

APPLIED ENERGETICS, INC.
Form 10-Q
November 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2018

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 001-14015

APPLIED ENERGETICS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

77-0262908

(IRS Employer Identification Number)

2480 W Ruthrauff Road, Suite 140 Q

Tucson, Arizona

85705

(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code (520) 628-7415

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), (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer:

Accelerated filer:

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the exchange act.

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

As of November 8, 2018 there were 198,697,396 shares of the issuer's common stock, par value \$.001 per share, outstanding.

APPLIED ENERGETICS, INC.

QUARTERLY REPORT ON FORM 10-Q

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PART I. FINANCIAL INFORMATION**ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

APPLIED ENERGETICS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

| | September 30, 2018 (Unaudited) | December 31, 2017 |
|--|--------------------------------------|----------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$327,203 | \$2,764 |
| Other receivables | 312 | 312 |
| Other assets | 11,721 | — |
| Total current assets | 339,236 | 3,076 |
| Long-term assets | | |
| Property and equipment | 38,887 | — |
| Other long-term assets | 255,893 | — |
| Total long-term assets | 294,780 | — |
| TOTAL ASSETS | \$634,016 | \$3,076 |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | | |
| Current liabilities | | |
| Accounts payable | \$209,989 | \$80,743 |
| Accrued compensation | 347,333 | 266,480 |
| Accrued officer compensation | 206,000 | 230,500 |
| Notes payable net of unamortized discount of \$-0- at September 30, 2018 and \$102,219 at December 31, 2017 | — | 53,097 |
| Due to related parties | 50,000 | — |
| Accrued expenses | 68,776 | 185,927 |
| Accrued dividends | 48,079 | 48,079 |
| Total current liabilities | 930,177 | 864,826 |
| Total liabilities | 930,177 | 864,826 |
| Commitments and contingencies | | |
| Stockholders' equity (deficit) | | |
| Series A Convertible Preferred Stock, \$.001 par value, 2,000,000 shares authorized; 13,602 shares issued and outstanding at September 30, 2018 and at December 31, 2017 | 14 | 14 |
| | 197,697 | 157,785 |

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Common stock, \$.001 par value, 500,000,000 shares authorized; 197,697,396 and 157,785,520 shares issued and outstanding at September 30, 2018 and at December 31, 2017, respectively

| | | |
|--|--------------|--------------|
| Additional paid-in capital | 81,778,672 | 79,452,635 |
| Accumulated deficit | (82,272,544) | (80,472,184) |
| Total stockholders' equity (deficit) | (296,161) | (861,750) |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | \$634,016 | \$3,076 |

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APPLIED ENERGETICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | For the three months ended September 30, | |
|--|---|--------------|
| | 2018 | 2017 |
| Operating expenses | | |
| General and administrative | \$723,316 | \$180,353 |
| Research and development | 48,508 | — |
| Total operating expenses | 771,824 | 180,353 |
| Operating loss | (771,824) | (180,353) |
| Other (expense) | | |
| Interest (expense) | (174) | (451) |
| Total other (expense) | (174) | (451) |
| Net loss | (771,998) | (180,804) |
| Preferred stock dividends | (8,501) | (8,501) |
| Net loss attributable to common stockholders | \$(780,499) | \$(189,305) |
| Net loss per common share – basic and diluted | \$(0.01) | \$(0.01) |
| Weighted average number of shares outstanding, basic and diluted | 192,260,657 | 157,785,520 |

See accompanying notes to condensed consolidated financial statements (unaudited).

APPLIED ENERGETICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | For the nine months ended September 30, | |
|--|--|--------------|
| | 2018 | 2017 |
| Operating expenses | | |
| General and administrative | \$1,457,539 | \$463,834 |
| Research and development | 98,000 | — |
| Total operating expenses | 1,555,539 | 463,834 |
| Operating loss | (1,555,539) | (463,834) |
| Other income/(expense) | | |
| Interest (expense) | (244,820) | (451) |
| Total other income | (244,820) | (451) |
| Net loss | (1,800,359) | (464,285) |
| Preferred stock dividends | (25,504) | (25,504) |
| Net loss attributable to common stockholders | \$(1,825,863) | \$(489,789) |
| Net loss per common share – basic and diluted | \$(0.01) | \$(0.01) |
| Weighted average number of shares outstanding, basic and diluted | 177,799,785 | 155,118,854 |

See accompanying notes to condensed consolidated financial statements (unaudited).

APPLIED ENERGETICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | For the nine months ended September 30, | |
|---|---|-------------|
| | 2018 | 2017 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$(1,800,359) | \$(464,285) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Non-cash stock based compensation expense | 45,905 | 65,309 |
| Warrant expense | — | 40,590 |
| Loss on early payoff of note payable | 174,412 | — |
| Shares issued for services | 398,674 | — |
| Amortization of beneficial conversion feature | 204,119 | — |
| Amortization of financing costs | 22,721 | 172 |
| Interest expense | 17,806 | 279 |
| Changes in assets and liabilities: | | |
| Other long-term assets | (255,893) | — |
| Prepays and deposits | (19,895) | — |
| Accounts payable | 158,353 | 24,376 |
| Accrued expenses and compensation | (60,799) | 234,900 |
| Net cash used in operating activities | (1,114,956) | (98,659) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of equipment | (38,887) | — |
| Net cash used in investing activities | (38,887) | — |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from notes payable net of financing costs | 149,750 | 50,000 |
| Proceeds from issuance of common stock | 1,690,000 | 62,500 |
| Repayment on notes payable | (361,468) | — |
| Net cash provided by financing activities | 1,478,282 | 112,500 |
| Net increase in cash and cash equivalents | 324,439 | 13,841 |
| Cash and cash equivalents, beginning of period | 2,764 | 680 |
| Cash and cash equivalents, end of period | \$327,203 | \$14,521 |
| Supplemental Cash Flow Information | | |
| Cash paid for interest | \$12,949 | \$— |
| Cash paid for taxes | \$— | \$— |

See accompanying notes to condensed consolidated financial statements (unaudited).

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APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying interim unaudited condensed consolidated financial statements include the accounts of Applied Energetics, Inc. and its wholly owned subsidiary North Star Power Engineering, Inc. as of September 30, 2018 (collectively, “company,” “Applied Energetics,” “we,” “our” or “us”). All intercompany balances and transactions have been eliminated. In the opinion of management, all adjustments (which include normal recurring adjustments) necessary for a fair presentation of the results for the interim periods presented have been made. The results for the three-month and nine-month periods ended September 30, 2018, may not be indicative of the results for the entire year. The interim unaudited condensed consolidated financial statements should be read in conjunction with the company’s audited consolidated financial statements contained in our Annual Report on Form 10-K.

