VistaGen Therapeutics, Inc.
Form 10-Q
August 14, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

or

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

For the transition period from to .

Commission File Number: 000-54014

VistaGen Therapeutics, Inc.
(Exact name of registrant as specified in its charter)

Nevada	20-5093315
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

384 Oyster Point Boulevard, No. 8
South San Francisco, CA 94080
(Address of principal executive offices including zip code)

(650) 244-9997
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	[ ]	Accelerated filer	[ ]
Non-Accelerated filer	[ ]	Smaller reporting company	[X]
(do not check if a smaller reportireporting company)			

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

As of August 13, 2012, 17,028,250 shares of the registrant’s common stock, $0.001 par value, were issued and outstanding.

Table of Contents

VistaGen Therapeutics, Inc.

Quarterly Report on Form 10-Q
for the Quarter Ended June 30, 2012

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

VISTAGEN THERAPEUTICS, INC.
(a development stage company)
CONDENSED CONSOLIDATED BALANCE SHEETS
(Amounts in $100's, except share amounts)

	June 30, 2012 (Unaudited)	March 31, 2012 (Note 2)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 31,700	$ 81,000
Unbilled contract payments receivable	-	106,200
Prepaid expenses	511,200	50,900
Total current assets	542,900	238,100
Property and equipment, net	73,100	74,500
Security deposits and other assets	29,000	29,000
Total assets	$ 645,000	$ 341,600
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 2,562,800	$ 1,750,800
Accrued expenses	630,200	657,300
Notes payable and accrued interest	970,600	646,800
Notes payable and accrued interest to related parties	214,700	175,100
Capital lease obligations	7,200	10,500
Deferred revenue	-	13,200
Total current liabilities	4,385,500	3,253,700
Non-current liabilities:		
Notes payable, net of discount of $211,200 at June 30, 2012 and $228,900 at March 31, 2012	2,375,000	2,620,000
Notes payable to related parties, net of discount of $21,100 at June 30, 2012 and $24,300 at March 31, 2012	69,500	100,800
Convertible promissory notes, net of discount of $489,500 at June 30, 2012 and $499,300 at March 31, 2012	10,500	700
Accrued interest on convertible promissory notes	20,200	5,300
Accrued officers' compensation	57,000	57,000
Capital lease obligations	11,800	9,700
Total non-current liabilities	2,544,000	2,793,500
Total liabilities	6,929,500	6,047,200
Commitments and contingencies		
Stockholders' deficit:		
	400	400

Preferred stock, $0.001 par value; 10,000,000 shares authorized at June 30, 2012 and March 31, 2012; 437,055 Series A shares issued and outstanding at June 30, 2012 and March 31, 2012				
Common stock, $0.001 par value; 200,000,000 shares authorized at June 30, 2012 and March 31, 2012; 19,643,821 and 18,704,267 shares issued at June 30, 2012 and March 31, 2012, respectively		19,600		18,700
Additional paid-in capital		53,785,600		52,539,500
Treasury stock, at cost, 2,083,858 shares of common stock held at June 30, 2012 and March 31, 2012		(3,231,700)		(3,231,700)
Notes receivable from sale of common stock		(250,000)		(250,000)
Deficit accumulated during development stage		(56,608,400)		(54,782,500)
Total stockholders' deficit		(6,284,500)		(5,705,600)
Total liabilities and stockholders' deficit	$	645,000	$	341,600

See accompanying notes to Condensed Consolidated Financial Statements.

Table of Contents

VISTAGEN THERAPEUTICS, INC.
(a development stage company)

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(Unaudited)
(Amounts in $100's, except share and per share amounts)

	Three Months Ended June 30,		May 26, 1998 (Inception) Through June 30,
	2012	2011	2012
Revenues:			
Grant revenue	$200,400	$554,600	$12,963,100
Collaboration revenue	-	-	2,283,600
Other	-	-	1,123,500
Total revenues	200,400	554,600	16,370,200
Operating expenses:			
Research and development	866,300	1,027,900	26,991,200
Acquired in-process research and development	-	-	7,523,200
General and administrative	1,055,300	1,126,600	28,173,700
Total operating expenses	1,921,600	2,154,500	62,688,100
Loss from operations	(1,721,200)	(1,599,900)	(46,317,900)
Other expenses, net:			
Interest expense, net	(102,800)	(731,600)	(9,544,300)
Change in put and note extension option and warrant liabilities	-	(78,000)	418,500
Loss on early extinguishment of debt	-	-	(1,193,500)
Other income	-	-	47,500
Loss before income taxes	(1,824,000)	(2,409,500)	(56,589,700)
Income taxes	(1,900)	(1,600)	(18,700)
Net loss	$(1,825,900)	$(2,411,100)	$(56,608,400)
Basic and diluted net loss per common share	$(0.11)	$(0.22)	
Weighted average shares used in computing basic and diluted net loss per common share	16,842,655	11,105,854	
Comprehensive loss	$(1,825,900)	$(2,411,100)	$(56,608,400)

