

DAIS ANALYTIC CORP  
Form 10-Q  
November 14, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 000-53554

DAIS ANALYTIC CORPORATION  
(Exact name of Registrant as specified in its charter)

New York  
(State or other jurisdiction of incorporation  
or organization)

14-1760865  
(IRS Employer Identification No.)

11552 Prosperous Drive, Odessa, FL 33556  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (727) 375-8484

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 at least the past 90 days. Yes  No

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>

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

There were 55,017,604 shares of the Registrant's \$0.01 par value common stock outstanding as of November 14, 2012.

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Dais Analytic Corporation

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## PART I— FINANCIAL INFORMATION

DAIS ANALYTIC CORPORATION  
BALANCE SHEETS

	September 30, 2012 (unaudited)	December 31, 2011
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 80,993	\$ 262,740
Accounts receivable, net	438,227	686,648
Other receivables	19,842	73,648
Inventory	251,106	342,908
Prepaid expenses and other current assets	91,223	160,164
Deferred offering costs	-	54,932
<b>Total Current Assets</b>	<b>881,391</b>	<b>1,581,040</b>
Property and equipment, net	104,846	188,162
<b>OTHER ASSETS:</b>		
Deposits	2,280	2,280
Patents, net of accumulated amortization of \$148,483 and \$128,962 at September 30, 2012 and December 31, 2011, respectively	95,086	89,869
<b>Total Other Assets</b>	<b>97,366</b>	<b>92,149</b>
<b>TOTAL ASSETS</b>	<b>\$ 1,083,603</b>	<b>\$ 1,861,351</b>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable, including related party payables of \$87,349 and \$58,367 at September 30, 2012 and December 31, 2011, respectively	\$ 771,415	\$ 552,660
Accrued compensation and related benefits	1,416,857	1,405,606
Accrued interest	334,466	320,548
Accrued expenses, other	130,866	83,861
Current portion of deferred revenue	63,666	298,459
Current portion of notes payable, related party	3,000,624	2,142,069
<b>Total Current Liabilities</b>	<b>5,717,894</b>	<b>4,803,203</b>
<b>LONG-TERM LIABILITIES:</b>		
Warrant liability	279,732	1,888,218
Deferred revenue, net of current portion	27,674	70,840
<b>Total Long-Term Liabilities</b>	<b>307,406</b>	<b>1,959,058</b>
<b>STOCKHOLDERS' DEFICIT</b>		
Preferred stock; \$0.01 par value; 10,000,000 shares authorized; 0 shares issued and outstanding	-	-

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Common stock, \$0.01 par value; 200,000,000 shares authorized; 37,774,817 shares issued and 37,517,604 shares outstanding	377,749	377,749
Capital in excess of par value	33,972,768	33,966,619
Accumulated deficit	(38,020,102)	(37,973,166)
	(3,669,585 )	(3,628,798 )
Treasury stock at cost, 257,213 shares	(1,272,112 )	(1,272,112 )
Total Stockholders' Deficit	(4,941,697 )	(4,900,910 )
<b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT</b>	<b>\$1,083,603</b>	<b>\$1,861,351</b>

The accompanying notes are an integral part of these financial statements.

DAIS ANALYTIC CORPORATION  
STATEMENTS OF OPERATIONS (UNAUDITED)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
<b>REVENUE:</b>				
Sales	\$828,969	\$605,449	\$2,476,467	\$2,547,222
License fees	20,500	20,500	61,500	61,500
	849,469	625,949	2,537,967	2,608,722
<b>COST OF GOODS SOLD</b>	518,166	466,271	1,707,554	1,973,835
<b>GROSS MARGIN</b>	331,303	159,678	830,413	634,887
<b>OPERATING EXPENSES</b>				
Research and development expenses, net of government grant proceeds of \$0, \$305,425, \$67,240 and \$592,897, respectively	192,749	(3,838 )	427,743	9,317
Selling, general and administrative expenses	418,696	487,961	1,383,106	2,202,771
Impairment of fixed assets	62,288	-	62,288	-
<b>TOTAL OPERATING EXPENSES</b>	673,733	484,123	1,873,137	2,212,088
<b>LOSS FROM OPERATIONS</b>	(342,430 )	(324,445 )	(1,042,724 )	(1,577,201 )
<b>OTHER EXPENSE (INCOME)</b>				
Change in fair value of warrant liability	(108,633 )	126,008	(1,608,486 )	783,944
Amortization of discount on convertible note payable	-	341,138	358,555	791,706
Other income	-	(1,200 )	-	(1,200 )
Interest expense	94,893	105,367	254,208	235,239
Interest income	-	(374 )	(65 )	(1,038 )
<b>TOTAL OTHER EXPENSE (INCOME)</b>	(13,740 )	570,939	(995,788 )	1,808,651
<b>NET LOSS</b>	\$(328,690 )	\$(895,384 )	\$(46,936 )	\$(3,385,852 )
<b>NET LOSS PER COMMON SHARE, BASIC AND DILUTED</b>	\$(0.01 )	\$(0.02 )	\$(0.00 )	\$(0.10 )
<b>WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING, BASIC AND DILUTED</b>	37,774,817	36,682,582	37,774,817	35,126,357

The accompanying notes are an integral part of these financial statements.

DAIS ANALYTIC CORPORATION  
STATEMENTS OF STOCKHOLDERS' DEFICIT (UNAUDITED)

	Common Stock Shares	Common Stock Amount	Capital in Excess of Par Value	Accumulated Deficit	Treasury Stock	Total Stockholders' Deficit
Balance, December 31, 2011	37,774,817	\$377,749	\$33,966,619	\$(37,973,166)	\$(1,272,112)	\$(4,900,910)
Stock based compensation	-	-	111,149	-	-	111,149
Revaluation of common stock issued to vendors for services	-	-	(105,000 )	-	-	(105,000 )
Net loss	-	-	-	(46,936 )	-	(46,936 )
Balance, September 30, 2012	37,774,817	\$377,749	\$33,972,768	\$(38,020,102)	\$(1,272,112)	\$(4,941,697)

The accompanying notes are an integral part of these financial statements.

DAIS ANALYTIC CORPORATION  
STATEMENTS OF CASH FLOWS (UNAUDITED)

For the Nine Months  
Ended September 30,  
2012                      2011

**CASH FLOWS FROM OPERATING ACTIVITIES:**

Net loss	\$(46,936 )	\$(3,385,852)
Adjustments to reconcile net income (loss) to net cash and cash equivalents (used) by operating activities:		
Depreciation and amortization	46,550	38,979
Issuance of common stock, stock options and stock warrants for services and amortization of common stock issued for services	-	127,400
Stock based compensation expense	111,149	671,099
Change in fair value of warrant liability	(1,608,486)	783,944
(Decrease) increase in allowance for doubtful accounts	(22,195 )	42,263
Impairment of equipment	62,288	-
Write off of deferred offering costs	55,164	-
Amortization of deferred loan costs	30,224	-
Amortization of discount on convertible note payable	358,555	791,707
(Increase) decrease in:		
Accounts receivable	270,616	(9,571 )
Other receivables	53,806	(54,631 )
Inventory	91,802	(78,303 )
Prepaid expenses and other assets	(51,515 )	(28,027 )
Increase (decrease) in:		
Accounts payable and accrued expenses	279,678	427,596
Accrued compensation and related benefits	11,251	(20,416 )
Deferred revenue	(277,959 )	(94,098 )
Net cash used by operating activities	(636,008 )	(787,910 )

**CASH FLOWS FROM INVESTING ACTIVITIES:**

Increase in patent costs	(24,739 )	(19,869 )
Purchase of property and equipment	(6,000 )	(72,573 )
Net cash used by investing activities	(30,739 )	(92,442 )