LIQUIDITY AND MANAGEMENT’S PLAN

The accompanying unaudited financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. For the nine months ended September 30, 2018, the company incurred a net loss of approximately \$1,800,000, had negative cash flows from operations of approximately \$1,115,000, investing activities reflected the acquisition of equipment for \$39,000, financing activities reflected \$1,690,000 proceeds from issuance of common stock, \$150,000 proceeds from a note payable, partially offset by \$361,000 repayment on note payable and expects to incur additional future losses due to the reactivation of its business activities. These matters raise substantial doubt as to the company’s ability to continue as a going concern unless the company is able to obtain additional financing for its continuing operations. The financial statements do not include any adjustments relating to the recoverability of assets and the amount or classification of liabilities that might be necessary should the company be unable to continue as a going concern.

As of September 30, 2018, the company had approximately \$327,000 in cash and cash equivalents.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with United States Generally Accepted Accounting Principles (“GAAP”) requires management to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. Management bases its assumptions on historical experiences and on various other estimates that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. In addition, management considers the basis and methodology used in developing and selecting these estimates, the trends in and amounts of these estimates, specific matters affecting the amount of and changes in these estimates, and any other relevant matters related to these estimates, including significant issues concerning accounting principles and financial statement presentation. Such estimates and assumptions could change in the future, as more information becomes known which could materially impact the amounts reported and disclosed herein. Significant estimates include measurements of income tax assets and liabilities.

RECENT ACCOUNTING PRONOUNCEMENTS

The company has reviewed issued accounting pronouncements and plans to adopt those that are applicable to it. The company does not expect the adoption of any other pronouncements to have an impact on its results of operations or financial position.

APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

2. SHARE-BASED COMPENSATION

Share-Based Compensation – Contractors

For the nine months ended September 30, 2018 and 2017, share-based compensation expense totaled approximately \$46,000 and \$65,000, respectively.

There was no related income tax benefit recognized because our deferred tax assets are fully offset by a valuation allowance.

We determine the fair value of option grant share-based awards at their grant date, using a Black-Scholes-Merton Option-Pricing Model applying the assumptions in the following table:

| | Nine months ended September 30, | | |
|--|---------------------------------------|-----------|---|
| | 2018 | 2017 | |
| Expected life (years) | N/A | 5 | |
| Dividend yield | N/A | 0 | % |
| Expected volatility | N/A | 80 | % |
| Risk free interest rates | N/A | 1.97 | % |
| Weighted average fair value of options at grant date | N/A | \$0.02980 | |

For the nine months ended September 30, 2018, no options to purchase stock were granted, additionally, no options to purchase stock were exercised, expired or forfeited; no restricted stock units were granted, vested or forfeited; and no restricted stock awards were granted, vested or forfeited. At September 30, 2018, options to purchase 14,000,000

shares of common stock were outstanding with a weighted average exercise price of \$0.136 with a weighted average remaining contract term of approximately 3.5 years with an aggregate intrinsic value of \$103,000. At September 30, 2018 options for 3,500,000 shares were exercisable.

As of September 30, 2018, there was approximately \$51,000 of unrecognized compensation cost related to unvested stock options granted and outstanding, net of estimated forfeitures. The cost is expected to be recognized on a weighted average basis over a period of approximately three years.

During the nine months ended September 30, 2017 the company granted each member of the Scientific Advisory Board options to purchase 2 million shares of \$.001 par value common stock at a price of \$0.05 per share for a total of 8,000,000 shares being granted. These options have a five year term and vest to the extent of 500,000 shares on the first anniversary of the grant and to the extent of 62,500 options per month during the 24 months following the initial vesting date.

During the nine months ended September 30, 2017 the company also granted each member of the Scientific Advisory Board performance options to purchase 1.5 million shares of \$0.001 par value common stock at a price of \$0.25 per share for a total of 6,000,000 shares being granted. These options have a five year term and vest on the date the company has cumulative revenues of \$5 million.

On July 16, 2018, the company entered into a Master Services Agreement (the "Agreement") with Westpark Advisors, LLC. The Agreement calls for Westpark Advisors to perform certain development and operational services, subject to a minimum hours requirement of 1,920, as follows:

In exchange for services detailed in the Agreement, Westpark Advisors is to receive compensation as follows: \$16,700 per month in cash; upon signing of the Agreement, options to purchase 250,000 shares of the Company's common stock, at an exercise price of \$0.13 per share, which vest every 90 days in four equal tranches and expire as to each tranche three years after the vesting date; and additional options to purchase one million shares of the Company's common stock, at an exercise price of \$0.13 per share, upon the successful award of a contract in excess of \$500,000 which Westpark Advisors sourced, captured and pursued. The Agreement also calls for the Company to reimburse Westpark Advisors for all reasonable expenses that have been pre-approved in writing. The option agreements have not yet been issued.

APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

3. NET LOSS PER SHARE

Basic net loss per common share is computed by dividing net loss available to common shareholders by the weighted average number of common shares outstanding during the period before giving effect to stock options, stock warrants, restricted stock units and convertible securities outstanding, which are considered to be dilutive common stock equivalents. Diluted net loss per common share is calculated based on the weighted average number of common and potentially dilutive shares outstanding during the period after giving effect to convertible preferred stock, stock options, warrants and restricted stock units. Contingently issuable shares are included in the computation of basic loss per share when issuance of the shares is no longer contingent. Due to the losses from continuing operations for the nine months ended September 30, 2018 and 2017, basic and diluted loss per common share were the same, as the effect of potentially dilutive securities would have been anti-dilutive.

Potentially dilutive securities not included in the diluted loss per share calculation, due to net losses from continuing operations, were as follows:

| | Nine months ended September 30, | |
|---------------------------------------|------------------------------------|------------|
| | 2018 | 2017 |
| Options to purchase common shares | 14,000,000 | 14,000,000 |
| Warrants to purchase common shares | — | 1,320,598 |
| Convertible preferred stock | 43,215 | 40,381 |
| Total potentially dilutive securities | 14,043,215 | 15,360,979 |

4. DIVIDENDS

Dividends on Preferred Stock are accrued when the amount and kind of dividend is determined and are payable quarterly on the first day of February, May, August and November, in cash or shares of common stock. The holders of shares of Series A Convertible Preferred Stock are entitled to receive dividends at the initial rate of 6.5% of the liquidation preference per share (the "Initial Dividend Rate"), payable, at the option of the corporation, in cash or shares of common stock or a combination of cash and common stock. Upon the occurrence of the company's failure to pay dividends in the five business days following a dividend payment date (a "Payment Default"), the dividend rate shall immediately and automatically increase to 7.5% of the liquidation preference per share for as long as such Payment Default continues (or return to the Initial Dividend Rate at such time as such Payment Default no longer continues), and if a Payment Default shall occur on two consecutive Dividend Payment Dates, the dividend rate shall immediately and automatically increase to 10% of the Liquidation Preference for as long as such Payment Default continues and shall immediately and automatically return to the Initial Dividend Rate at such time as the Payment Default is no longer continuing.