See accompanying notes to Condensed Consolidated Financial Statements.

Table of Contents

VISTAGEN THERAPEUTICS, INC.

(a development stage company)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Amounts in $100's)

	Three Months Ended June 30,		Period From May 26, 1998 (Inception) Through June 30, 2012
	2012	2011	
Cash flows from operating activities:			
Net loss	$(1,825,900)	$ (2,411,100)	$ (56,608,400)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	5,900	10,800	749,600
Acquired in-process research and development	-	-	7,523,200
Amortization of imputed discount on non-interest bearing notes	-	-	45,000
Amortization of discounts on 7%, 7.5% and 10% notes	20,900	15,600	280,100
Amortization of discounts on Platinum notes	-	384,300	3,548,700
Amortization of discounts on August 2010 short-term notes	-	14,300	572,000
Amortization of discounts on February 2012 12% convertible notes	9,800	-	5,600
Loss on early extinguishment of debt	-	-	1,193,500
Change in put and note term extension option and warrant liabilities	-	77,900	(418,600)
Stock-based compensation	71,000	439,700	4,425,300
Expense related to modification of warrants	436,400	-	1,178,100
Fair value of Series C preferred stock, common stock, and warrants granted for services prior to the Merger	-	131,300	1,056,600
Fair value of common stock granted for services following the Merger	26,200	-	478,200
Fair value of warrants granted for services following the Merger	19,300	-	583,800
Fair value of additional warrants granted pursuant to exercises of modified warrants (May-June 2012) and under Discounted Warrant Exercise Program (2011)	34,800	-	172,900
Fair value of common stock issued for note term modification	-	-	22,400
Consulting services by related parties settled by issuing promissory notes	-	-	44,600
Gain on sale of assets	-	-	(16,800)
Changes in operating assets and liabilities:			
Unbilled contract payments receivable	106,200	(106,300)	-
Prepaid expenses and other current assets	(3,700)	(187,500)	(8,200)
Security deposits and other assets	-	-	(29,000)
Accounts payable and accrued expenses	816,100	583,900	17,396,700
Deferred revenues	(13,200)	(39,400)	-
Net cash used in operating activities	(296,200)	(1,086,500)	(17,804,700)

Cash flows from investing activities:			
Purchases of equipment, net	-	-	(680,800)
Net cash used in investing activities	-	-	(680,800)
Cash flows from financing activities:			
Net proceeds from issuance of common stock and warrants, including units	-	2,217,200	2,800,000
Net proceeds from issuance of preferred stock and warrants	-	-	4,198,600
Proceeds from exercise of modified warrants (May-June 2012) and under Discounted Warrant Exercise Program (2011)	257,300	-	1,423,600
Proceeds from issuance of notes under line of credit	-	-	200,000
Proceeds from issuance of 7% note payable to founding stockholder	-	-	90,000
Net proceeds from issuance of 7% convertible notes	-	-	575,000
Net proceeds from issuance of 10% convertible notes and warrants	-	-	1,655,000
Net proceeds from issuance of Platinum notes and warrants	-	-	3,700,000
Net proceeds from issuance of 2008/2010 notes and warrants	-	-	2,971,800
Net proceeds from issuance of 2006/2007 notes and warrants	-	-	1,025,000
Net proceeds from issuance of 7% notes payable	-	-	55,000
Net proceeds from issuance of August 2010 short-term notes and warrants	-	-	800,000
Net proceeds from issuance of February 2012 12% convertible notes and warrants	-	-	466,500
Repayment of capital lease obligations	(5,700)	(6,900)	(106,200)
Repayment of notes	(4,700)	(321,100)	(1,337,100)
Net cash provided by financing activities	246,900	1,889,200	18,517,200
Net increase in cash and cash equivalents	(49,300)	802,700	31,700
Cash and cash equivalents at beginning of period	81,000	139,300	-
Cash and cash equivalents at end of period	$31,700	$ 942,000	$ 31,700

See accompanying notes to Condensed Consolidated Financial Statements.

