CYTODYN INC
Form 10-Q
April 10, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended February 28, 2015

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1933**
For the transition period from _____ to _____

Commission File Number: 000-49908

CYTODYN INC.

(Exact name of registrant as specified in its charter)

Colorado	**75-3056237**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer or Identification No.)**
1111 Main Street, Suite 660 Vancouver, Washington	**98660**
(Address of principal executive offices)	**(Zip Code)**

(Registrant s telephone number, including area code) (360) 980-8524

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 ¨

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 x

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

On March 31, 2015, there were 63,440,195 shares outstanding of the registrant s no par value common stock.

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PART I

Item 1. Financial Statements.

CytoDyn Inc.

Consolidated Balance Sheets

	February 28, 2015 (unaudited)	May 31, 2014
Assets		
Current assets:		
Cash	$ 1,670,390	$ 4,886,122
Prepaid expenses	231,247	488,821
Deferred offering costs	43,292	68,292
Total current assets	1,944,929	5,443,235
Furniture and equipment, net	25,145	16,797
Intangibles, net	2,704,739	2,967,239
Total Assets	$ 4,674,813	$ 8,427,271
Liabilities and Shareholders (Deficit) Equity		
Current liabilities:		
Accounts payable	$ 2,213,069	$ 1,286,715
Accrued liabilities	127,508	65,000
Accrued salaries and severance	69,450	395,364
Accrued interest payable	115,820	41,276
Convertible notes payable, net	2,462,509	
Related party, convertible note payable, net	1,091,265	
Related party, derivative liability	156,842	
Stock rescission liability	353,000	378,000
Total current liabilities	6,589,463	2,166,355
Long-term liabilities		
Related party, convertible note payable, net	1,226,451	
Related party, derivative liability	557,452	
Convertible notes payable, net		2,338,684
Total liabilities	8,373,366	4,505,039
Shareholders (deficit) equity:		
Series B convertible preferred stock, no par value; 400,000 shares authorized, 95,100 shares issued and outstanding at February 28, 2015 and May 31, 2014, respectively	259,501	266,251

Common stock, no par value; 100,000,000 shares authorized, 59,259,116 and 55,753,311 issued and outstanding at February 28, 2015 and May 31, 2014, respectively	32,591,694	30,367,779
Additional paid-in capital	21,322,572	20,100,434
Common and preferred stock subject to rescission	(353,000)	(378,000)
Accumulated (deficit)	(57,519,320)	(46,434,232)
Total shareholders (deficit) equity	(3,698,553)	3,922,232
Total liabilities and shareholders (deficit) equity	$ 4,674,813	$ 8,427,271

See accompanying notes to consolidated financial statements.

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CytoDyn Inc.

Consolidated Statements of Operations

(Unaudited)

	Three Months Ended February 28,		Nine Months Ended February 28,	
	2015	2014	2015	2014
Operating expenses:				
General and administrative	$ 750,648	$ 915,970	$ 2,075,521	$ 2,255,448
Amortization and depreciation	90,157	88,072	270,197	263,692
Research and development	2,264,064	1,655,914	6,414,531	2,387,866
Legal fees	187,582	215,611	478,466	570,425
Total operating expenses	3,292,451	2,875,567	9,238,715	5,477,431
Operating loss	(3,292,451)	(2,875,567)	(9,238,715)	(5,477,431)
Interest income	338	3,197	2,026	5,591
Gain on settlement of accounts payable		97,253		111,199
Change in fair value of derivative liability	1,261,545		455,970	
Interest expense:				
Amortization of discount on convertible notes	(254,485)	(402,467)	(1,298,825)	(3,449,868)
Amortization of discount on related party convertible notes	(143,012)		(203,711)	
Amortization of debt issuance costs		(3,332)		(120,000)
Inducement interest	(202,295)		(555,628)	
Interest on notes payable	(91,293)	(93,481)	(246,204)	(505,032)
Total interest expense	(691,085)	(499,280)	(2,304,368)	(4,074,900)
Loss before income taxes	(2,721,653)	(3,274,397)	(11,085,087)	(9,435,541)
Provision for taxes on income				
Net loss	$ (2,721,653)	$ (3,274,397)	$ (11,085,087)	$ (9,435,541)
Basic and diluted loss per share	$ (0.05)	$ (0.06)	$ (0.19)	$ (0.22)
Basic and diluted weighted average common shares outstanding	58,961,254	55,472,263	56,985,042	43,786,195

See accompanying notes to consolidated financial statements.