As of September 30, 2018, we had 13,602 shares of our 6.5% Series A Convertible Preferred Stock outstanding. The company has not paid the dividends commencing with the quarterly dividend due August 1, 2013. Dividend arrearages as of September 30, 2018 was approximately \$179,000. Our Board of Directors suspended the declaration of the dividend, commencing with the dividend payable as of February 1, 2015 since we did not have a surplus (as such term is defined in the Delaware general corporation Law) as of December 31, 2014, until such time as we have a surplus or net profits for a fiscal year.

Our Series A Preferred Stock has a liquidation preference of \$25.00 per Share. The Series A Preferred Stock bears dividends at the rate of 6.5% of the liquidation preference per share per annum, which accrues from the date of issuance, and is payable quarterly. Dividends may be paid in: (i) cash, (ii) shares of our common stock (valued for such purpose at 95% of the weighted average of the last sales prices of our common stock for each of the trading days in the ten trading day period ending on the third trading day prior to the applicable dividend payment date), provided that the issuance and/or resale of all such shares of our common stock are then covered by an effective registration statement or (iii) any combination of the foregoing. If the company fails to make a dividend payment within five business days following a dividend payment date, the dividend rate shall immediately and automatically increase by 1% from 6.5% of the liquidation preference per offered share of Series A preferred stock to 7.5% of such liquidation preference. If a payment default shall occur on two consecutive dividend payment dates, the dividend rate shall immediately and automatically increase to 10% of the liquidation preference for as long as such payment default continues and shall immediately and automatically return to the initial dividend rate at such time as the payment default is no longer continuing.

APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

5. NOTES PAYABLE

On September 15, 2017 the company borrowed \$53,000 under a convertible note maturing June 20, 2018. The note bears interest of 12% payable at maturity. Any amount of principal or interest on the note which is not paid when due shall bear interest at the rate of twenty two percent (22%) per annum from the due date thereof until the same is paid. The note is convertible into shares of the company's \$0.001 par value common stock after March 24, 2018 (the "Initial Conversion Date"). The conversion rate is variable and will be 58% of the average of the lowest one-day trading price during the twenty trading days preceding the holders notice of conversion. The number of shares issuable on conversion is limited to 4.99% of the company's then issued and outstanding common stock. The company at the request of the note holder has reserved 36,369,879 shares of its \$0.001 common stock for conversion. The note can be prepaid at the company's option until the Initial Conversion Date. The company issued the note holder warrants to purchase 1,320,598 shares of its \$0.001 par value common stock at an exercise price of \$0.0301, The Warrants are exercisable at any time over a 7-year period commencing on the date of issuance. The company calculated a beneficial conversion feature of \$53,000 on this note against which approximately \$53,000 has been amortized.

The above transaction of a note for \$53,000 and attached warrants of 1,320,598 shares were put in place by previous management. On March 12, 2018, the company's newly elected board of directors discussed its options concerning the above referenced loan and attached warrant and agreed that it would be in the best interest of the company and its shareholders to pay in full the \$53,000 convertible note funded on October 18, 2017, and additionally repurchase the warrant. On March 16, 2018, the company paid in full the \$53,000 convertible note and cancelled its associated warrant to purchase 1,320,598 shares of common stock in a negotiated transaction. This note carried special early stock conversion rights at a material discount to market, and was considered to be a dilutive derivative event that could harm the future abilities of the company to operate and raise money. The total cost to the company to pay off this \$53,000 note before the conversion date was \$81,000. Additionally, the company cancelled the above referenced attached warrant which allowed the loan holder to purchase 1,320,598 shares of common stock at a material discount to the market. This warrant was given to the noteholder by previous management as an incentive to make the above referenced loan. The cost to the company to cancel the warrant was \$40,000. The total combined cost to the company to cancel the loan and warrant was \$121,000. The payment was comprised of \$56,000 principal and accrued interest, prepayment premium of \$25,000 and \$40,000 to buy back the warrant. The note was paid in full on March 16, 2018. The company borrowed the \$121,000 used to pay off this loan before the conversion date, via an interest free loan from two directors of the company.

On October 18, 2017 the company borrowed \$33,000 under a convertible note maturing July 20, 2018. The note bears interest of 12% payable at maturity. Any amount of principal or interest on the note which is not paid when due shall bear interest at the rate of twenty two percent (22%) per annum from the due date thereof until the same is paid. The note is convertible into shares of the company's \$0.001 par value common stock after April 16, 2018 (the "Initial Conversion Date"). The conversion rate is variable and will be 58% of the average of the lowest one-day trading price during the twenty trading days preceding the holders notice of conversion. The number of shares issuable on conversion is limited to 4.99% of the company's then issued and outstanding common stock. The company at the request of the note holder has reserved 18,062,397 shares of its \$0.001 common stock for conversion. The note can be prepaid at the company's option until the Initial Conversion Date. The company calculated a beneficial conversion feature of approximately \$24,000 on this note against which \$14,000 has been amortized.

APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

The above transaction of a note for \$33,000 was put in place by previous management. On April 10, 2018, the company's newly elected board of directors discussed its options concerning the above referenced convertible loan funded on October 18, 2017 in the amount of \$33,000 and agreed that it would be in the best interest of the company and its shareholders to pay in full the referenced note which was put in place by previous management. This note carried special early stock conversion rights at a material discount to market and was considered by the company to be a dilutive derivative event that could harm the future abilities of the company to operate and raise money. The cost to the company to pay off this \$33,000 note before the conversion date was \$51,000. The payment was comprised of \$35,000 principal and accrued interest, and prepayment premium of \$16,000. The note was paid in full on April 12, 2018.

