated Financial Statements included in Part 1, Item 1 of this Quarterly Report on Form 10-Q.

Summary

During the nine months ended December 31, 2013, our scientific personnel have continued to expand the drug rescue capabilities of CardioSafe 3D™ and further develop LiverSafe 3D™. Scientific operations were curtailed somewhat during the quarter ended September 30, 2013 as we decommissioned our former lab space in preparation for our move to expanded lab and office facilities at the end of July 2013 and completed the corresponding relocation, recalibration and recertification of our laboratories and equipment following the move. Limited cash resources during the quarter ended December 31, 2013 have limited certain scientific activities and collaborations. Nevertheless, we have continued to advance the capabilities of our heart and liver cells and pursue our internal evaluation of prospective drug rescue candidates. We successfully completed Phase 1 clinical development of AV-101 during our fiscal year ended March 31, 2013 and directed effort during our first fiscal quarter to finalizing AV-101 Phase 1b clinical study reports, as required under the terms of our NIH grant awards and to facilitate further collaborative development of AV-101.

Throughout this fiscal year, our executive management has been significantly focused on providing sufficient operating capital to advance our research and development objectives while meeting our continuing operational needs. To that end, in April 2013, we entered into a Securities Purchase Agreement (as amended, the “Securities Purchase Agreement”) with Autilion AG, a company organized and existing under the laws of Switzerland (“Autilion”). Under the terms of the Securities Purchase Agreement, Autilion is contractually obligated to purchase an aggregate of 72.0 million restricted shares of our common stock at a purchase price of \$0.50 per share for aggregate cash proceeds to us of \$36.0 million (the “Autilion Financing”). At December 31, 2013, we had completed a nominal initial closing of the Autilion Financing. Although there can be no assurance that an additional closing of the Autilion Financing will occur, in early January 2014, Autilion informed the Company of its expectation that the Company will receive the full \$36.0 million committed under the terms of the Securities Purchase Agreement between mid-January and mid-February 2014. [As of the date of this report, there has not been a subsequent closing of the Autilion Financing.] The Securities Purchase Agreement also provides for the election to our Board of Directors of a designee of Autilion upon completion of the Autilion Financing. This transaction is described in greater detail in Note 9, Capital Stock, in the Condensed Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q.

For strategic purposes and to meet our working capital needs prior to the closing of the Autilion Financing, during June and July 2013, we offered certain warrant holders the opportunity to exercise outstanding warrants having an exercise price of \$1.50 per share to purchase shares of our restricted common stock at a reduced exercise price of \$0.50 per share. Through July 2013, warrant holders exercised modified warrants to purchase an aggregate of 528,370 restricted shares of our common stock and we received cash proceeds of \$264,200. In addition, certain long-term warrant holders exercised modified warrants to purchase 16,646 shares of our restricted common stock in lieu of payment by us in satisfaction of amounts due for professional services in the aggregate amount of \$8,300. Additionally, in July 2013, we issued to Platinum a senior secured convertible note in the face amount of \$250,000 (the “July 2013 Note”) and a five-year warrant to purchase 250,000 shares of our restricted common stock at an exercise price of \$0.50 per share. Between August 2013 and February 10, 2014 we entered into strategic securities purchase agreements with accredited investors pursuant to which we sold to such investors Units of our securities consisting, in aggregate, of: (i) one-year 10% convertible notes in the aggregate face amount of \$970,000; (ii) an aggregate of 1,940,000 shares of our restricted common stock; and (iii) warrants exercisable through July 30, 2016 to purchase an aggregate of 1,940,000 restricted shares of our common stock at an exercise price of \$1.00 per share. We received



cash proceeds of \$970,000 from the sale of the Units, including \$50,000 in lieu of repayment of previous advances made to us by one of our executive officers. Under certain circumstances, the July 2013 Note issued to Platinum is convertible into Units.

-26-

---

Table of Contents

## Comparison of Three Months Ended December 31, 2013 and 2012

The following table summarizes the results of our operations for the three months ended December 31, 2013 and 2012 (amounts in \$000).