Table of Contents

VISTAGEN THERAPEUTICS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. History and Organization

VistaGen Therapeutics, Inc. ("VistaGen" or the "Company") is a biotechnology company focused on using proprietary pluripotent stem cell technology for drug rescue and cell therapy. Drug rescue involves the combination of human pluripotent stem cell technology with modern medicinal chemistry to generate new chemical variants of once-promising small molecule drug candidates that pharmaceutical companies have discontinued during preclinical or early clinical development due to heart or liver toxicity, despite positive efficacy data demonstrating their potential therapeutic and commercial benefits. VistaGen plans to use its pluripotent stem cell technology to generate early indications, or predictions, of how humans will ultimately respond to new drug candidates before they are ever tested in humans.

VistaGen successfully completed its initial Phase I safety study of AV-101 for neuropathic pain in December 2010. In the first quarter of calendar 2012, VistaGen began a Phase 1b clinical study of AV-101, which it expects to complete during 2012. Neuropathic pain, a serious and chronic condition causing pain after an injury or disease of the peripheral or central nervous system, affects approximately 1.8 million people in the U.S. alone. To date, VistaGen has been awarded over $8.9 million from the U.S. National Institutes of Health (NIH) for development of AV-101.

The Company is in the development stage and, since inception, has devoted substantially all of its time and efforts to stem cell research and stem-cell based bioassay development, small molecule drug development, creating, protecting and patenting intellectual property, recruiting personnel and raising working capital.

The Merger

VistaGen was incorporated in California on May 26, 1998 (inception date). Excaliber Enterprises, Ltd. ("Excaliber") was organized as a Nevada corporation on October 6, 2005. On May 11, 2011, Excaliber acquired all outstanding shares of VistaGen for 6,836,452 shares of Excaliber's common stock (the "Merger"), and assumed VistaGen's pre-Merger obligations to contingently issue common shares in accordance with stock option agreements, warrant agreements, and a convertible promissory note. As part of the Merger, Excaliber repurchased 5,064,207 shares of its common stock from two stockholders for a nominal amount, leaving 784,500 shares of Excaliber common stock outstanding at the date of the Merger. The 6,836,452 shares issued to VistaGen stockholders in connection with the Merger represented approximately 90% of the outstanding shares of Excaliber's common stock after the Merger. As a result of the Merger, the business of VistaGen became the business of Excaliber. Shortly after the Merger:

- Each of the prior directors of VistaGen was appointed as a director of Excaliber;
- The prior directors and officers of Excaliber resigned as officers and directors of Excaliber;
- VistaGen's prior officers were appointed as officers of like tenor of Excaliber;
- Excaliber's directors approved a two-for-one (2:1) forward stock split of Excaliber's common stock;
- Excaliber's directors approved an increase in the number of shares of common stock Excaliber was authorized to issue from 200 million to 400 million shares;
- Excaliber changed its name to "VistaGen Therapeutics, Inc.";
- VistaGen's common stock began trading on the OTC Bulletin Board under the symbol "VSTA" effective on June 21, 2011; and
- Excaliber adopted VistaGen's fiscal year-end of March 31, with VistaGen as the accounting acquirer.

Table of Contents

VistaGen, as the accounting acquirer in the Merger, recorded the Merger as the issuance of stock for the net monetary assets of Excaliber, accompanied by a recapitalization. This accounting for the transaction was identical to that resulting from a reverse acquisition, except that no goodwill or other intangible assets were recorded. A total of 1,569,000 shares of common stock, representing the shares held by stockholders of Excaliber immediately prior to the Merger and effected for the post-Merger two-for-one forward stock split noted above, have been retroactively reflected as outstanding for all periods presented in the accompanying Condensed Consolidated Financial Statements.