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CytoDyn Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended February 28,	
	2015	2014
Cash flows from operating activities:		
Net loss	$ (11,085,087)	$ (9,435,541)
Adjustments to reconcile net loss to net cash used by operating activities:		
Amortization and depreciation	270,197	263,692
Amortization of debt issuance costs		120,000
Amortization of discount on convertible notes	1,298,825	3,449,868
Amortization of discount on related party notes	203,711	
Gain on settlement of accounts payable		(111,199)
Change in fair value of derivative liability	(455,970)	
Interest expense associated with conversion and exercise inducement	555,628	193,160
Stock-based compensation	450,782	784,337
Changes in current assets and liabilities:		
Decrease (increase) in prepaid expenses	257,575	(347,914)
Increase (decrease) in accounts payable, accrued salaries and severance, accrued interest and accrued liabilities	738,224	(552,122)
Net cash used in operating activities	(7,766,115)	(5,635,719)
Cash flows from investing activities:		
Furniture and equipment purchases	(16,053)	(11,217)
Net cash used in investing activities	(16,053)	(11,217)
Cash flows from financing activities:		
Proceeds from issuance of convertible notes payable	3,500,000	1,200,000
Payment on convertible note payable		(250,000)
Proceeds from sale of common stock		13,642,667
Payments of offering costs		(2,204,063)
Proceeds from exercise of warrants	1,066,436	50,000
Net cash provided by financing activities	4,566,436	12,438,604
Net change in cash	(3,215,732)	6,791,668
Cash, beginning of period	4,886,122	603,681
Cash, end of period	$ 1,670,390	$ 7,395,349

See accompanying notes to consolidated financial statements.

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CytoDyn Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended February 28,	
	2015	2014
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$ 2,198	$
Interest	$ 170,934	$ 165,354
Non-cash investing and financing transactions:		
Common stock issued upon conversion of convertible debt	$ 1,175,000	$ 2,459,000
Common stock issued or to be issued for accrued interest payable	$ 729	$ 84,905
Original issue discount and intrinsic value of beneficial conversion feature related to debt issued with warrants	$	$ 1,200,000
Preferred and common stock subject to recission liability	$ 25,000	$ 158,500
Amortization of deferred offering costs related to recission liability	$	$ 28,638
Accounts payable extinguished through settlements	$	$ 76,181
Original issue discount related to valuation of compound embedded derivative of convertible note payable issued with anti-dilution feature	$ 1,170,264	$
Original issue discount related to valuation of relative fair value of warrants issued with convertible notes payable	$ 215,732	$

See accompanying notes to consolidated financial statements.

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CYTODYN INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF FEBRUARY 28, 2015

(UNAUDITED)

Note 1 Organization

CytoDyn Inc. (the Company) was incorporated under the laws of Colorado on May 2, 2002 under the name RexRay Corporation (RexRay). In October 2003, the Company (under its previous name RexRay Corporation) entered into an Acquisition Agreement with CytoDyn of New Mexico, Inc. Pursuant to the acquisition agreement, the Company acquired assets related to one of the Company s drug candidates, Cytolin, including the assignment of the patent license agreement dated July 1, 1994 between CytoDyn of New Mexico, Inc. and Allen D. Allen covering three United States patents, along with foreign counterpart patents, which describe a method for treating Human Immunodeficiency Virus (HIV) disease with the use of monoclonal antibodies.

CytoDyn Inc. is developing a class of therapeutic monoclonal antibodies to address significant unmet medical needs in the areas of HIV and Acquired Immune Deficiency Syndrome (AIDS).

Advanced Genetic Technologies, Inc. (AGTI) was incorporated under the laws of Florida on December 18, 2006 pursuant to an acquisition during 2006.

On May 16, 2011, the Company formed a wholly owned subsidiary, CytoDyn Veterinary Medicine LLC (CVM) under the laws of the State of Florida, which explores the possible application of the Company s existing proprietary monoclonal antibody technology to the treatment of Feline Immunodeficiency Virus (FIV). The Company views the formation of CVM and the exploration of the application of its existing proprietary monoclonal antibody technology to FIV as an effort to strategically diversify the use of its proprietary monoclonal antibody technology.