	Three Months Ended December 31,	
	2013	2012
Grant Revenue	\$-	\$-
Operating expenses:		
Research and development	551	1,120
General and administrative	897	799
Total operating expenses	1,448	1,919
Loss from operations	(1,448 )	(1,919 )
Interest and other expenses (net)	(361 )	(235 )
Change in warrant liabilities	1,940	358
Loss on early extinguishment of debt	-	(3,537 )
Income (loss) before income taxes	131	(5,333 )
Income taxes	-	(2 )
Net income (loss)	\$131	\$(5,335 )
Deemed dividend on Series A Preferred Stock	-	(10,193 )
Net income (loss) attributable to common stockholders	\$131	\$(15,528 )

## Revenue

We reported no grant or subcontract revenue for the quarter ended December 31, 2013 or 2012. We have successfully completed our Phase I development of AV-101, our prodrug candidate for the treatment of neuropathic pain and, potentially, depression and other neurological conditions. Our NIH grant related to AV-101 expired in its normal course on June 30, 2012 and has not been extended or renewed. We had drawn the maximum amount available under the grant prior to its expiration. Revenue associated with our earlier subcontract research arrangement terminated in May 2012.

Table of Contents

## Research and Development Expense

Research and development expense totaled \$551,000 for the quarter ended December 31, 2013, a decrease of 51% compared to \$1,120,000 for the quarter ended December 31, 2012. The following table indicates the primary components of research and development for each of the periods (in \$000):

	Three Months Ended	
	December 31,	
	2013	2012
Salaries and benefits	\$223	\$202
Stock-based compensation	160	575
UHN research under SRCA	-	91
Technology licenses and royalties	29	8
Project-related third-party research and supplies:		
AV-101	6	127
All other including CardioSafe and LiverSafe	68	81
	74	208
Rent	54	29
Depreciation	11	7
Total Research and Development Expense	\$551	\$1,120

The increase in R&D salaries and benefits expense reflects the impact of the addition of a research technician in April 2013, the partial restoration in April 2013 of an earlier voluntary salary reduction to below his contractual pay rate taken by our President and Chief Scientific Officer, and general increases in employee benefits costs. In addition to the ratable amortization of stock-based compensation expense over the requisite service period of the respective grants made in both the current year and in prior years, stock-based compensation expense for the quarter ended December 31, 2013 includes approximately \$82,000 as the impact of October 2013 and December 2013 modifications to reduce the exercise price of certain outstanding option grants to \$0.40 per share or \$0.50 per share, as well as approximately \$33,000 attributable to the expense resulting from the March 2013 grant of a warrant to our President and Chief Scientific Officer that vests over three years, subject to certain vesting acceleration events. Stock-based compensation expense for the quarter ended December 2012 includes approximately \$558,000 as the impact of October 2012 modifications reducing the exercise price to \$0.75 per share and reducing any remaining vesting period to two years for certain option grants having exercise prices between \$1.13 per share and \$2.58 per share made to certain scientific employees and consultants in prior years. Our 2012/2013 sponsored research project budget under the collaboration agreement with Dr. Gordon Keller's laboratory at UHN ended on September 30, 2013. We are currently in discussions with Dr. Keller and UHN regarding the scope of our 2013/2014 sponsored research project budget under the agreement, and we anticipate finalizing such budget in the near term.. The expense recorded in 2012 reflects our stem cell research collaboration in accordance with our agreements with UHN made in the third and fourth quarters of our fiscal year ended March 31, 2012 and in a further modification effective beginning in October 2012. Technology license expense increased in 2013 reflecting increased costs for patent prosecution and protection that we are required to fund under the terms of certain of our license agreements. We recognize these costs as they are invoiced to us by the licensors and they do not occur ratably throughout the year or between years. We began Phase 1b clinical trials of AV-101 early in calendar 2012 and completed them by mid-year 2012. AV-101 expenses in the current quarter of calendar 2013 reflect the costs associated with monitoring for and responding to potential feedback related to our final clinical trial and other reports required under the terms of the prior NIH grant, primarily through our contract research collaborator, Cato Research Ltd. The 2013 increases in rent and depreciation expenses reflect increased rental costs and the amortization of tenant improvements related to our relocation to expanded facilities in late-July 2013.