In October 2011, the Company's stockholders amended the Company's Articles of Incorporation to (1) reduce the number of shares of common stock the Company is authorized to issue from 400 million shares to 200 million shares; (2) authorize the Company to issue up to 10 million shares of preferred stock; and (3) authorize the Company's Board of Directors to prescribe the classes, series and the number of each class or series of preferred stock and the voting powers, designations, preferences, limitations, restrictions and relative rights of each class or series of preferred stock. In December 2011, the Company's Board of Directors authorized the creation of a series of up to 500,000 shares of Series A Preferred Stock, par value $0.001 ("Series A Preferred"). Each share of Series A Preferred is convertible at the option of the holder into ten shares of the Company's common stock.

The consolidated financial statements in this report represent the activity of VistaGen (the California corporation) from May 26, 1998, and the consolidated activity of VistaGen (the California corporation) and Excaliber from May 11, 2011 (the date of the Merger). The consolidated financial statements also include the accounts of VistaGen's wholly-owned subsidiaries, Artemis Neuroscience, Inc. ("Artemis"), a Maryland corporation, and VistaStem Canada, Inc., an Ontario corporation.

2. Basis of Presentation and Going Concern

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not contain all of the information and footnotes required for complete consolidated financial statements. In the opinion of management, the accompanying unaudited Condensed Consolidated Financial Statements reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company's interim financial information. The accompanying Condensed Consolidated Balance Sheet at March 31, 2012 has been derived from the Company's audited consolidated financial statements at that date but do not include all disclosures required by U.S. GAAP. Additionally, certain reclassifications have been made to the Condensed Consolidated Balance Sheet at March 31, 2012 to conform to current year presentation. The operating results for the three months ended June 30, 2012 are not necessarily indicative of the operating results to be expected for the Company's fiscal year ending March 31, 2013 or for any other interim period or any other future year.

The accompanying unaudited Condensed Consolidated Financial Statements and notes to Condensed Consolidated Financial Statements should be read in conjunction with the Company's audited Consolidated Financial Statements for the fiscal year ended March 31, 2012 contained in its Annual Report on Form 10-K, as filed with the United States Securities and Exchange Commission.

The accompanying Condensed Consolidated Financial Statements have been prepared assuming the Company will continue as a going concern. As a development stage company without sustainable revenues, the Company has experienced recurring losses and negative cash flows from operations. From inception through June 30, 2012, the Company has a deficit accumulated during its development stage of $56.6 million. The Company expects these conditions to continue for the foreseeable future as it expands its Human Clinical Trials in a Test Tube™ platform and executes its drug rescue and cell therapy business programs.

At June 30, 2012, the Company had $31,700 in cash and cash equivalents. On July 2, 2012, Platinum Long Term Growth Fund VII, LLC ("Platinum"), the Company's largest institutional investor, purchased from the Company a secured 10% convertible promissory note in the principal amount of $500,000 (the "July 2012 Platinum Note"). (See Note 11, Subsequent Events.) In the event the Company consummates an equity or equity-based financing, or series of financing transactions resulting in gross proceeds to the Company of at least $3.0 million ("Qualified Financing"), the principal and accrued interest due under the terms of the July 2012 Platinum Note shall automatically convert into such securities as are issued in connection with the Qualified Financing. In connection with the Company's June 29, 2012 Exchange Agreement with Platinum (see Note 9, Capital Stock), Platinum has also agreed to invest at least $500,000 in the Qualified Financing, provided that the Company secures binding commitments from other investors in the Qualified Financing aggregating at least $3.0 million prior to September 29, 2012. The Company does not believe that its cash and cash equivalents at June 30, 2012, together with the proceeds of the July 2012 Platinum Note will enable it to fund its operations through the next twelve months. The Company anticipates that its cash expenditures during the next twelve months will be approximately $4 million to $6 million and it plans to meet its cash needs and fund its working capital requirements through a combination of additional private placements of its securities, which may include both debt and equity securities, stem cell technology-based research and development collaborations, stem cell technology and drug candidate license fees and government grant awards. If the Company is unable to obtain sufficient financing, it may be required to reduce, defer, or discontinue certain of its research and development activities or it may not be able to continue as a going concern.

Table of Contents

3. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include those relating to revenue recognition, share-based compensation, and assumptions that have been used to value warrant modifications and previous put option, note term extension and warrant liabilities.

Revenue Recognition

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

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

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

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

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

associated project costs are incurred.