On November 16, 2017 the company borrowed \$38,000 under a convertible note maturing August 20, 2018. The note bears interest of 12% payable at maturity. Any amount of principal or interest on the note which is not paid when due shall bear interest at the rate of twenty two percent (22%) per annum from the due date thereof until the same is paid. The note is convertible into shares of the company's \$0.001 par value common stock after May 16, 2018 (the "Initial Conversion Date"). The conversion rate is variable and will be 58% of the average of the lowest one-day trading price during the twenty trading days preceding the holders notice of conversion. The number of shares issuable on conversion is limited to 4.99% of the company's then issued and outstanding common stock. The company at the request of the Note Holder has reserved 20,716,914 shares of its \$0.001 common stock for conversion. The note can be prepaid at the company's option until the Initial Conversion Date. The company calculated a beneficial conversion feature of approximately \$28,000 on this note against which \$13,000 has been amortized.

The above transaction of a note for \$38,000 was put in place by previous management. On May 4, 2018 the company's newly elected board of directors discussed its options concerning the above referenced convertible loan funded on November 16, 2017 in the amount of \$38,000 and agreed that it would be in the best interest of the company and its shareholders to pay in full the referenced note which was put in place by previous management. This note carried special early stock conversion rights at a material discount to market and was considered by the company to be a dilutive derivative event that could harm the future abilities of the company to operate and raise money. The cost to the company to pay off this \$38,000 note before the conversion date was \$58,000. The payment was comprised of \$40,000 principal and accrued interest, and prepayment premium of \$18,000. The note was paid in full on May 7, 2018.

On December 27, 2017 the company borrowed \$28,000 under a convertible note maturing September 20, 2018. The note bears interest of 12% payable at maturity. Any amount of principal or interest on the note which is not paid when due shall bear interest at the rate of twenty two percent (22%) per annum from the due date thereof until the same is paid. The note is convertible into shares of the company's \$0.001 par value common stock after April 16, 2018 (the "Initial Conversion Date"). The conversion rate is variable and will be 58% of the average of the lowest one-day trading price during the twenty trading days preceding the holders notice of conversion. The number of shares issuable on conversion is limited to 4.99% of the company's then issued and outstanding common stock. The company at the request of the note holder has reserved 17,164,750 shares of its \$0.001 common stock for conversion. The note can be prepaid at the company's option until the Initial Conversion Date. The company calculated a beneficial conversion feature of approximately \$20,000 on this note against which \$7,000 has been amortized.

The above transaction of a note for \$28,000 was put in place by previous management. On May 4, 2018 the company's newly elected board of directors discussed its options concerning the above referenced convertible loan funded on December 27, 2017 in the amount of \$28,000 and agreed that it would be in the best interest of the company and its shareholders to pay in full the referenced note which was put in place by previous management. This note carried special early stock conversion rights at a material discount to market and was considered by the company to be a dilutive derivative event that could harm the future abilities of the company to operate and raise money. The cost to the company to pay off this \$28,000 note before the conversion date was \$41,000. The payment was comprised of \$29,000 principal and accrued interest, and prepayment premium of \$12,000. The note was paid in full on May 18, 2018.

APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

On January 8, 2018 the company borrowed \$105,000 under a convertible note maturing August 28, 2018. The note bears interest of 12% payable at maturity. Any amount of principal or interest on the note which is not paid when due shall bear interest at the rate of twenty-four percent (24%) per annum from the due date thereof until the same is paid. The note is convertible into shares of the company's \$0.001 par value common stock after April 27, 2018 (the "Initial Conversion Date"). The conversion rate is variable and will be 55% of the lowest one-day trading price during the twenty trading days preceding the holders notice of conversion. The number of shares issuable on any conversion is limited to 4.99% of the company's then issued and outstanding common stock. The note holder may increase the 4.99% limit to 9.99% on 61 days prior notice to the company. The company, at the request of the note holder, has reserved 40 million shares of its \$0.001 common stock for conversion. The note can be prepaid at the company's option until May 29, 2018. The company also entered into a security agreement pledging substantially all of its assets except for those related to Laser Guided Energy as collateral for the note.

The above transaction of a note for \$105,000 was put in place by previous management. On April 25, 2018, the company's newly elected board of directors discussed its options concerning the above referenced convertible loan funded on January 08, 2017 in the amount of \$105,000, the board agreed that it would be in the best interest of the company and its shareholders to pay in full the referenced note before its conversion date. The note carried special early stock conversion rights at a material discount to market, in addition it pledged virtually all the assets of the company as collateral. The company's board of directors considered this to be a significant derivative event that was extremely dilutive to existing shareholders. Additionally, it was the opinion of the company's board of directors that this loan harmed the future abilities of the company to operate as a going concern and would make it nearly impossible to raise money in the future. The cost to the company to pay off this \$105,000 note before the conversion date was \$163,000. The payment was executed as paid in full on April 27, 2018 and was comprised of \$109,000 principal and accrued interest, and a prepayment premium of \$54,000 for a total of \$163,000.

On March 8, 2018 the company borrowed \$26,500 under a convertible note maturing December 15, 2018. The note bears interest of 12% payable at maturity. Any amount of principal or interest on the note which is not paid when due shall bear interest at the rate of twenty two percent (22%) per annum from the due date thereof until the same is paid. The note is convertible into shares of the company's \$0.001 par value common stock after September 5, 2018 (the "Initial Conversion Date"). The conversion rate is variable and will be 51% of the average of the lowest one day trading price during the thirty trading days preceding the holders notice of conversion. The number of shares issuable on conversion is limited to 4.99% of the company's then issued and outstanding Common Stock. The company at the request of the Note Holder has reserved 11,008,640 shares of its \$0.001 common stock for conversion. The note can be prepaid at the company's option until the Initial Conversion Date.

The above transaction of a note for \$26,500 was put in place by previous management. On May 4, 2018 the company's newly elected board of directors discussed its options concerning the above referenced convertible loan funded on December 27, 2017 in the amount of \$26,500 and agreed that it would be in the best interest of the company and its shareholders to pay in full the referenced note which was put in place by previous management. This note carried special early stock conversion rights at a material discount to market and was considered by the company to be a dilutive derivative event that could harm the future abilities of the company to operate and raise money. The cost to the company to pay off this \$26,500 note before the conversion date was \$37,000. The payment was comprised of \$27,000 principal and accrued interest, and prepayment premium of \$10,000. The note was paid in full on May 18, 2018.