Table of Contents

## General and Administrative Expense

General and administrative expense was \$897,000 for the quarter ended December 31, 2013, an increase of 12% compared with \$799,000 for the quarter ended December 31, 2012. The following table indicates the primary components of general and administrative expenses for each of the periods (in \$000):

	Three Months Ended	
	December 31,	
	2013	2012
Salaries and benefits	\$155	\$165
Stock-based compensation	309	239
Consulting services	24	37
Legal, accounting and other professional fees	74	64
Investor relations	30	204
Insurance	33	30
Travel and entertainment	2	9
Rent and utilities	40	21
Warrant modification expense	207	-
All other expenses	23	30
<b>Total General and Administrative Expense</b>	<b>\$897</b>	<b>\$799</b>

The decrease in administrative salaries and benefits expense reflects the impact of (i) the partial restoration in April 2013 of an earlier voluntary salary reduction to below his contractual pay rate taken by our Chief Executive Officer; (ii) the September 2012 conversion of our Chief Financial Officer from part-time consultant to full-time employee status; (iii) the April 2013 conversion of an administrative assistant from part-time consultant to part-time employee status, and (iv) general annual increases in employee benefits costs; all offset by the impact of a voluntary resignation of an administrative staff member. In addition to the ratable amortization of stock-based compensation expense over the requisite service period of the respective grants made in both the current year and in prior years, stock-based compensation expense for the quarter ended December 31, 2013 includes approximately \$170,000 as the impact of October 2013 and December 2013 modifications to reduce the exercise price of certain outstanding option grants to \$0.40 per share or \$0.50 per share, as well as approximately \$67,000 attributable to the expense resulting from the March 2013 grant of warrants vesting over three years, subject to certain vesting acceleration events, to certain members of our senior management and to the independent members of our Board of Directors. Stock-based compensation expense for the quarter ended December 2012 includes approximately \$231,000 as the impact of October 2012 modifications reducing the exercise price to \$0.75 per share and reducing any remaining vesting period to two years for certain option grants having exercise prices between \$1.13 per share and \$2.58 per share made to certain administrative employees and consultants in prior years. The increase in legal, accounting and other professional fees primarily reflects the impact of temporary employee fees offset by the impact of the September 2012 conversion of our Chief Financial Officer from part-time consultant to full-time employee status, as noted above. During 2012, we had engaged third parties to provide us with investor relations services and to conduct market awareness initiatives; for strategic purposes, we have significantly scaled back those initiatives during 2013. The 2013 increase in rent and utilities reflects increased costs related to our relocation to expanded facilities in late-July 2013. Warrant modification expense reflects the impact of October 2013 and December 2013 strategic reductions in the exercise price of certain outstanding warrants, generally from \$1.75 per share or \$1.50 per share, to \$0.50 per share, and in limited cases, the extension of the term of certain outstanding warrants.



Table of Contents

## Interest and Other Expenses, Net

Interest expense, net totaled \$361,000 for the three months ended December 31, 2013, a 54% increase compared to the \$235,000 reported for the three months ended December 31, 2012. The following table summarizes the primary components of interest expense for each of the periods (in \$000):

	Three Months Ended	
	December 31,	
	2013	2012
Interest expense on promissory notes, including discount amortization	\$383	\$262
Charge related to registration rights for February 2012 12% convertible notes	-	(21 )
Charge for investment banker warrants related to February 2012 Convertible promissory notes	-	28
Other interest expense, including on capital leases and premium financing	2	2
	385	271
Effect of foreign currency fluctuations on notes payable	(21 )	\$(9 )
Interest Income	(3 )	\$(27 )
Interest Expense, net	\$361	\$235

The increase in interest expense is primarily attributable to the accrued interest and discount amortization recorded for the July 2012 through July 2013 issuances and restructuring of an aggregate of \$3.5 million of 10% senior secured convertible notes to Platinum, including the \$250,000 convertible note issued in July 2013, as well as the restructuring in September and October 2012 of an additional \$3.9 million of debt into new convertible notes to other service providers including Morrison & Foerster, Cato Research Ltd., and University Health Network. These transactions are described in greater detail in Note 7, Convertible Promissory Notes and Other Notes Payable, in the Condensed Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q.