Table of Contents

Research and Development Expenses

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

Stock-Based Compensation

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

The Company recorded share-based compensation costs of $71,000 and $439,700 for the three month periods ended June 30, 2012 and 2011, respectively. During the three months ended June 30, 2012, the Company granted options to purchase an aggregate of 155,000 shares of its common stock at an exercise price of $0.51 per share (the quoted market price on the grant date) to its employees (excluding senior management) and certain scientific consultants. During the three months ended June 30, 2011, the Company granted options to purchase an aggregate of 800,000 shares of its common stock at an exercise price of $1.75 per share to certain of its employees and scientific consultants. At June 30, 2012, there were options outstanding to purchase 4,920,771 shares of the Company's common stock at a weighted average exercise price of $1.51 per share.

Comprehensive Loss

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

Loss per Common Share

Basic loss per share of common stock excludes the effect of dilution and is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding for the period. Diluted loss per share of common stock reflects the potential dilution that could occur if securities or other contracts to issue shares of common stock were exercised or converted into shares of common stock. For all periods presented, potentially dilutive securities are excluded from the computation in loss periods, as their effect would be antidilutive.

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

	June 30,	
	2012	2011
All series of preferred stock issued and outstanding	4,370,550	-
Outstanding options under the 2008 and 1999 Stock Incentive Plan and 1998 Scientific Advisory Board Plan	4,920,771	4,719,153
Outstanding warrants to purchase common stock	3,604,392	6,540,314

February 2012 12% convertible promissory notes and accrued interest (1)	347,897	-
Total	13,243,610	11,259,467

(1) assumes mandatory conversion in connection with a qualified financing at $2.00 per share, plus fee warrants to placement agent

Table of Contents

Recent Accounting Pronouncements

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income, which was issued to enhance comparability between entities that report under U.S. GAAP and International Financial Reporting Standards ("IFRS"), and to provide a more consistent method of presenting non-owner transactions that affect an entity's equity. ASU 2011-05 eliminates the option to report other comprehensive income and its components in the statement of changes in stockholders' equity and requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement or in two separate but consecutive statements. This pronouncement became effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company's adoption of this ASU effective April 1, 2012 did not have any impact on its results of operations or financial position; however it required modifying the format of the former "Condensed Consolidated Statements of Operations" to include total comprehensive loss and changing the title of the statements to "Condensed Consolidated Statements of Operations and Comprehensive Loss."

In May 2011, the FASB issued ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards ("IFRS"). This pronouncement was issued to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and IFRS. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. The Company's adoption of ASU No. 2011-04 effective April 1, 2012 did not have a material impact on its consolidated results of operations or financial condition.

4. Fair Value Measurements

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

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

- Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Where quoted prices are available in an active market, securities are classified as Level 1 of the valuation hierarchy. If quoted market prices are not available for the specific financial instrument, then the Company estimates fair value by using pricing models, quoted prices of financial instruments

with similar characteristics or discounted cash flows. In certain cases where there is limited activity or less transparency around inputs to valuation, financial assets or liabilities are classified as Level 3 within the valuation hierarchy.

Table of Contents

The Company does not use derivative instruments for hedging of market risks or for trading or speculative purposes. No assets or liabilities were carried at fair value at June 30, 2012 or March 31, 2012.

During 2007 and 2008, the Company issued three convertible promissory notes with an aggregate principal balance of $4.0 million (the "Original Platinum Notes") to Platinum Long Term Growth VII, LLC ("Platinum"). On May 5, 2011, the Original Platinum Notes were amended, restated and consolidated into a single note (the "Platinum Note") with a principal balance of $4.0 million ("May 2011 Amendment"). In conjunction with the issuance of the Original Platinum Notes, the Company determined that i) the cash payment option or put option, which provided the lender with the right to require the Company to repay part of the debt at a 25% premium, and ii) the note term extension option, which provided the lender with the right to extend the maturity date by one year, were embedded derivatives that should be bifurcated and accounted for separately as liabilities. In conjunction with the issuance of the Original Platinum Notes, the Company also issued warrants to purchase 560,000 shares of its common stock. These warrants included certain exercise price adjustment features and, as a result, the Company determined that the warrants were liabilities, which were recorded at their estimated fair value. The Company determined the fair value of the i) put option and note term extension option using an internal valuation model with Level 3 inputs and ii) the warrant liability using a lattice model with Level 3 inputs. Inputs used to determine fair value include estimated value of the underlying common stock at the valuation measurement date, the remaining contractual term of the notes, risk-free interest rates, expected volatility of the price of the underlying common stock, and the probability of a qualified financing. Changes in the fair value of these liabilities prior to the May 2011 Amendment were recognized as a non-cash charge or income in other income (expense) in the consolidated statements of operations.