**CASH FLOWS FROM FINANCING ACTIVITIES:**

Proceeds from issuance of notes payable, related party	2,050,000	1,500,000
Payments on notes payable, related party	(1,565,000)	(50,000 )
Payments for loan and offering costs	-	(450,396 )
Net cash provided by financing activities	485,000	999,604
Net (decrease) increase in cash and cash equivalents	(181,747 )	119,252
Cash and cash equivalents, beginning of period	262,740	304,656
Cash and cash equivalents, end of period	\$ 80,993	\$ 423,908



## SUPPLEMENTAL CASH FLOW INFORMATION:

Cash paid for interest	\$210,066	\$76,512
NON-CASH FINANCING AND INVESTING ACTIVITIES:		
Issuance of note payable with a beneficial conversion feature	\$-	\$1,064,760
Issuance of note payable with a discount equivalent to the relative fair value of the accompanying warrant	\$-	\$435,240
Application of proceeds due under note payable, including interest, to purchase 2,667,503 shares of common stock	\$-	\$693,550
Settlement of accounts payable with the issuance of 202,703 shares of common stock	\$-	\$75,000
Reclassification of warrant liability to equity upon warrant exercise	\$-	\$965,354
Revaluation of common stock issued for services	\$105,000	\$-
Loan costs paid with note payable, related party	\$15,000	\$-

The accompanying notes are an integral part of these financial statements.

Dais Analytic Corporation  
Notes to Financial Statements  
Three and Nine Months Ended September 30, 2012  
(Unaudited)

1. Background Information

Dais Analytic Corporation, a New York corporation, (the “Company”) has developed and is commercializing applications using its nano-structure polymer technology. The first commercial product is an energy recovery ventilator (“ERV”) (cores and systems) for use in commercial Heating, Ventilating, and Air Conditioning (HVAC) applications. In addition to direct sales, the Company licenses its nano-structured polymer technology to strategic partners in the aforementioned application and is in various stages of development with regard to other applications employing its base technologies. The Company was incorporated in April 1993 with its corporate headquarters located in Odessa, Florida.

The accompanying financial statements of the “Company” are unaudited, but in the opinion of management, reflect all adjustments necessary to fairly state the Company’s financial position, results of operations, stockholders’ deficit and cash flows as of and for the dates and periods presented. The financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information.

The unaudited financial statements and notes are presented as permitted by Form 10-Q. Accordingly, certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted although the Company generally believes that the disclosures are adequate to ensure that the information presented is not misleading. The accompanying financial statements and notes should be read in conjunction with the audited financial statements and notes of the Company for the fiscal year ended December 31, 2011 included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 30, 2012. The results of operations for the three and nine month periods ended September 30, 2012 are not necessarily indicative of the results that may be expected for any future quarters or for the entire year ending December 31, 2012.

## 2. Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred significant losses since inception. As of September 30, 2012, the Company has an accumulated deficit of \$38,020,102, negative working capital of \$4,836,503 and a stockholders' deficit of \$4,941,697. The Company used \$636,008 and \$787,910 of cash in operations during the nine months ended September 30, 2012 and 2011, respectively, which was funded by proceeds from product sales and debt and equity financings. There is no assurance that such debt and equity financing will be available in the future. In view of these matters, there is substantial doubt that the Company will continue as a going concern. The Company is currently pursuing the following sources of short and long-term working capital:

1. We are currently holding preliminary discussions with parties who are interested in licensing, purchasing the rights to, or establishing a joint venture to commercialize certain applications of our technology.
2. We are seeking growth capital from certain strategic and/or government (grant) related sources. In addition to said capital, these sources may, pursuant to any agreements that may be developed in conjunction with such funding, assist in the product definition and design, roll-out, and channel penetration of our products.
3. We are seeking growth capital from the sale of our securities to the public.

The Company has entered into an agreement to sell its common stock subsequent to September 30, 2012. See Note 9 for additional details.

The Company's ability to continue as a going concern is highly dependent on our ability to obtain additional sources of cash flow sufficient to fund our working capital requirements. However, there can be no assurance that the Company will be successful in its efforts to secure such cash flow. Any failure by us to timely procure additional financing or investment adequate to pay our outstanding debt and fund our ongoing operations, including planned product development initiatives and commercialization efforts, will have material adverse consequences on our financial condition, results of operations and cash flows.

The financial statements of the Company do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classifications of liabilities that might be necessary should the Company be unable to continue as a going concern.

## 3. Significant Accounting Policies

In the opinion of management, all adjustments necessary for a fair statement of (a) the results of operations for the three and nine month periods ended September 30, 2012 and 2011, (b) the financial position at September 30, 2012 and December 31, 2011, and (c) cash flows for the nine month periods ended September 30, 2012 and 2011, have been made.

The significant accounting policies followed are:

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.



Cash and cash equivalents - Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits. The Company has never experienced any losses related to these balances. All non-interest bearing cash balances were fully insured at September 30, 2012 and December 31, 2011 due to a temporary federal program in effect from December 31, 2010 through December 31, 2012. Under the program, there is no limit to the amount of insurance for eligible accounts. Beginning 2013, insurance coverage will revert to \$250,000 per depositor at each financial institution, and the Company's non-interest bearing cash balances may again exceed federally insured limits.

Accounts receivable - Accounts receivable consist primarily of receivables from the sale of our ERV products. The Company regularly reviews accounts receivable for any bad debts based on an analysis of the Company's collection experience, customer credit worthiness, and current economic trends. At September 30, 2012, the day's sales outstanding were 68, as compared to 76 at December 31, 2011. Based on management's review of accounts receivable, we have recorded an allowance for doubtful accounts of \$2,576 at September 30, 2012 and an allowance of \$24,771 at December 31, 2011.

Inventory - Inventory consists primarily of raw materials and is stated at the lower of cost, determined by first-in, first-out method, or market. Market is determined based on the net realizable value, with appropriate consideration given to obsolescence, excessive levels, deterioration and other factors.

Property and equipment - Property and equipment are recorded at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets ranging from 5 to 7 years. Gains and losses upon disposition are reflected in the statement of operations in the period of disposition. Maintenance and repair expenditures are charged to expense as incurred. Property and equipment are evaluated for impairment when events change or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. During the nine months ended September 30, 2012, the Company recognized \$62,288 in impairment costs.

Revenue recognition - Generally, the Company recognizes revenue for its products upon shipment to customers, provided no significant obligations remain and collection is probable. During the nine months ended September 30, 2012 and 2011, four customers accounted for approximately 63% and 55% of revenues, respectively.

Our ConsERV product typically carries a warranty of two years for all parts contained therein with the exception of the energy recovery ventilator core which typically carries a 10 year warranty. The warranty includes replacement of defective parts. The Company has recorded an accrual of approximately \$79,600 and \$47,400 for future warranty expenses at September 30, 2012 and December 31, 2011, respectively.

Revenue derived from the sale of licenses is deferred and recognized as revenue on a straight-line basis over the life of the license, or until the license arrangement is terminated. The Company recognized revenue of \$20,500 and \$61,500 from license agreements for both three and nine months ended September 30, 2012 and 2011.

Employee stock based compensation - The Company recognizes all share-based awards to employees, including grants of employee stock options, as compensation expense in the financial statements based on their fair values. That expense will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period).

The value of each award is estimated at the grant date using the Black-Scholes option model with the following assumptions for awards granted during the nine months ended September 30, 2011. There were no awards granted during the nine months ended September 30, 2012.