Note 2 Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and reflect all adjustments, consisting solely of normal recurring adjustments, needed to fairly present the financial results for these periods. The consolidated financial statements and notes are presented as permitted by Form 10-Q. Accordingly, certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements should be read in conjunction with the financial statements for the fiscal years ended May 31, 2014 and 2013 and notes thereto in the Company s Annual Report on Form 10-K for the fiscal year ended May 31, 2014, filed with the Securities and Exchange Commission on July 10, 2014. Operating results for the three and nine months ended February 28, 2015 and February 28, 2014 are not necessarily indicative of the results that may be expected for the entire year. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair statement of (a) the results of operations for the three and nine month periods ended February 28, 2015 and February 28, 2014, (b) the financial position at February 28, 2015, and (c) cash flows for the nine-month periods ended February 28, 2015 and February 28, 2014, have been made.

Principles of Consolidation

The consolidated financial statements include the accounts of CytoDyn Inc. and its wholly owned subsidiaries, AGTI and CVM. All intercompany transactions and balances are eliminated in consolidation.

Reclassifications

Certain prior year amounts shown in the accompanying consolidated financial statements have been reclassified to conform to the 2015 presentation. These reclassifications did not have any effect on total current assets, total assets, total current liabilities, total liabilities, total shareholders (deficit)/equity or net loss.

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Going Concern

The consolidated accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the accompanying consolidated financial statements, the Company had losses for all periods presented. The Company incurred a net loss of $11,085,087 for the nine months ended February 28, 2015 and has an accumulated deficit of $57,519,320 as of February 28, 2015. These factors, among others, raise substantial doubt about the Company s ability to continue as a going concern.

The consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company s continuation as a going concern is dependent upon its ability to obtain additional operating capital, complete development of its product candidates, obtain U.S. Food & Drug Administration (FDA) approval, outsource manufacturing of the product candidates, and ultimately achieve initial revenues and attain profitability. The Company is currently engaging in significant research and development activities related to these product candidates, and expects to incur significant research and development expenses in the future. These research and development activities are subject to significant risks and uncertainties. The Company intends to finance our future development activities and our working capital needs largely from the sale of debt and equity securities, combined with additional funding from other traditional sources. There can be no assurance, however, that the Company will be successful in these endeavors.

Use of Estimates

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

Cash

Cash is maintained at financial institutions and, at times, balances may exceed federally insured limits. We have never experienced any losses related to these balances. Currently, the FDIC provides insurance coverage up to $250,000 per depositor at each financial institution, and our cash balances may exceed federally insured limits. Balances in excess of federally insured limits at February 28, 2015 and May 31, 2014 approximated $1,468,000 and $4,589,000, respectively.

Identified Intangible Assets

The Company follows the provisions of FASB ASC Topic 350 Intangibles Goodwill and Other, (ASC Topic 350) which establishes accounting standards for the impairment of long-lived assets, such as intangible assets subject to amortization. The Company reviews long-lived assets to be held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the sum of the undiscounted expected future cash flows over the remaining useful life of a long-lived asset group is less than its carrying value, the asset is considered impaired. Impairment losses are measured as the amount by which the carrying amount of the asset group exceeds the fair value of the asset. There were no impairment charges for the three and nine-months ended February 28, 2015 and 2014. The value of the Company s patents would be significantly impaired by any adverse developments as they relate to the clinical trials pursuant to the patents acquired as discussed in Notes 9 and 10. These patents are being amortized over ten years, which was the estimated weighted average life of the

patent portfolio at the time of acquisition. The Company continues to explore opportunities to prolong the patent protection period.

Research and Development

Research and development costs are expensed as incurred.

Stock-Based Compensation

U.S. GAAP requires companies to measure the cost of employee services received in exchange for the award of equity instruments based on the fair value of the award at the date of grant. The expense is to be recognized over the period during which an employee is required to provide services in exchange for the award (requisite service period).