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APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

The following reconciles notes payable as of September 30, 2018 and December 31, 2017:

| | September 30, 2018 | December 31, 2017 |
|---|-----------------------|----------------------|
| Convertible notes payable | \$(98,903) | \$152,000 |
| Accrued interest | (3,317) | 3,316 |
| Financing costs | (13,250) | (12,000) |
| Amortization of financing costs | 22,721 | 2,529 |
| Beneficial conversion feature | (111,370) | (124,689) |
| Amortization of beneficial conversion feature | 204,119 | 31,941 |
| | \$— | \$53,097 |

6. DUE TO RELATED PARTIES

During the three months ended June 30, 2018, the company, under its new management, has borrowed \$2,500, giving a total borrowed of \$132,000 from two members of its board of directors. These loans are interest free and are payable on demand. On May 1, 2018, both directors submitted subscription agreements for \$60,000 for 1,000,000 shares of company common stock, each to be settled with the company's debt. On July 23, 2018, the remaining balance of \$12,000 was paid back to one director.

It has come to the board's attention that on July 31, 2018, our now deceased CEO deposited \$50,000 into the company's account. Although it has been suggested that the funds may have been intended for use toward Mr. Dearmin's healthcare, the board does not know for certain what the purpose of the funds were or the nature of any intended investment. Accordingly, the board is investigating the appropriate disposition of the funds which will likely be to the estate of Mr. Dearmin. Until such a determination is made, the board does not intend to use these funds for any corporate purpose. For reporting purposes, the company has treated the deposit as a due to related party.

7. EQUITY

On December 4, 2017 previous management entered into a financial services agreement with BMA Securities for which, on January 26, 2018, it issued 5,000,000 shares of stock valued at \$150,000.

On January 24, 2018, we issued 1,242,710 shares of common stock in settlement of invoices valued at \$38,524.26 with a vendor. This transaction was consummated by previous management to pay its attorney fees.

On April 12, 2018 the company received \$120,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock.

On April 16, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

On April 17, 2018 the company received \$100,000 from an individual based on a subscription agreement with the company for which the company issued 1,666,667 shares of its common stock.

On April 26, 2018 the company received \$90,000 from an individual based on a subscription agreement with the company for which the company issued 1,500,000 shares of its common stock.

On May 4, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

On May 8, 2018 the company received \$120,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock.

On May 14, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

On May 14, 2018 the company received \$200,000 from an individual based on a subscription agreement with the company for which the company issued 3,333,333 shares of its common stock.

On May 15, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

On May 16, 2018 the company received \$20,000 from an individual based on a subscription agreement with the company for which the company issued 333,333 shares of its common stock.

On May 25, 2018 the company received \$600,000 from an individual based on a subscription agreement with the company for which the company issued 10,000,000 shares of its common stock.

On June 13, 2018 the company received \$140,000 from an individual based on a subscription agreement with the company for which the company issued 2,333,333 shares of its common stock.

On September 20, 2018 the company received \$120,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock.

On September 25, 2018 the company received a total of \$60,000 from two individuals based on subscription agreements with the company for which the company issued 1,000,000 shares of its common stock.

On October 3, 2018 the company received \$90,000 from an individual based on a subscription agreement with the company for which the company issued 1,500,000 shares of its common stock.

Effective October 19, 2018 the company received \$20,000 and a note for \$100,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock. The note is non-interest bearing and is to be paid in five monthly payments of \$20,000 starting November 20, 2018.

On October 22, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

Effective October 30, 2018, AERG entered into a Mutual Release and Hold Harmless Agreement (“Agreement”) with Gregory Fettig and Mr. Fettig’s former law firm, Duff Bornsen and Fettig, LLP (collectively, the “Fettig Parties”). The Agreement resolves claims concerning the issuance of 5,000,000 shares of AERG common stock, par value \$.001 per share, to the Fettig Parties as authorized by prior Company director George Farley as compensation for legal services rendered to the Company by the Fettig Parties valued at \$5,000. The Agreement also resolves claims concerning unpaid invoices to AERG for legal services performed by the Fettig Parties.

Pursuant to the Agreement, AERG paid the Fettig Parties an aggregate of \$12,000, representing full satisfaction of fees for legal services of \$9,825 plus additional consideration of \$2,175. The Fettig Parties agreed to surrender to AERG the stock certificate representing the 5,000,000 shares.

The Agreement also contains standard representations and warranties and mutual releases and indemnification provisions.

On November 1, 2018 the company received \$120,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock.

8. LEGAL PROCEEDINGS

In its Current Report on Form 8-K, filed April 9, 2018, Applied Energetics, Inc. indicated that its management was engaged in corporate due diligence on previous company financial and stock transactions with particular attention on large dilutive events, including issuance of shares that were registered on the Company’s Registration Statement on Form S-1 and as executive compensation from March 2, 2015.

On July 3, 2018, having determined that sufficient evidence existed of wrongdoing by prior management, with our legal counsel, Enterprise Counsel Group, located in Irvine, CA and our Delaware counsel located in Wilmington, DE,

we commenced a lawsuit in the Court of Chancery of the State of Delaware.

In connection with the lawsuit, we have filed a Verified Complaint with the following six causes of action:

1. Breach of Fiduciary Duty of Loyalty against George Farley
2. Breach of Fiduciary Duty of Care against George Farley
3. Aiding and Abetting Breach of Fiduciary Duty against AnnMarieCo LLC (“AMC”)
4. Conversion against George Farley

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APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

5. Fraudulent Transfer against George Farley and AMC

6. Injunctive Relief against George Farley and AMC

We have also filed for a Temporary Restraining Order to prohibit the shares indicated in the complaint to be transferred or sold until the court makes a final judgement.

On August 14, 2018, the Delaware Court of Chancery issued an order requiring the Company to post a bond in the total amount of \$200,446.52. On August 21, 2018, the Company posted the bond via Atlantic Specialty Insurance Company acting as surety. Pursuant to the contract between the Company and Atlantic Specialty Insurance Company, the Company deposited \$200,446.52 in cash as collateral for the surety agreement.

On August 23, 2018, the Delaware Court of Chancery court extended the hearing date on the Company's motion for a preliminary injunction to October 23, 2018, and simultaneously ordered an increase in the bond amount of \$55,446.52. On August 30, 2018, the Company posted the increased bond amount, again with Atlantic Specialty Insurance Company acting as surety, and deposited the additional \$55,446.52 in cash with the surety.

On October 16, 2018, the Delaware Court of Chancery, Vice Chancellor Tamika Montgomery-Reeves presiding, entered a scheduling order continuing the hearing date on the Company's motion for a preliminary injunction against defendants George Farley and AMC to December 14, 2018.