	Nine Months Ended September 30, 2011
Dividend rate	0%
Risk free interest rate	1.45% – 2.93%
Expected term	6.5 years
Expected volatility	101% – 114%

The basis for the above assumptions are as follows: the dividend rate is based upon the Company's history of dividends; the risk-free interest rate for periods within the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant; the expected term was calculated based on the Company's historical pattern of options granted and the period of time they are expected to be outstanding; and expected volatility was calculated by review of the Company's historical activity.

Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based on historical experience of forfeitures, the Company estimated forfeitures at 0% for the nine month periods ended September 30, 2012 and 2011.

Non-employee stock-based compensation - The Company's accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of EITF 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services," now ASC 505 and EITF 00-18 "Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees," now ASC 505. The measurement date for the fair value of the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached or (ii) the date at which the consultant or vendor's performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement. Stock-based compensation related to non-employees is accounted for based on the fair value of the related stock or options or the fair value of the services, whichever is more readily determinable in accordance with ASC 718. The fair value of common stock issued for services is based on the closing stock price on the date the common stock was issued. During the nine months ended September 30, 2012, the Company did not issue any non-employee stock based compensation. During the nine months ended September 30, 2011, the Company issued 427,895 shares of common stock valued at \$156,245 for services rendered.

Research and development expenses and grant proceeds - Expenditures for research, development and engineering of products are expensed as incurred. For the three and nine months ended September 30, 2012, the Company incurred research and development costs of approximately \$193,000 and \$495,000, respectively. For the three and nine months ended September 30, 2011, the Company incurred research and development costs of approximately \$301,600 and \$602,200 respectively. The Company accounts for proceeds received from government grants for research as a reduction in research and development costs. For the three and nine months ended September 30, 2012, the Company recorded approximately \$0 and \$67,200, respectively, in grant proceeds against research and development expenses on the statement of operations. For the three and nine months ended September 30, 2011, the Company recorded approximately \$305,400 and \$592,900, respectively, in grant proceeds against research and development expenses on the statements of operations.

Government grants - Grants are recognized when there is reasonable assurance that the grant will be received and that any conditions associated with the grant will be met. When grants are received related to Property and Equipment, the Company reduces the basis of the assets resulting in lower depreciation expense over the life of the associated asset. Grants received related to expenses are reflected as a reduction of the associated expense in the period in which the expense is incurred.

Financial instruments - Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value

hierarchy are described below:

- Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, including quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates); and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 - Inputs that are both significant to the fair value measurement and unobservable.



Fair value estimates discussed herein are based upon certain market assumptions and pertinent information available to management as of September 30, 2012. The Company uses the market approach to measure fair value for its Level 1 financial assets and liabilities, which include cash equivalents of \$407 at September 30, 2012. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities.

The respective carrying value of certain on-balance sheet financial instruments approximated their fair values due to the short-term nature of these instruments. These financial instruments include cash, accounts receivable, other receivables, accounts payable, accrued compensation and accrued expenses. The fair value of the Company's convertible notes payable is discussed in Note 4.

The Company's financial liabilities measured at fair value consisted of the following as of September 30, 2012:

	Fair Value Measurements at September 30, 2012			
	Total carrying value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Warrant liability	\$ 279,732	—	—	\$ 279,732

A reconciliation of the beginning and ending fair values of financial instruments valued using significant unobservable inputs (Level 3) is presented as follows:

	Warrant Liability
Balance at December 31, 2011	\$ 1,888,218
Change in fair value	(1,608,486)
Balance at September 30, 2012	\$ 279,732

Income taxes - Income taxes are accounted for under the asset and liability method. Deferred income tax assets and liabilities are computed on the basis of differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based upon enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

The Company accounts for tax uncertainties under the provisions of FASB ASC 740-10 "Uncertainty in Income Taxes" (ASC 740-10). The Company has not recognized a liability as a result of the implementation of ASC 740-10. A reconciliation of the beginning and ending amount of unrecognized tax benefits has not been provided since there is no unrecognized benefit since the date of adoption. The Company has not recognized interest expense or penalties as a result of the implementation of ASC 740-10. If there were an unrecognized tax benefit, the Company would recognize interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses.

Earnings (loss) per share - Basic income (loss) per share is computed by dividing net income (loss) attributable to common stockholders by the weighted average common shares outstanding for the period. Diluted income (loss) per share is computed giving effect to all potentially dilutive common shares. Potentially dilutive common shares may consist of incremental shares issuable upon the exercise of stock options and warrants and the conversion of notes payable to common stock. In periods in which a net loss has been incurred, all potentially dilutive common shares are

considered anti-dilutive and thus are excluded from the calculation. At September 30, 2012 and 2011, the Company had 55,505,342 and 54,577,323 potentially dilutive common shares that were not included in the computation of income (loss) per share.

Derivative financial instruments - The Company does not use derivative instruments to hedge exposure to cash flow, market or foreign currency risk. Terms of convertible promissory note instruments are reviewed to determine whether or not they contain embedded derivative instruments that are required under ASC 815 "Derivative and Hedging" (ASC 815) to be accounted for separately from the host contract, and recorded on the balance sheet at fair value. The fair value of derivative liabilities, if any, is required to be revalued at each reporting date, with corresponding changes in fair value recorded in current period operating results.

Freestanding warrants issued by the Company in connection with the issuance or sale of debt and equity instruments are considered to be derivative instruments and are evaluated and accounted for in accordance with the provisions of ASC 815. Pursuant to ASC 815, an evaluation of specifically identified conditions is made to determine whether fair value of warrants issued is required to be classified as equity or as a derivative liability.

Reclassifications - Certain reclassifications have been made to the financial statements for the three and nine months ended September 30, 2011 to conform to the presentation for the three and nine months ended September 30, 2012.

Recent accounting pronouncements - Recent accounting pronouncements issued by FASB (including EITF), the AICPA and the SEC did not or are not believed by management to have a material impact on the Company's present or future financial statements.

#### 4. Notes Payable

Notes payable consist of the following:

	September 30, 2012	December 31, 2011
Unsecured convertible note payable, related party; interest at 10% per annum until June 14, 2012 and 20% per annum thereafter; (all principal and interest was paid in full as of October 29, 2012)	\$ 1,000,000	\$ 1,000,000
Secured convertible note payable, related party; interest at 10% per annum until June 14, 2012 and 20% per annum thereafter; (all principal and interest was paid in full as of July 13, 2012)	—	1,500,000
Secured convertible promissory note, related party; interest at 6% per annum; due October 26, 2012	2,000,000	—
Note payable; related party	624	624
	3,000,624	2,500,624
Less unamortized discount	—	(358,555)
Less amounts currently due, net of unamortized discount	(3,000,624)	(2,142,069)
Long-term portion	\$ —	\$ —

#### Notes Payable

##### Unsecured Note

On March 22, 2011, the Company entered into a Securities Amendment and Exchange Agreement and an Amended and Restated Convertible Promissory Note ("Convertible Note", collectively "Exchange Agreements") with an investor. Pursuant to the terms and subject to the conditions set forth in the Exchange Agreements, the Company and the investor amended and restated the \$1,000,000 unsecured promissory note to, among other things, add a conversion option and extend the maturity date to March 22, 2012 (as amended and restated, the "2011 Convertible Note"). Interest

in the amount of 10% per annum, commencing on December 17, 2009 and calculated on a 365 day year, and the principal amount of \$1,000,000 was due in full on March 22, 2012. The initial conversion price is \$0.26 per share, which is subject to adjustment for standard anti-dilution provisions. All interest and principal due and owing pursuant to the 2011 Convertible Note was paid on October 29, 2012.