Under the terms of the October 2012 Note Exchange and Purchase Agreement we entered with Platinum, we issued certain Senior Secured Convertible Promissory Notes and a related Exchange Warrant and Investment Warrants in October 2012, February 2013 and March 2013. We also issued a similar senior secured promissory note and related warrant to Platinum in July 2013. Upon Platinum's exchange of the shares of our Series A preferred stock held by Platinum into shares of our common stock, we will also be required to issue a Series A Exchange Warrant to Platinum. All of these notes and warrants are described more completely in Note 7, Convertible Promissory Notes and Other Notes Payable, in the Condensed Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q. We determined that the various warrants included certain exercise price adjustment features requiring us to treat the warrants as liabilities. Accordingly, we recorded a non-cash warrant liability at its estimated fair value as of the date of warrant issuance or contract execution. During the quarter ended December 31, 2013, we recognized non-cash income of \$1,940,000 related to the net decrease in the estimated fair value of these liabilities since September 30, 2013, which resulted primarily from the decrease in the market price of our common stock in relation to the anticipated exercise price of the warrants. During the quarter ended December 31, 2012, we recognized non-cash income of \$358,000 related to the net decrease in the estimated fair value of the warrant liabilities since their initial October 2012 issuance date, which again resulted primarily from the decrease in the market price of our common stock in relation to the anticipated exercise price of the warrants.

In the quarter ended December 31, 2012, we recognized non-cash losses on the early extinguishment of debt in the aggregate amount of \$3.5 million as a result of the restructuring of notes payable to Platinum and Cato Holding Company, and the restructuring of accounts payable to Cato Research, Ltd. and University Health Network that were converted to notes payable, as well as upon the conversion by the holders of our 12% Convertible Promissory Notes issued in February 2012 into restricted shares of our common stock and warrants, all of which were treated as

extinguishment of debt for accounting purposes.

-30-

---



Table of Contents

In October 2012, in connection with the Note and Exchange Agreement we entered with Platinum, as described in Note 7, Convertible Promissory Notes and Other Notes Payable, and Note 9, Capital Stock, in the Condensed Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q, we recorded a non-cash deemed dividend of \$10.2 million as a result of the modification of the exchange rights for the Series A Preferred Stock held by Platinum and the related contingent grant of a five-year warrant to purchase shares of our common stock upon Platinum's exercise of its Series A preferred stock exchange rights.

## Comparison of Nine Months Ended December 31, 2013 and 2012

The following table summarizes the results of our operations for the nine months ended December 31, 2013 and 2012 (amounts in \$000).

	Nine Months Ended December 31,	
	2013	2012
Revenues:		
Grant revenue	\$-	\$200
Operating expenses:		
Research and development	1,916	3,092
General and administrative	2,048	2,430
Total operating expenses	3,964	5,522
Loss from operations	(3,964 )	(5,322 )
Other expenses, net:		
Interest expense, net	(1,000 )	(612 )
Change in warrant liabilities	3,824	358
Loss on early extinguishment of debt	-	(3,537 )
Loss before income taxes	(1,140 )	(9,113 )
Income taxes	(3 )	(4 )
Net loss	\$(1,143 )	\$(9,117 )
Deemed dividend on Series A Preferred Stock	-	(10,193 )
Net loss attributable to common stockholders	\$(1,143 )	\$(19,310 )

## Revenue

The following table compares our primary revenue sources between the periods (in \$000):

	Nine Months Ended December 31,	
	2013	2012
NIH - AV-101 grant	\$-	\$187
Subcontract revenue	-	13
Total Revenue	\$-	\$200

Table of Contents

We have successfully completed our Phase I development of AV-101, our prodrug candidate for the treatment of neuropathic pain and, potentially, depression and other neurological conditions. Our NIH grant related to AV-101 expired in its normal course on June 30, 2012. We had drawn the maximum amount available under the grant prior to its expiration. Revenue associated with our earlier subcontract research arrangement terminated in May 2012.