The October 16, 2018 order also required the Company to increase its bond amount by an additional \$185,301.86 (\$80,301.86 for AMC and \$105,000.00 for Mr. Farley) to account for the continued hearing date. On October 24, 2018, the Company posted the additional bond amount of \$185,301.86.

We may from time to time be involved in legal proceedings arising from the normal course of business.

9. SUBSEQUENT EVENTS

On October 3, 2018 the company received \$90,000 from an individual based on a subscription agreement with the company for which the company issued 1,500,000 shares of its common stock.

Effective October 19, 2018 the company received \$20,000 and a note for \$100,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock. The note is non-interest bearing and is to be paid in five monthly payments of \$20,000 starting November 20, 2018.

On October 22, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

On October 16, 2018, the Delaware Court of Chancery, Vice Chancellor Tamika Montgomery-Reeves presiding, entered a scheduling order continuing the hearing date on the Company's motion for a preliminary injunction against defendants George Farley and AMC to December 14, 2018.

The October 16, 2018 order also required the Company to increase its bond amount by an additional \$185,301.86 (\$80,301.86 for AMC and \$105,000.00 for Mr. Farley) to account for the continued hearing date. On October 24, 2018, the Company posted the additional bond amount of \$185,301.86.

Effective October 30, 2018, AERG entered into a Mutual Release and Hold Harmless Agreement ("Agreement") with Gregory Fettig and Mr. Fettig's former law firm, Duff Bornsen and Fettig, LLP (collectively, the "Fettig Parties"). The Agreement resolves claims concerning the issuance of 5,000,000 shares of AERG common stock, par value \$.001 per share, to the Fettig Parties as authorized by prior Company director George Farley as compensation for legal services rendered to the Company by the Fettig Parties valued at \$5,000. The Agreement also resolves claims concerning unpaid invoices to AERG for legal services performed by the Fettig Parties.

Pursuant to the agreement, AERG paid the Fettig Parties an aggregate of \$12,000, representing full satisfaction of fees for legal services of \$9,825 plus additional consideration of \$2,175. The Fettig Parties agreed to surrender to AERG the stock certificate representing the 5,000,000 shares.

The agreement also contains standard representations and warranties and mutual releases and indemnification provisions.

On November 1, 2018 the company received \$120,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock.

The company's management has evaluated subsequent events occurring after September 30, 2018, the date of our most recent balance sheet, through the date our financial statements were issued. Where applicable, all material subsequent events have been disclosed in their respective footnotes.

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APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

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

Our discussion and analysis of the financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related disclosures included elsewhere herein and in Management's Discussion and Analysis of Financial Condition and Results of Operations included as part of our Annual Report on Form 10-K for the year ended December 31, 2017.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-Q constitute forward-looking statements within the meaning of the securities laws. Forward-looking statements include all statements that do not relate solely to the historical or current facts and can be identified by the use of forward-looking words such as "may", "believe", "will", "would", "could", "should", "expect", "project", "anticipate", "estimates", "possible", "plan", "strategy", "target", "prospect" or "continue" and other similar terms and phrases. These forward-looking statements are based on the current plans and expectations of our management and are subject to a number of uncertainties and risks that could significantly affect our current plans and expectations, as well as future results of operations and financial condition and may cause our actual results, performances or achievements to be materially different from any future results, performances or achievements expressed or implied by such forward-looking statements. Important factors that could cause our actual results to differ materially from our expectations are described in Item 1A (Risk Factors) of our Annual Report on Form 10-K, for the year ended December 31, 2017. Although we believe that the expectations reflected in such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to have been correct. We do not assume any obligation to update these forward-looking statements to reflect actual results, changes in assumptions, or changes in other factors affecting such forward-looking statements.

RECENT EVENTS

Tom Dearmin Passing

On August 6, 2018, the company announced that its President and Acting Chief Executive Officer, Thomas C. Dearmin, died due to unexpectedly severe complications from a recent illness on August 3, 2018 in Orange County, CA. Tom was a dear friend to all of us here at the company, and his value was exponential as he helped the company through this transition period of building a new management team and putting the company on a new path. Tom was, and always will be, the symbol of Applied Energetics core values and dedication to its employees and partners. He will be missed dearly, and we intend to continue on the path to which he led us. On behalf of everyone here at the company, we extend our deepest sympathies to Tom's family.

On August 6th, the board of directors held a meeting at which it discussed the continuity of the company's strategic direction and operations while the board undertakes a search for Mr. Dearmin's successor. Brad Adamczyk has agreed to assume Mr. Dearmin's managerial responsibilities and, accordingly, was elected to serve as the Principle Executive Officer. Westpark Advisors, through its agreement with the company described below, continues to lead Business Development in Washington D.C. and Steve McCahon continues to lead the Scientific Lab in Tucson, AZ.

Westpark Advisors

As previously reported on Form 8-K, on July 16, 2018, Applied Energetics, Inc. entered into a Master Services Agreement (the "Agreement") with Westpark Advisors, LLC. The Agreement calls for Westpark Advisors to perform certain development and operational services, subject to a minimum hours requirement of 1,920, as follows:

In exchange for services detailed in the Agreement, Westpark Advisors is to receive compensation as follows: \$16,700 per month in cash; upon signing of the Agreement, options to purchase 250,000 shares of the Company's common stock, at an exercise price of \$0.13 per share, which vest every 90 days in four equal tranches and expire as to each tranche three years after the vesting date; and additional options to purchase one million shares of the Company's common stock, at an exercise price of \$0.13 per share, upon the successful award of a contract in excess of \$500,000 which Westpark Advisors sourced, captured and pursued. The Agreement also calls for the Company to reimburse Westpark Advisors for all reasonable expenses that have been pre-approved in writing.

APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

Westpark is retained to assist the company in launching its comprehensive sales and marketing strategy for the greater Washington DC area and broader DoD markets. Westpark Advisors is expected to focus on the company's 2nd generation Banshee Counter-IED technologies, along with Laser Guided Energy and the company's novel laser technologies. Westpark Advisors is to provide business development, program management and strategy consulting services, including sales and marketing of the company's product line. We expect that their expansive network and knowledge of the defense market will prove valuable in relaunching the company's brand, products, and capabilities. Managing Director, Patrick Williams is to serve as Westpark's account lead and provide full-time support to the company.

Legal

As previously reported in our Current Report on Form 8-K on July 3, 2018, we commenced a lawsuit in the Court of Chancery of the State of Delaware against prior management.