On March 22, 2011, in connection with the above Exchange Agreements, the Company entered into amendments to existing warrant agreements with the investor to extend the terms of the existing stock purchase warrants, dated on or about December 31, 2007 and March 12, 2009, respectively, to March 22, 2016 and to provide for cashless exercise unless such warrant shares are registered for resale under a registration statement. In addition, on March 22, 2011, the Company issued an additional stock purchase warrant to the investor. Subject to the terms of the warrant, the investor may purchase 1,000,000 shares of the Company's common stock at \$0.45 per share, exercisable commencing on the earliest of the consummation of the qualified offering (as defined in the Exchange Agreements), the date of conversion of the 2011 Convertible Note in full, or the date of conversion of the Convertible Note by the investor in the greatest number of shares of the Company's common stock not to exceed 9.99% beneficial ownership of Company outstanding common stock and terminating on March 22, 2016.

The 2011 Convertible Note is a hybrid financial instruments that blends characteristics of both debt and equity securities. The note embodies settlement alternatives to the holder providing for either redemption of principal and interest in cash (forward component) or conversion into the Company's common stock (embedded conversion feature). The forward component was valued using the present value of discounted cash flows arising from the contractual principal and interest payment terms and the embedded conversion feature was valued using the Monte Carlo simulation method. The fair value of the 2011 Convertible Note was estimated to be \$1,964,905 on the date of the exchange, which resulted in a loss on extinguishment of debt of \$964,905. Further, in accordance with ASC 470-20-25 and ASC 470-50-40, the net premium of \$964,905 associated with the 2011 Convertible Note was reclassified to capital in excess of par value under the presumption that such net premium represented a capital contribution. Consequently, the 2011 Convertible Note is being carried at face value. The fair value of the additional warrant to purchase 1,000,000 shares and the value associated with the previously issued warrants that were amended was determined to be \$716,890 using the Black-Scholes option model and is included in the aggregate loss on extinguishment of \$1,681,795. Since the loan is held by a related party, the loss on extinguishment has been treated as a capital transaction and, as a result, this transaction had no net effect on capital in excess of par value.

#### Secured Note

Also, on March 22, 2011, the Company entered into a 10% note and warrant purchase agreement, secured convertible promissory note and a Patent Security Agreement ("Financing Agreements") with the investor. Pursuant to the terms and subject to the conditions set forth in the Financing Agreements, the investor provided a loan in the principal amount of \$1,500,000 to the Company, which was secured by all patents, patent applications and similar protections of the Company and all rents, royalties, license fees and "accounts" with respect to such intellectual property assets. Pursuant to this secured convertible promissory note ("Secured Note"), interest in the amount of 10% per annum, calculated on a 365 day year, and the principal amount of \$1,500,000 was due and payable on March 22, 2012, subsequently extended to May 7, 2012, but repayment is accelerated upon a qualified offering (as defined in the note). All interest and principal due and owing pursuant to this Secured Note was paid on July 13, 2012. On July 13, 2012, the Patent Security Agreement was terminated coincident with the payment of the Secured Note.

On March 22, 2011, in connection with the Financing Agreements, the Company issued a Stock Purchase Warrant to the investor to purchase 3,000,000 shares of the Company's common stock at \$0.45 per share, exercisable until March 22, 2016. The Warrant was fair valued on the date of issuance, which amounted to \$1,204,787. The warrant value was recorded as a debt discount based on the relative fair value of the warrant to the total proceeds received, which amounted to \$435,240. The Warrant was fair valued using the Black-Scholes-Merton valuation model. In addition, the debt contained a beneficial conversion feature, which was valued at the date of issuance at \$1,762,163; however, since this amount is in excess of the net value of the debt less the warrant discount, the beneficial conversion feature will be limited to \$1,064,760 and recorded as a discount on the loan. The total debt discount of \$1,500,000 is being amortized using the effective interest method over the 12-month term of the Secured Note. For the three and nine months ended September 30, 2012, the Company recognized \$0 and \$358,555, respectively, in additional interest expense representing amortization of this debt discount. For the three and nine months ended September 30, 2011, the

Company recognized \$341,138 and \$791,706, respectively, in additional interest expense representing amortization of this debt discount.

The fair value of warrants issued in 2011 related to the above debt transaction were calculated using the Black-Scholes model with the following assumptions: Expected life in years: 5-10 years; Estimated volatility 115%-117%, Risk-free interest rate: 1.89%-2.07%; Dividend yield: 0%.

#### Forbearance Agreement

On June 15, 2012, we entered into a forbearance agreement (the “Forbearance Agreement”), with the investor. Under the Forbearance Agreement, the investor agreed to forebear from disposing of or selling any collateral secured by the Patent Security Agreement until the earliest of: (i) July 15, 2012; (ii) two business days after our receipt of a written notice after any subsequent event of default, (iii) two business days after our receipt of a written notice that any representations, warranties or information we provided to the investor in any document or instrument in connection with the Forbearance Agreement is materially false, incomplete or misleading, (iv) two business days after our receipt of a written notice that a proceeding or other action has been commenced by any creditor against us, other than the investor (v) the date on which a court enters an order for relief or take any similar action in respect of us in an involuntary case under any applicable bankruptcy law, or (vi) the date on which a petition for relief under any applicable bankruptcy, is filed by or against us, each as further described in the Forbearance Agreement.

On July 13, 2012 we paid in full all principal and interest due pursuant to the Secured Note. On October 29, 2012 we paid in full all principal and interest due pursuant to the 2011 Convertible Note. Upon payment of the 2011 Convertible Note the Forbearance Agreement was terminated.

#### 2012 Secured Convertible Promissory Note

On July 13, 2012, the Company issued a Secured Convertible Promissory Note and Patent Security Agreement (collectively, the “Agreements”) to an investor (“Investor”). Pursuant to the terms and subject to the conditions set forth in the Agreements, the Investor provided a loan in the amount of \$2,000,000 to the Company, which will be secured by all current and future patents, patent applications and similar protections of the Company and all rents, royalties, license fees and “accounts” with respect to such intellectual property assets (“Collateral”). Pursuant to the Secured Convertible Promissory Note (the “2012 Note”), interest in the amount of 6% per annum, calculated on a 365 day year, and the principal amount of \$2,000,000 and accrued interest will be paid on or before October 15, 2012, subsequent extended to October 26, 2012. The Investor has the right to convert principal and accrued interest into the Company’s common stock at \$0.26 per share. The initial conversion price may be adjusted pursuant to standard anti-dilution provisions. The proceeds of this 2012 Note were used in part to pay, in full, all outstanding principal and interest due pursuant to the Secured Note issued March 22, 2011.

Pursuant to the Patent Security Agreement, the Company shall not, without the Investor’s prior consent, sell, dispose or otherwise transfer all or any portion of the Collateral, except for license grants in the ordinary course of business. In addition, the Company will take all actions reasonably necessary to prosecute to allowance applications for patents and maintain all patents, and to seek to recover damages for infringement, misappropriation or dilution of the Collateral with limited exceptions.

On October 30, 2012, the Company and MG Energy LLC, a Delaware limited liability company (“MG Energy”), entered into the License and Supply Agreement (the “Agreement”), effective October 26, 2012, pursuant to which the Company licensed certain intellectual property and improvements thereto to MG Energy, for use in the manufacture and sale of energy recovery ventilators (“ERV”) and certain other HVAC systems for installation in commercial, residential or industrial buildings in North America and South America. MG Energy also agreed to purchase its requirements of the Company’s moisture transfer material from the Company for MG Energy’s use, pursuant to the terms and conditions of the Agreement. Energy recovery ventilators are mechanical equipment, of which an energy recovery ventilator air to air exchanger core is a component, that assists in the recovery of energy from the exhaust air expelled by an HVAC system for the purpose of pre-conditioning the incoming outdoor air’s components prior to supplying the conditioned air to a residential or commercial building, either directly or as part of an air-conditioning system.