## Research and Development Expense

Research and development expense totaled \$1,916,000 for the nine months ended December 31, 2013, a decrease of 38% compared to \$3,092,000 for the nine months ended December 31, 2012. The following table indicates the primary components of research and development for each of the periods (in \$000):

	Nine Months Ended	
	December 31,	
	2013	2012
Salaries and benefits	\$679	\$587
Stock-based compensation	340	667
UHN research under SRCA	160	391
Technology licenses and royalties	365	108
Project-related third-party research and supplies:		
AV-101	44	1,049
All other including CardioSafe and LiverSafe	166	189
	210	1,238
Rent	129	86
Depreciation	33	15
Total Research and Development Expense	\$1,916	\$3,092

The increase in R&D salaries and benefits expense reflects the impact of (i) the addition of a research technician in April 2013; (ii) the partial restoration in April 2013 of an earlier voluntary salary reduction to below his contractual pay rate taken by our President and Chief Scientific Officer; and (iii) general annual increases in employee benefits costs. In addition to the ratable amortization of stock-based compensation expense over the requisite service period of the respective grants made in both the current year and in prior years, stock-based compensation expense for the nine months ended December 31, 2013 includes approximately \$82,000 as the impact of October 2013 and December 2013 modifications to reduce the exercise price of certain outstanding option grants to \$0.40 per share or \$0.50 per share, as well as approximately \$100,000 attributable to the expense resulting from the March 2013 grant of a warrant to our President and Chief Scientific Officer that vests over three years, subject to certain vesting acceleration events. Stock-based compensation expense for the quarter ended December 2012 includes approximately \$558,000 as the impact of October 2012 modifications reducing the exercise price to \$0.75 per share and reducing any remaining vesting period to two years for certain option grants having exercise prices between \$1.13 per share and \$2.58 per share made to certain scientific employees and consultants in prior years. Our 2012/2013 sponsored research project budget under the collaboration agreement with Dr. Gordon Keller's laboratory at UHN ended on September 30, 2013. We are currently in discussions with Dr. Keller and UHN regarding the scope of our 2013/2014 sponsored research project budget under the agreement, and we anticipate finalizing such budget in the near term. The expense recorded in 2012 reflects our stem cell research collaboration in accordance with our agreements with UHN made in the third and fourth quarters of our fiscal year ended March 31, 2012 and in a further modification effective beginning in October 2012. Technology license expense has increased in 2013 reflecting significantly increased costs for patent prosecution and protection that we are required to fund under the terms of certain of our license agreements. We recognize these costs as they are invoiced to us by the licensors and they do not occur ratably throughout the year or between years. We began Phase 1b clinical trials of AV-101 early in calendar 2012, completing them by mid-year 2012. We recorded significant expense related to the trials during the nine months ended December 31,

2012. AV-101 expenses in the nine months ended December 31, 2013 reflect the costs associated with finalizing the AV-101 clinical trial results, preparing the final clinical trial and other reports required under the terms of the NIH grant and monitoring for feedback related to the reports, activities performed primarily through our contract research collaborator, Cato Research Ltd. The increase in rent expense and depreciation for the nine months ended December 31, 2013 reflects increased rental costs and the amortization of tenant improvements related to our relocation to expanded facilities in late-July 2013.

Table of Contents

## General and Administrative Expense

General and administrative expense totaled \$2,048,000 for the nine months ended December 31, 2013, a reduction of 16% compared with \$2,430,000 for the nine months ended December 31, 2012. The following table indicates the primary components of general and administrative expenses for each of the periods (in \$000):

	Nine Months Ended	
	2013	2012
Salaries and benefits	\$553	\$433
Stock-based compensation	553	295
Consulting services	87	122
Legal, accounting and other professional fees	275	357
Investor relations	90	509
Insurance	97	92
Travel and entertainment	18	23
Rent and utilities	98	65
Warrant modification expense	174	440
All other expenses	103	94
<b>Total General and Administrative Expense</b>		