The lawsuit pertains to the following six causes of action:

1. Breach of Fiduciary Duty of Loyalty against George Farley
2. Breach of Fiduciary Duty of Care against George Farley
3. Aiding and Abetting Breach of Fiduciary Duty against AnnMarieCo LLC ("AMC")
4. Conversion against George Farley
5. Fraudulent Transfer against George Farley and AMC

6. Injunctive Relief against George Farley and AMC

We have also filed for a Temporary Restraining Order to prohibit the shares indicated in the complaint to be transferred or sold until the court makes a final judgement.

In its Current Report on Form 8-K filed July 9, 2018, Applied Energetics, Inc. (the “Company”) indicated that it had filed a lawsuit against George Farley and AnnMarieCo LLC (“AMC”) in the Court of Chancery in the state of Delaware. This report provides an update on the progress of the litigation.

In connection with the lawsuit, the Company requested a temporary restraining order prohibiting Mr. Farley and AMC from selling their 25 million shares of the Company’s common stock which the Company alleges were improperly issued. On July 20, 2018, the Delaware Court of Chancery, Vice Chancellor Tamika Montgomery-Reeves presiding, entered a “status quo” order upon the stipulation of the parties, whereby Mr. Farley and AMC agreed not to transfer, alienate or sell any of their shares pending a ruling on the Company’s motion for a preliminary injunction.

On July 26, 2018, the Delaware Court of Chancery entered a scheduling order setting dates and deadlines for, among other matters, a hearing and briefing schedule on the amount of the bond the Company would be required to post to maintain the “status quo” order through the preliminary injunction hearing, a hearing and briefing schedule on the motion for a preliminary injunction, and a discovery schedule.

Also, in connection with the lawsuit, on August 8, 2018, the Company filed a motion to disqualify Mr. Farley’s attorney, Ryan Whalen, who had previously represented the Company.

On August 14, 2018, the Delaware Court of Chancery issued an order requiring the Company to post a bond in the total amount of \$200,446.52. On August 21, 2018, the Company posted the bond via Atlantic Specialty Insurance Company acting as surety. Pursuant to the contract between the Company and Atlantic Specialty Insurance Company, the Company deposited \$200,446.52 in cash as collateral for the surety agreement.

APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

On August 23, 2018, the Delaware Court of Chancery court extended the hearing date on the Company's motion for a preliminary injunction to October 23, 2018, and simultaneously ordered an increase in the bond amount of \$55,446.52. On August 30, 2018, the Company posted the increased bond amount, again with Atlantic Specialty Insurance Company acting as surety, and deposited the additional \$55,446.52 in cash with the surety.

On September 7, 2018, the Delaware Court of Chancery entered an order setting a briefing schedule on the Company's motion to disqualify Mr. Whalen.

On September 10, 2018, the Delaware Court of Chancery entered an order governing the production and exchange of confidential documents and information among the parties in discovery.

In another Current Report on Form 8-K filed September 13, 2018, the Company updated the status of the litigation to include events that occurred up to that date. This report further updates the progress of the litigation.

On October 16, 2018, the Delaware Court of Chancery, Vice Chancellor Tamika Montgomery-Reeves presiding, entered a scheduling order continuing the hearing date on the Company's motion for a preliminary injunction against defendants George Farley and AMC to December 14, 2018.

The October 16, 2018 order also required the Company to increase its bond amount by an additional \$185,301.86 (\$80,301.86 for AMC and \$105,000.00 for Mr. Farley) to account for the continued hearing date. On October 24, 2018, the Company posted the additional bond amount of \$185,301.86.

As with any litigation, the Company cannot predict the outcome with certainty, but the Company expects to provide further updates on the status of the litigation as circumstances warrant.

Capital Program

As of Sept 20, 2018, we commenced an approximately \$600-750 thousand-dollar offering of 10-12.5 million shares of the company's common stock at a price of \$0.06 per share. We believe this funding will provide management with short term operating capital, legal expenses while also creating flexibility for the next phase of the company's business plan. As of the date of this report, the company has collected approximately \$440,000 from this equity offering.

Overview

Applied Energetics, Inc. is a corporation organized and existing under the laws of the State of Delaware. Our executive office is located at 2480 W Ruthrauff Road, Suite 140 Q, Tucson, Arizona, 85705 and our telephone number is (520) 628-7415.

AE owns and controls critical intellectual property that is integral and necessary for the development of Ultra-Short Pulse ("USP") Lasers, Laser Guided Energy ("LGE") and Direct Discharge Electrical products for military and commercial applications. AE owns 30, 19 approved patents, of which 10 are classified by the DoD. and 11 Government Sensitive Patent Applications ("GSPA")'s, which are defined as 'held under secrecy order of the US government'. These GSPA's are reviewed each year by the government agency that classified the application and allows AE greatly extended protection rights. The classified patents have no expiration date until such time as they are no longer classified after which that they will have the normal 17-year patent protection. Our patent portfolio was recently reviewed by the newly elected board and verified with the US Patent Office as current as of April 9, 2018. Our patent portfolio is also viewable at or website www.aergs.com. We expect to increase our patent portfolio in the near future.

APPLIED ENERGETICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(Unaudited)

RESULTS OF OPERATIONS

COMPARISON OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017:

| | 2018 | 2017 |
|----------------------------|-------------|-------------|
| General and administrative | \$(723,316) | \$(180,353) |
| Research and development | (48,508) | — |
| Interest (expense) | (174) | (451) |
| Net loss | \$(771,998) | \$(180,804) |

GENERAL AND ADMINISTRATIVE

General and administrative expenses increased approximately \$543,000 to \$723,000 for the three months ended September 30, 2018 compared to \$180,000 for the three months ended September 30, 2017 primarily due to the increase of professional expenses of \$513,000 and an increase in supplied and insurance expense of \$28,000.

RESEARCH AND DEVELOPMENT

Research and development expenses increased approximately \$49,000 to \$49,000 for the three months ended September 30, 2018 compared to \$-0- for the three months ended September 30, 2017 primarily due to the initiation of research and development activities through our teaming agreement with Applied Optical Sciences, Inc.

NET LOSS

Our operations for the three months ended September 30, 2018 resulted in a net loss of approximately \$772,000, an increase of approximately \$591,000 compared to the \$181,000 loss for the three months ended September 30, 2017 primarily due to an increase in professional fees, the increase in research and development costs and an increase in supplies and insurance expense.