Under the Agreement, MG Energy has agreed to retire the 2012 Note, dated July 13, 2012, including all interest accrued thereon, issued by the Company to the Investor, who assigned the Secured Promissory Note to MG Energy.

This retirement is nonrefundable and noncreditable. MG Energy has also agreed to pay a royalty on the net sales price on products sold using the Company's intellectual property. Coincident with the retirement of the 2012 Note, the related Patent Security Agreement was terminated.

Other Notes and Accrued Interest

During the nine months ended September 30, 2012, the Company entered into an agreement with a related party to borrow \$50,000 which is due on demand and bears interest at 4%. We paid all interest and principal due under this note on August 1, 2012.



Accrued interest on the above notes was \$334,466 and \$320,548 at September 30, 2012 and December 31, 2011, respectively.

## 5. Related Party Transactions

Timothy N. Tangredi, our Chief Executive Officer and Chairman, is a founder and a member of the board of directors of Aegis BioSciences, LLC (“Aegis”). Mr. Tangredi currently owns 52% of Aegis’ outstanding equity and spends approximately one to two days per month on Aegis business for which he is compensated by Aegis. Aegis has two exclusive, world-wide licenses from us under which it has the right to use and sell products containing our polymer technologies in biomedical and health care applications. As a result of a \$150,000 payment made by Aegis, the first license is considered fully paid and as such no additional license revenue will be forthcoming. Pursuant to the second license Aegis made an initial one-time payment of \$50,000 and is to make royalty payments of 1.5% of the net sales price it receives with respect to any personal hygiene product, surgical drape or clothing products (the latter when employed in medical and animal related fields) and license revenue it receives should Aegis grant a sublicense to a third party. To date Aegis has sold no such products nor has it received any licensing fees requiring a royalty payment be made to us. All obligations for such payments will end on the earlier of June 2, 2015 or upon the aggregate of all sums paid to us by Aegis under the agreement reaching \$1 million. The term of each respective license runs for the duration of the patented technology.

The Company rents a building that is owned by two stockholders of the Company, one of which is the Chief Executive Officer. Rent expense for this building is \$3,800 per month. The Company recognized rent expense of approximately \$11,400 in each of the three and nine months ended September 30, 2012 and 2011. At September 30, 2012 and December 31, 2011, \$87,349 and \$58,367, respectively, were included in accounts payable for amounts owed for rent.

The Company also has accrued compensation due to the Chief Executive Officer and two other employees for deferred salaries earned and unpaid as of September 30, 2012 and December 31, 2011 of \$1,416,857 and \$1,405,606, respectively.

The above terms and amounts are not necessarily indicative of the terms and amounts that would have been incurred had comparable transactions been entered into with independent parties.

## 6. Stock Options and Warrants

### Options

In June 2000 and November 2009, our Board of Directors adopted, and our shareholders approved, the 2000 Plan and 2009 Plan, respectively (together the “Plans”). The Plans provide for the granting of options to qualified employees of the Company, independent contractors, consultants, directors and other individuals. The Company’s Board of Directors approved and made available 11,093,886 and 15,000,000 shares of common stock to be issued pursuant to the 2000 Plan and the 2009 Plan. The Plans permit grants of options to purchase common shares authorized and approved by the Company’s Board of Directors.

The average fair value of options granted at market during nine months ended September 30, 2011 was \$0.27 per option. There were no options awarded during the nine months ended September 30, 2012. There were no options exercised during the nine months ended September 30, 2012 and 2011.



The following summarizes the information relating to outstanding stock options activity with employees during 2012 and 2011:

	Common Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2011	17,402,757	\$ 0.32	6.66	\$ 352,065
Expired/Forfeited	(1,115,425)	\$ 0.33		
Outstanding at September 30, 2012	16,287,332	\$ 0.32	6.07	\$ -
Exercisable at September 30, 2012	15,831,082	\$ 0.31	5.89	\$ -

Stock compensation expense was approximately \$28,000 and \$111,100 for the three and nine months ended September 30, 2012, respectively, and \$41,000 and \$671,100 for the three and nine months ended September 30, 2011, respectively. The total fair value of shares vested during the nine months ended September 30, 2012 and 2011 was approximately \$83,700 and \$527,200, respectively.

As of September 30, 2012, there was approximately \$102,800 of unrecognized employee stock-based compensation expense related to non vested stock options, of which \$27,800, \$65,600 and \$9,400 is expected to be recognized for the remainder of the fiscal year ending December 31, 2012, and for the fiscal years ending 2013 and 2014, respectively.

The following table represents our non vested share-based payment activity with employees for the nine months ended September 30, 2012:

	Number of Options	Weighted Average Grant Date Fair Value
Nonvested options - December 31, 2011	1,094,236	\$ 0.29
Granted	—	\$ —
Vested	(308,958)	\$ 0.27
Forfeited	(329,028)	\$ —
Nonvested options – September 30, 2012	456,250	\$ 0.29

#### Warrants

At September 30, 2012, the Company had outstanding warrants to purchase the Company's common stock which were issued in connection with multiple financing arrangements and consulting agreements. Information relating to these warrants is summarized as follows:

Warrants	Remaining Number Outstanding	Weighted Average	Weighted Average

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		Remaining Life (Years)	Exercise Price
Warrants-Additional Financing	218,500	.39	\$ 0.55
Warrants-Robb Trust Note	25,000	.20	\$ 0.55
Warrants-Financing	17,000,000	1.00	\$ 0.30
Warrants-Placement Agent Warrants	401,333	.33	\$ 0.25
Warrants-Tangredi	3,000,000	.50	\$ 0.36
Warrants-Ehrenberg	250,000	.84	\$ 0.30
Warrants-Consulting Agreement	825,000	2.02	\$ 0.30
Warrants-Note Conversions	2,302,538	1.67	\$ 0.39
Warrants-Stock Purchases	1,720,770	2.75	\$ 0.40
Warrants-Services	400,000	2.31	\$ 0.50
Tota	26,143,141		

## 7. Terminated Sales Agreements

On August 21, 2009, we entered into an Exclusive Distribution Agreement with Genertec, under which we are to supply and Genertec is to distribute, on an exclusive basis, three of our nanotechnology-based membrane products and related products in Greater China, including mainland China, Hong Kong, Macau and Taiwan. The agreement provides that during the initial five year term of the agreement, Genertec will order and purchase these products in the aggregate amount of \$200 million. A minimum quantity of said products is to be purchased by Genertec during each contract year of the initial term.

In April of 2010, the Company entered into a technical and sales agreement with CAST Systems Control Technology Co., Ltd. (“CAST”) and Genertec with a value of up to approximately \$48 million over a twelve month period. Under the terms of the Agreement, the Company will supply to CAST, through Genertec, key system components of its nanotechnology clean water process.

During 2011, Genertec expressed a desire to limit its participation in this endeavor as they find NanoAir and NanoClear to have engineering requirements they are not best suited to undertake. During the nine months ended September 30, 2012, we terminated the Genertec and CAST agreements and recognized the \$150,000 deposit as revenue.

## 8. Derivative Financial Instruments

In September 2008, the FASB ratified the consensus reached on EITF Issue No. 07-5, Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity’s Own Stock (“EITF 07-5”) (codified as ASC 815-40-15-5). This EITF provides guidance for determining whether an equity-linked financial instrument (or embedded feature) is indexed to an entity’s own stock. The EITF applies to any freestanding financial instrument or embedded feature that has all the characteristics of a derivative under ASC 815-10-15-13 through 15-130, Accounting for Derivative Instruments and Hedging Activities, for purposes of determining whether that instrument or embedded feature qualifies for the first part of the scope exception. The EITF also applies to any freestanding financial instrument that is potentially settled in an entity’s own stock, regardless of whether the instrument has all the characteristics of a derivative under ASC 815-10-13 through 15-130, for purposes of determining whether the instrument is within the scope of EITF No. 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock (“EITF 00-19”) (codified as ASC subtopic 815-40). EITF No. 07-5 was effective beginning the first quarter of fiscal 2009.