As a result of the May 2011 Amendment, the Original Platinum Notes were amended and restated on May 5, 2011, eliminating the cash payment option. Further, concurrent with the Merger transaction described in Note 1 above, the warrants were determined not to be liabilities, since the exercise price adjustment feature ended upon the Company becoming a public company as a result of the Merger. The increase in fair value of the warrant liability of $7,000 and the increase in the put option and note term extension option liabilities of $71,000 were recognized in other expense, net in the statement of operations for the quarter ended June 30, 2011. The remaining put option and note term extension option liabilities, in the amount of $161,700, were reclassified to note discount in connection with the May 2011 Amendment. The aggregated fair value of the warrants at May 11, 2011, $424,100, was reclassified from a liability to additional paid-in capital, a component of stockholders' deficit.

In December 2011, the Company and Platinum entered into a Note and Warrant Exchange Agreement pursuant to which the Platinum Note and warrants issued to Platinum were cancelled in exchange for shares of the Company's Series A preferred stock.

5. Prepaid Expenses

Prepaid expenses consist of the following:

	June 30, 2012	March 31, 2012
Investor relations and awareness services paid by issuance of common stock or warrants	$399,400	$19,700
Insurance	93,200	19,000
Legal fees	9,900	6,100
Investment banker fees	5,000	-
All other	3,700	6,100

	$511,200	$50,900

Table of Contents

6. Accrued Expenses

Accrued expenses consist of the following:

	June 30, 2012	March 31, 2012
Accrued professional services	$109,500	$107,400
Accrued research and development expenses	150,400	237,500
Accrued vacation pay and other compensation	247,500	229,900
Accrued placement agent fees	50,000	50,000
Accrued registration rights payments	5,500	-
All other	67,300	32,500
	$630,200	$657,300

Table of Contents

7. Convertible Promissory Notes and Other Notes Payable

The following table summarizes the activity for the Company's unsecured convertible promissory notes and other notes payable for the three months ended June 30, 2012:

	Principal Balance 3/31/2012	Additions	Payments	Amort-ization	Foreign Currency Adjustments/ Other Reclass-ifications	Principal Balance 6/30/2012	Accrued Interest 6/30/2012
Convertible Promissory Notes:							
February 2012 12% convertible promissory notes	$ 500,000	$ -	$ -	$ -	$ -	$ 500,000	$ 20,200
Note discount	(499,300)	-	-	9,800	-	(489,500)	
12% convertible notes, net	$ 700	$ -	$ -	$ 9,800	$ -	$ 10,500	
Notes Payable:							
To Related parties:							
7 % Note payable to Cato Holding Co.	293,300					293,300	$ 12,000
Note discount	(24,300)	-	-	3,200	-	(21,100)	
Total notes payable to related parties	$ 269,000	$ -	$ -	$ 3,200	$ -	$ 272,200	
less: current portion	(168,200)	-	-	-	(34,500)	(202,700)	
non-current portion and discount	$ 100,800	$ -	$ -	$ 3,200	$ (34,500)	$ 69,500	
Accrued officer's compensation							
Non-interest bearing notes payable to Officer for deferred salary	$ 57,000	$ -	$ -	$ -	$ -	$ 57,000	$ -
To Unrelated parties							
7.0% Notes payable - all current	$ 63,800	$ -	$ -	$ -	$ -	$ 63,800	$ 1,500
7.5% Notes payable to vendors for accounts payable converted to notes payable:							
Burr, Pilger, Mayer	$ 93,400	$ -	$ (1,600)	$ -	$ -	$ 91,800	$ 500
Desjardins	224,300	-	-	-	(18,400)	205,900	6,800
McCarthy Tetrault	459,400	-	-	-	(35,500)	423,900	13,100
Morrison Foerster	2,420,100	-	-	-	-	2,420,100	83,200
note discount	(228,900)	-	-	17,700	-	(211,200)	-
	2,968,300	-	(1,600)	17,700	(53,900)	2,930,500	$ 103,600

less: current portion	(367,700)	-	1,600