The Company accounts for common stock options and common stock warrants based on the fair market value of the instrument using the Black-Scholes option pricing model utilizing certain weighted average assumptions such as expected stock price volatility, term of the options and warrants, risk-free interest rates, and expected dividend yield at the grant date. The risk-free interest rate assumption is

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based upon observed interest rates appropriate for the expected term of the stock options. The expected volatility is based on the historical volatility of the Company s common stock at consistent intervals. The Company has not paid any dividends on its common stock since its inception and does not anticipate paying dividends on its common stock in the foreseeable future. The computation of the expected option term is based on the simplified method, as the Company s stock options are plain vanilla options and the Company has a limited history of exercise data. For common stock options and warrants with periodic vesting, the Company recognizes the related compensation costs associated with these options and warrants on a straight-line basis over the requisite service period.

U.S. GAAP requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based on limited historical experience of forfeitures, the Company estimated future unvested option forfeitures at 0% for all periods presented.

Preferred Stock

As of February 28, 2015, the Company s Board of Directors is authorized to issue up to 5,000,000 shares of preferred stock without shareholder approval. As of February 28, 2015, the Company has authorized the issuance of 400,000 shares of Series B convertible preferred stock. The remaining preferred shares authorized have no specified rights other than the shares are non-voting.

Deferred Offering Costs

In connection with a stock rescission liability as discussed in Note 3, the Company has recorded approximately $43,300 and $68,300 in deferred offering costs as of February 28, 2015, and May 31, 2014, respectively. These deferred offering costs have been recorded as a current asset for the respective periods. The asset will be offset against equity and reduce equity at the end of the applicable period during which the investors described in Note 3 do not assert their rescission rights and retain their shares. Conversely, if the investors assert their rescission rights and forfeit their shares, the deferred offering costs will be expensed at that time.

Stock for Services

The Company periodically issues common stock, warrants and common stock options to consultants for various services. Costs of these transactions are measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. The value of the common stock is measured at the earlier of (i) the date at which a firm commitment for performance by the counterparty to earn the equity instruments is reached or (ii) the date at which the counterparty s performance is complete.

Loss Per Common Share

Basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share is computed by dividing net loss by the weighted average common shares and potentially dilutive common share equivalents. The effects of potential common stock equivalents are not included in computations when their effect is anti-dilutive. Because of the net losses for all periods presented, the basic and diluted weighted average shares outstanding are the same since including the additional shares would have an anti-dilutive effect on the loss per share calculation. Common stock options and warrants to purchase 23,055,950 and 31,970,327 shares of common stock were not included in the computation of basic and diluted weighted average common shares outstanding for the nine-months ended February 28, 2015 and February 28, 2014, respectively, as inclusion would be anti-dilutive for these periods. Additionally, as of February 28, 2015, 95,100 shares of Series B convertible preferred stock can potentially convert into 951,000 shares of common stock,

and $6,596,250 of face amount convertible debt can potentially convert into 7,628,333 shares of common stock.

Fair Value of Financial Instruments

At February 28, 2015 and May 31, 2014 the carrying value of the Company s cash, accounts payable and accrued liabilities approximate their fair value due to the short-term maturity of the instruments. The Company carries derivative financial instruments at fair value as required by U.S. GAAP.

Derivative financial instruments consist of financial instruments that contain a notional amount and one or more underlying variables (e.g., interest rate, security price, variable conversion rate or other variables), require no initial net investment and permit net settlement. Derivative financial instruments may be free-standing or embedded in other financial instruments. The Company follows the provisions of FASB ASC 815 Derivatives and Hedging (ASC 815), as their instruments are recorded as a derivative liability, at fair value, with changes in fair value reflected in income.

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Fair Value Hierarchy

The three levels of inputs that may be used to measure fair value are as follows:

Level 1. Quoted prices in active markets for identical assets or liabilities.

Level 2. Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets with insufficient volume or infrequent transactions (less active markets), or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data for substantially the full term of the assets or liabilities. Level 2 inputs also include non-binding market consensus prices that can be corroborated with observable market data, as well as quoted prices that were adjusted for security-specific restrictions.

Level 3. Unobservable inputs to the valuation methodology are significant to the measurement of the fair value of assets or liabilities. These Level 3 inputs also include non-binding market consensus prices or non-binding broker quotes that we were unable to corroborate with observable market data.

Liability measured at fair value on a recurring basis by level within the fair value hierarchy as of February 28, 2015 and May 31, 2014 is as follows:

	Fair Value Measurement at February 28, 2015 (1)		Fair Value Measurement at May 31, 2014 (1)	
	Using Level 3	Total	Using Level 3	Total
Liability:				
Derivative liability	$ 714,294	$ 714,294	$	$