Due to certain adjustments that may be made to the exercise price of certain warrants issued in December 2007, January 2008 and August 2008, if the Company issues or sells shares of its common stock at a price which is less than the then current warrant exercise price, these warrants have been classified as a liability as opposed to equity in accordance with the Derivatives and Hedging Topic of the FASB ASC 815-10-15 as it was determined that these warrants were not indexed to the Company’s stock. As a result, the fair market value of these warrants was remeasured on January 1, 2009 and marked to market at each subsequent financial reporting period. The change in fair value of the warrants is recorded in the statement of operations and is estimated using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended September 30, 2012		September 30, 2011		Nine Months Ended September 30, 2012		September 30, 2011	
Exercise price	\$	0.25	\$	0.25	\$	0.25	\$	0.25
Market value of stock at end of period	\$	0.10	\$	0.38	\$	0.10	\$	0.38
Expected dividend rate		0%		0%		0%		0%

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Expected volatility	221% - 240%	165%	221% - 240%	164% - 173%
Risk-free interest rate	0.10%	0.13% - 0.25%	0.10%	0.13% - 0.25%

All warrants issued by the Company other than the above noted warrants are classified as equity.

## 9. Subsequent Events

On October 17, 2012, the Company entered into a Securities Purchase Agreement (the “SPA”) with Green Valley International Investment Management Company Limited (the “Equity Investor”) pursuant to which the Company will offer up to \$7.0 million of the Company’s common stock, \$0.01 par value per share (the “Common Stock”), and warrants (the “Warrants”) to purchase up to 17,500,000 shares of Common Stock (such offer being the “Offering”).

The Company will issue the Common Stock and Warrants in three tranches. Upon the receipt of the funds for the first tranche on or about October 26, 2012, the Company issued \$2 million of newly issued Common Stock for \$0.10 per share and issued 5,000,000 warrants. Upon the receipt of the funds for the second tranche on or about November 20, 2012, the Company will issue \$2 million of newly issued Common Stock for \$0.10 per share and issue 5,000,000 warrants. Upon the receipt of the funds for the third tranche on or about December 28, 2012, the Company will issue \$3 million of newly issued Common Stock for \$0.10 per share and issue 7,500,000 warrants.

The Warrants are exercisable for 60 months beginning on the date of their issuance. The warrants have an exercise price of \$0.30, and are subject to standard anti-dilution adjustments for stock splits and other subdivisions.

Pursuant to terms of the Offering, officers of the Company and the Equity Investor have signed lock-up agreements restricting the sale of Common Stock. The Equity Investor does not have any registration rights with respect to the Common Stock or Warrants. No underwriter or placement agent was used in the sale of the Common Stock or Warrants.

On November 14, 2012, in connection with a private offering, the Company sold and issued 17,500,000 shares to one purchaser for \$1,750,000 in cash. In addition, under the terms of the private placement offering, the Equity Investor also received a warrant to purchase 4,375,000 shares of the Company’s common stock with an exercise period of five years from the date of issue at an exercise price of \$.30 per share.

The issuance of common stock at less than \$0.25 has triggered an adjustment to the exercise price of certain warrants issued in December 2007, January 2008 and August 2008. The new exercise price is calculated to be \$0.21 per share.

On October 29, 2012, the Company repaid \$1,323,562 (consisting of principal and interest ) to satisfy and terminate the unsecured convertible promissory note (the “Convertible Note”) issued to Platinum-Montaur Life Sciences, LLC (“Platinum-Montaur”). With the repayment of the Convertible Note, we also terminated a forbearance agreement, dated June 15, 2012 (the “Forbearance Agreement”), with Platinum Montaur.

On October 30, 2012, the Company and MG Energy LLC, a Delaware limited liability company (“MG Energy”), entered into the License and Supply Agreement (the “Agreement”), effective October 26, 2012, pursuant to which the Company licensed certain intellectual property and improvements thereto to MG Energy, for use in the manufacture and sale of energy recovery ventilators (“ERV”) and certain other HVAC systems for installation in commercial, residential or industrial buildings in North America and South America. MG Energy also agreed to purchase certain ConsERV products, including but not limited to, its requirements of moisture transfer material from the Company for MG Energy’s use, pursuant to the terms and conditions of the Agreement.

Under the Agreement, MG Energy has agreed to retire the \$2012 Note, dated July 13, 2012, including all interest accrued thereon, issued by the Company to Michael Gostomski, who assigned the Secured Promissory Note to MG Energy. This retirement is nonrefundable and noncreditable. MG Energy has also agreed to pay a royalty on the net sales price on products sold using the Company’s intellectual property. Coincident with the retirement of the 2012 Note, the related Patent Security Agreement was terminated.





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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the notes thereto included elsewhere in this quarterly report on Form 10-Q and in our annual report on Form 10-K filed with the Securities and Exchange Commission on March 30, 2012.

THIS FILING, INCLUDING BUT NOT LIMITED TO "MANAGEMENT'S DISCUSSION AND ANALYSIS", CONTAINS FORWARD-LOOKING STATEMENTS. THE WORDS "ANTICIPATED," "BELIEVE," "EXPECT," "PLAN," "INTEND," "SEEK," "ESTIMATE," "PROJECT," "WILL," "COULD," "MAY," AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS. THESE STATEMENTS INCLUDE, AMONG OTHERS, INFORMATION REGARDING FUTURE OPERATIONS, FUTURE CAPITAL EXPENDITURES, AND FUTURE NET CASH FLOW. SUCH STATEMENTS REFLECT THE COMPANY'S CURRENT VIEWS WITH RESPECT TO FUTURE EVENTS AND FINANCIAL PERFORMANCE AND INVOLVE RISKS AND UNCERTAINTIES, INCLUDING, WITHOUT LIMITATION, GENERAL ECONOMIC AND BUSINESS CONDITIONS, CHANGES IN FOREIGN, POLITICAL, SOCIAL, AND ECONOMIC CONDITIONS, REGULATORY INITIATIVES AND COMPLIANCE WITH GOVERNMENTAL REGULATIONS, THE ABILITY TO ACHIEVE FURTHER MARKET PENETRATION AND ADDITIONAL CUSTOMERS, AND VARIOUS OTHER MATTERS, MANY OF WHICH ARE BEYOND THE COMPANY'S CONTROL. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF SEVERAL FACTORS, INCLUDING THE RISKS FACED BY US AS DESCRIBED BELOW AND ELSEWHERE IN THIS FORM 10-Q AS WELL AS IN OUR FORM 10-K FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON MARCH 30, 2012. IN LIGHT OF THESE RISKS AND UNCERTAINTIES THERE CAN BE NO ASSURANCE THAT THE FORWARD-LOOKING STATEMENTS CONTAINED IN THIS FORM 10-Q WILL OCCUR. WE HAVE NO OBLIGATION TO PUBLICLY UPDATE OR REVISE THESE FORWARD-LOOKING STATEMENTS TO REFLECT NEW INFORMATION, FUTURE EVENTS, OR OTHERWISE, EXCEPT AS REQUIRED BY FEDERAL SECURITIES LAWS AND WE CAUTION YOU NOT TO PLACE UNDUE RELIANCE ON THESE FORWARD-LOOKING STATEMENTS. WE MAY NOT UPDATE THESE FORWARD-LOOKING STATEMENTS, EVEN THOUGH OUR SITUATION MAY CHANGE IN THE FUTURE.