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RESULTS OF OPERATIONS

COMPARISON OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017:

| | 2018 | 2017 |
|----------------------------|---------------|-------------|
| General and administrative | \$(1,457,539) | \$(463,834) |
| Research and development | (98,000) | — |
| Interest (expense) | (244,820) | (451) |
| Net loss | \$(1,800,359) | \$(464,285) |

GENERAL AND ADMINISTRATIVE

General and administrative expenses increased approximately \$994,000 to \$1,458,000 for the nine months ended September 30, 2018 compared to \$464,000 for the nine months ended September 30, 2017 primarily due to the increase of professional expenses of \$781,000, recognition of a loss on the early payoff of notes payable for \$174,000 and an increase in supplied and insurance expense of \$35,000.

RESEARCH AND DEVELOPMENT

Research and development expenses increased approximately \$98,000 to \$98,000 for the nine months ended September 30, 2018 compared to \$-0- for the nine months ended September 30, 2017 primarily due to the initiation of research and development activities through our teaming agreement with Applied Optical Sciences, Inc.

INTEREST EXPENSE

Interest expense increased \$244,370 to \$244,820 for the nine months ended September 30, 2018 compared to \$451 for the nine months ended September 30, 2017 primarily due to the increased level of borrowing by the company.

NET LOSS

Our operations for the nine months ended September 30, 2018 resulted in a net loss of approximately \$1,800,000, an increase of approximately \$1,336,000 compared to the \$464,000 loss for the nine months ended September 30, 2017 due to an increase in professional fees, loss on an early payoff of notes as well as increased borrowings and associated fees and an increase in insurance expense.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2018, we had approximately \$327,000 of cash and cash equivalents, an increase of approximately \$324,000 from December 31, 2017. During the first nine months of 2018, the net cash outflow from operating activities was approximately \$1,115,000. This amount was comprised primarily of our net loss of \$1,800,000, an increase in other long term assets of \$256,000, a decrease in accrued expenses, deposits and deferred rent of \$61,000 and an increase in prepaid expenses and deposits of \$20,000, partially offset by shares issued for services of \$399,000, amortization of beneficial conversion feature of \$204,000, loss on the early payoff on a note payable of \$174,000, an increase in accounts payable of \$158,000, noncash stock based compensation of \$46,000, amortization of financing costs of \$23,000, and interest expense of \$18,000. Investing activities reflected the purchase of equipment for \$39,000, and financing activities reflected \$1,690,000 proceeds from issuance of common stock, \$150,000 proceeds from a note payable, partially offset by \$361,000 repayment on note payable, resulting in net cash inflow of approximately \$324,000.

In their report accompanying our financial statements, our independent auditors stated that our financial statements for the year ended December 31, 2017 were prepared assuming that we would continue as a going concern, and that they have substantial doubt as to our ability to continue as a going concern. Our auditors' have noted that our recurring losses from operations and need to raise additional capital to sustain operations raise substantial doubt about our ability to continue as a going concern.

BACKLOG OF ORDERS

At November 9, 2018, we had a backlog (workload remaining on signed contracts) of \$0, to be completed within the next twelve months.

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Our management, with the participation of our Principal Executive Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2018. Based on that evaluation, our Principal Executive Officer has concluded that our disclosure controls and procedures as of September 30, 2018 are not effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in internal controls over financial reporting

There was no change in our internal controls over financial reporting that occurred during the period covered by this report, which has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II – OTHER INFORMATION

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On January 24, 2018 the company issued 497,084 shares of its common stock to an individual for approximately \$15,000 in services.

On January 24, 2018 the company issued 745,262 shares of its common stock to a company individual for approximately \$23,000 in services.

On January 26, 2018 the company issued 5,000,000 shares of its common stock to a company for \$150,000 in services.

On April 12, 2018 the company received \$120,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock.

On April 16, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

On April 17, 2018 the company received \$100,000 from an individual based on a subscription agreement with the company for which the company issued 1,666,667 shares of its common stock.

On April 26, 2018 the company received \$90,000 from an individual based on a subscription agreement with the company for which the company issued 1,500,000 shares of its common stock.

During the six months ended June 30, 2018, the company, under its new management, has borrowed a total of \$132,000 from Mr. Bradford T Adamczyk, the company's CEO and director, and Jonathan Barcklow, the company's director. These loans are interest free and are payable on demand. On May 1, 2018, both directors submitted subscription agreements for \$60,000 for 1,000,000 shares of company common stock, each to be settled with the

company's debt. On July 23, 2018, the remaining balance of \$12,000 was paid back to one director.

On May 4, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

On May 8, 2018 the company received \$120,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock.

On May 14, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

On May 14, 2018 the company received \$200,000 from an individual based on a subscription agreement with the company for which the company issued 3,333,333 shares of its common stock.

On May 15, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

On May 16, 2018 the company received \$20,000 from an individual based on a subscription agreement with the company for which the company issued 333,333 shares of its common stock.

On May 25, 2018 the company received \$600,000 from an individual based on a subscription agreement with the company for which the company issued 10,000,000 shares of its common stock.

On June 13, 2018 the company received \$140,000 from an individual based on a subscription agreement with the company for which the company issued 2,333,333 shares of its common stock.

On September 11 24, 2018 the company issued 3,502,500 shares of its common stock to an individual for \$210,150 in services.

On September 20, 2018 the company received \$120,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock.

On September 25, 2018 the company received a total of \$60,000 from two individuals based on subscription agreements with the company for which the company issued 1,000,000 shares of its common stock.

On October 3, 2018 the company received \$90,000 from an individual based on a subscription agreement with the company for which the company issued 1,500,000 shares of its common stock.

Effective October 19, 2018 the company received \$20,000 and a note for \$100,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock. The note is non-interest bearing and is to be paid in five monthly payments of \$20,000 starting November 20, 2018.

On October 22, 2018 the company received \$30,000 from an individual based on a subscription agreement with the company for which the company issued 500,000 shares of its common stock.

On November 1, 2018 the company received \$120,000 from an individual based on a subscription agreement with the company for which the company issued 2,000,000 shares of its common stock.

ITEM 6. EXHIBITS

| EXHIBIT NUMBER | DESCRIPTION |
|----------------|--|
| <u>31</u> | <u>Certification of Principal Executive Officer and Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a).</u> |
| <u>32</u> | <u>Principal Executive Officer and Principal Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Schema Document |
| 101.CAL | XBRL Calculation Linkbase Document |
| 101.DEF | XBRL Definition Linkbase Document |
| 101.LAB | XBRL Label Linkbase Document |
| 101.PRE | XBRL Presentation Linkbase Document |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**APPLIED ENERGETICS,
INC.**

By/s/ Bradford T Adamczyk
Bradford T Adamczyk
Principal Executive Officer

Date: November 9, 2018

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