### OVERVIEW

We have developed and patented a nano-structure polymer technology, which is being commercialized in products based on the functionality of these materials. We believe the applications of our technology have promise in a number of diverse market segments and products.

The initial product focus of the Company is ConsERV, an energy recovery ventilator. Our primary focus is to expand our marketing and sales of our ConsERV products. We also have new product applications in various stages of development. We believe that three of these product applications, including an advanced air conditioning system which is projected to be more energy efficient and have lower emissions compared to current HVAC equipment, a sea-water desalination product and an electrical energy storage device, may be brought to market in the foreseeable future if we receive adequate capital funding.

We expect ConsERV™ to continue to be our focused commercial product through 2012 with a growing emphasis on moving the development of the NanoClear and NanoAir technologies towards commercialization.

### REVENUES

We generate our revenues primarily from the sale of our ConsERV™ Systems, cores and moisture transfer membrane in largely commercial HVAC markets with a small amount of revenue coming from residential sales to consumers and HVAC distributors. Sales channels for our ConsERV™ products include OEMs, distributors, retailers, and consumers. We also occasionally license our technology to strategic partners and sell various prototypes of other product applications that use our polymer technology.

Our revenue growth is expected to arise from (i) fulfilling the ventilation needs from the requirements generated by the growing marketplace for “energy consultants” who work to lower their client’s energy costs and emissions, (ii) sales from the Company’s own ‘customer direct’ sales activities, all of which focus on the sale of product primarily into the commercial user marketplace with a growing emphasis on low rise structures (small commercial buildings, multi-purpose structures, and residences) and (iii) royalties and sale of products to our ConsERV licensee. In addition, the Company will work to secure orders for ConsERV™ “core only” sales from HVAC equipment manufacturers and from distribution firms servicing the equipment needs of the HVAC installer community. We are focused on creating additional license/supply relationships with HVAC or ERV OEMs preferably having a dominant presence in existing direct related sales channels.

#### COST OF SALES

Our cost of sales consists primarily of materials (including freight), direct labor, and outsourced manufacturing expenses incurred to produce our ConsERV™ products.

We are dependent on third parties to manufacture the key components needed for our nano-structured based materials and value added products made with these materials. Accordingly, a supplier’s failure to supply components in a timely manner, or to supply components that meet our quality, quantity and cost requirements or our technical specifications, or the inability to obtain alternative sources of these components on a timely basis or on terms acceptable to us, would create delays in production of our products or increase our unit costs of production. Certain of the components contain proprietary products of our suppliers, or the processes used by our suppliers to manufacture these components are proprietary. If we are required to replace any of our suppliers, while we should be able to obtain comparable components from alternative suppliers at comparable costs, it would create a delay in production.

Our cost of sales may fluctuate due to a number of factors, including, but not limited to:

- A change in key suppliers or the prices that they charge for the fundamental components of our ConsERV™ products;
- An increase in the labor resources needed to expand the production of our ConsERV™ products;
- Commercialization of new product applications of our polymer technology;
- Continued technological improvements in key materials or configuration(s); and
- Additional outsourcing of our manufacturing and assembly processes with strategic partners to reduce our ‘per unit’ cost structure.

#### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Our selling, general and administrative expenses consist primarily of payroll and related benefits, share-based compensation, professional fees, marketing and channel support costs, and other infrastructure costs such as insurance, information technology and occupancy expenses.

Our selling, general and administrative expenses may fluctuate due to a variety of factors, including, but not limited to:

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Additional expenses as a result of being a reporting company including, but not limited to, director and officer insurance, director fees, SEC reporting and compliance expenses, transfer agent fees, additional staffing, professional fees and similar expenses;

- Additional infrastructure needed to support the expanded commercialization of our ConsERV™ products and/or new product applications of our polymer technology for, among other things, administrative personnel, physical space, marketing and channel support and information technology; and
- The fair value of new share-based awards, which is based on various assumptions including, among other things, the volatility of our stock price

## Results of Operations

## Summary of Three Months Ended September 30, 2012 Results of Operations

The following table sets forth, for the periods indicated, certain data derived from our Statements of Operations and certain of such data expressed as a percentage of revenues:

	Three Months Ended	
	September 30, 2012	2011
Revenues	\$ 849,469	\$ 625,949
Percentage of revenues	100.0%	100.0%
Cost of goods sold	\$ 518,166	\$ 466,271
Percentage of revenues	61.0%	74.5%
Research and development expenses, net grant revenue	\$ 192,749	\$ (3,838)
Percentage of revenues	22.7%	0.6%
Selling, general and administrative expenses	\$ 418,696	\$ 487,961
Percentage of revenues	49.3%	78.0%
Impairment of fixed assets	\$ 62,288	\$ 0
Percentage of revenues	7.3%	0.0%
Interest expense	\$ 94,893	\$ 105,367
Percentage of revenues	11.2%	16.8%
Change in fair value of warrant liability (gain)	\$ (108,633)	\$ 126,008
Percentage of revenues	12.8%	20.1%
Amortization of discount on convertible note payable	\$ 0	\$ 341,138
Percentage of revenues	0.0%	54.5%
Net income	\$ (328,690)	\$ (895,384)
Percentage of revenues	38.7%	143.0%

**REVENUES:** Total revenues for the three months ended September 30, 2012 and 2011 were \$849,469 and \$625,949, respectively, an increase of \$223,520 or 35.7%. The increase in revenues in the 2012 period is primarily attributable to the overall increase in the number of units sold and the amount of “core only” sales over the same period in 2011.

**COST OF GOODS SOLD:** Cost of goods sold increased \$51,895 to \$518,166 and represented 61% of revenues, for the three months ended September 30, 2012 compared to \$466,271 or 74.50% of revenues for the three months ended September 30, 2011. Gross profit margin increased from 25.5% in 2011 to 39% in 2012. The increase in the gross profit margin was due to the increase in sales of higher gross margin products and the reduction of Dais personnel assigned to the production team.

**RESEARCH AND DEVELOPMENT EXPENSES, NET OF GRANT REVENUE:** Research and development expenses, net of grant revenue of \$192,749 for the three months ended September 30, 2012 increased from (\$3,838) for the same period ended September 30, 2011. The increase was primarily due to no grant revenues being earned during the three months ended September 30, 2012.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSES:** Selling, general and administrative expenses of \$418,696 for the three months ended September 30, 2012 decreased \$69,265 from \$487,961 in the same period of 2011 or 14%. The decrease was primarily due to a decrease in stock based compensation.

**IMPAIRMENT OF FIXED ASSETS:** Impairment of fixed assets increased to \$62,288 for the three months ended September 30, 2012 compared to \$0 for the same period ended September 30, 2011. This increase was due to the Company impairing one of its demonstration units as it was no longer functioning.

**INTEREST EXPENSE:** Interest expense was \$94,893 for the three months ended September 30, 2012 compared to \$105,367 for the same period of 2011, a decrease of \$10,474. The decrease was primarily due to the repayment of the secured loan in 2012.

**AMORTIZATION OF DISCOUNT ON NOTE PAYABLE:** Amortization of discount on note payable decreased to \$0 for the three months ended September 30, 2012 compared to \$341,138 for the same period ended September 30, 2011. The decrease was due to the related note payable reaching maturity in the first quarter 2012.

**CHANGE IN FAIR VALUE OF WARRANT LIABILITY:** The change in the fair value of warrant liability decreased by \$234,641 for the three months ended September 30, 2012 to (\$108,633) from \$126,008 in the prior period ended September 30, 2011 due to the change in the fair value of the underlying warrant liability based on the Black-Scholes option pricing model. See Note 8 in the accompanying Financial Statements.

**NET INCOME:** Net loss for the three months ended September 30, 2012 decreased by \$566,694 to \$328,690 from \$895,384 for the three months ended September 30, 2011. The decrease in net income is primarily due to the decrease in the change in the fair value of the warrant liability and increase in revenues as discussed above.

#### Summary of Nine Months Ended September 30, 2012 Results of Operations

The following table sets forth, for the periods indicated, certain data derived from our Statements of Operations and certain of such data expressed as a percentage of revenues:

	Nine Months Ended September 30,	
	2012	2011
Revenues	\$ 2,537,967	\$ 2,608,722
Percentage of revenues	100.0%	100.0%
Cost of goods sold	\$ 1,707,554	\$ 1,973,835
Percentage of revenues	67.3%	75.7%
Research and development expenses, net grant revenue	\$ 427,743	\$ 9,317
Percentage of revenues	16.9%	0.4%
Selling, general and administrative expenses	\$ 1,383,106	\$ 2,202,771
Percentage of revenues	57.0%	84.4%
Impairment of fixed assets	\$ 62,288	\$ 0
Percentage of revenues	2.5%	0.0%
Amortization of discount on convertible note payable	\$ 358,555	\$ 791,706
Percentage of revenues	14.1%	30.3%
Interest expense	\$ 254,208	\$ 235,239
Percentage of revenues	10.0%	9.0%
Change in fair value of warrant liability (gain)	\$ (1,608,486)	\$ 783,944
Percentage of revenues	63.4%	30.1%
Net income (loss)	\$ (46,936)	\$ (3,385,852)
Percentage of revenues	1.8%	129.8%

**REVENUES:** Total revenues for the nine months ended September 30, 2012 and 2011 were \$2,537,967 and \$2,608,722, respectively, a decrease of \$70,755 or 2.7%. The decrease in revenues in the 2012 period is primarily attributable to customer concerns related to our ability to repay the convertible secured promissory note in the principal amount of \$1.5 million. The note was repaid on July 13, 2012. In addition, during the nine month period 2012, we experienced a small decrease in sales due to relocating the production of our enthalpy cores to our Odessa location. The time required to establish the production line and complete quality assurance procedures resulted in fewer cores being produced than anticipated and hence fewer systems were shipped. During the nine months ended September 30, 2012 and 2011, four customers accounted for approximately 63% and 55% of revenues, respectively.





**COST OF GOODS SOLD:** Cost of goods sold decreased \$266,281 to \$1,707,554 and represented 67.3% of revenues, for the nine months ended September 30, 2012 compared to \$1,973,835 or 75.7% of revenues for the nine months ended September 30, 2011. Gross profit margin increased from 24% in 2011 to 33% in 2012. The increase in the gross profit margin was due to the recognition of the \$150,000 nonrefundable deposit related to the termination of the Genertec and the CAST agreements net of the increase in costs related to the relocation of the production of our enthalpy cores to our Odessa location, which required an increase in labor costs and additional training for quality assurance procedures.

**RESEARCH AND DEVELOPMENT EXPENSES, NET OF GRANT REVENUE:** Research and development expenses, net of grant revenue of \$427,743 for the nine months ended September 30, 2012 increased from \$9,317 for the same period ended September 30, 2011. The increase was primarily due to minimal grant revenues being earned during the nine months ended September 30, 2012.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSES:** Selling, general and administrative expenses of \$1,383,103 for the nine months ended September 30, 2012 represented a decrease of \$819,665 from \$2,202,771 in the same period of 2011. The decrease was primarily due to a decrease of \$559,950 in stock based compensation expense as the Company did not approve as many equity awards in 2012. It was also due to a \$100,096 decrease in professional fees as the Company entered into fewer consulting agreements. Overall, payroll expense decreased by \$79,334 and postage and shipping expense decreased by \$20,434. Finally, the Company reduced travel and entertainment expense by \$26,918.

**IMPAIRMENT OF FIXED ASSETS:** Impairment of fixed assets increased to \$62,288 for the nine months ended September 30, 2012 compared to \$0 for the same period ended September 30, 2011. This increase was due to the Company impairing one of its demonstration units as it was no longer functioning.

**INTEREST EXPENSE:** Interest expense was \$254,208 for the nine months ended September 30, 2012 compared to \$235,239 for the same period of 2011, an increase of \$18,969. The increase was primarily due to the secured and unsecured notes interest rate increasing to 20% and the issuance of the 2012 Note.

**AMORTIZATION OF DISCOUNT ON NOTE PAYABLE:** Amortization of discount on note payable decreased to \$358,555 for the nine months ended September 30, 2012 compared to \$791,706 for the same period ended September 30, 2011. The decrease was due to the related note payable reaching maturity in first quarter of 2012.

**CHANGE IN FAIR VALUE OF WARRANT LIABILITY:** The change in the fair value of warrant liability decreased by \$2,392,430 for the nine months ended September 30, 2012 to (\$1,608,486) from \$783,944 in the prior period ended September 30, 2011 due to the change in the fair value of the underlying warrant liability based on the Black-Scholes option pricing model. See Note 8 in the accompanying Financial Statements.

**NET LOSS:** Net loss for the nine months ended September 30, 2012 decreased by \$3,338,916 to \$46,936 from \$3,385,852 for the nine months ended September 30, 2011. The decrease in net loss is primarily due to the increase in the change in fair value of warrant liability and the decrease in interest expense as discussed above.

#### Liquidity and Capital Resources

The Company finances its operations primarily through sales of its ConsERV™ products, sale of its common stock, license agreements and the issuance of promissory notes.

Our historical revenues have not been sufficient to sustain our operations. We have not achieved profitability in any year since inception and we expect to continue to incur net losses and negative cash flow from operations until we can

produce sufficient revenues to cover our costs, which are not expected for several years. Furthermore, even if we achieve our goal of selling a greater number of ConsERV™ products, we anticipate that we will continue to incur losses until we can cost-effectively produce and sell our products to a wider market. Our profitability will require the continued successful commercialization of our ConsERV™ products and any future products we develop. No assurances can be given when this will occur.

#### Unsecured Note

On March 22, 2011, the Company entered into a Securities Amendment and Exchange Agreement and an Amended and Restated Convertible Promissory Note (“Convertible Note”, collectively “Exchange Agreements”) with an investor. Pursuant to the terms and subject to the conditions set forth in the Exchange Agreements, the Company and the investor amended and restated the \$1,000,000 unsecured promissory note to, among other things, add a conversion option and extend the maturity date to March 22, 2012 (as amended and restated, the “2011 Convertible Note”). Interest in the amount of 10% per annum, commencing on December 17, 2009 and calculated on a 365 day year, and the principal amount of \$1,000,000 was due in full on March 22, 2012. The initial conversion price is \$0.26 per share, which is subject to adjustment for standard anti-dilution provisions. All interest and principal due and owing pursuant to the 2011 Convertible Note was paid on October 29, 2012.

On March 22, 2011, in connection with the above Exchange Agreements, the Company entered into amendments to existing warrant agreements with the investor to extend the terms of the existing stock purchase warrants, dated on or about December 31, 2007 and March 12, 2009, respectively, to March 22, 2016 and to provide for cashless exercise unless such warrant shares are registered for resale under a registration statement. In addition, on March 22, 2011, the Company issued an additional stock purchase warrant to the investor. Subject to the terms of the warrant, the investor may purchase 1,000,000 shares of the Company’s common stock at \$0.45 per share, exercisable commencing on the earliest of the consummation of the qualified offering (as defined in the Exchange Agreements), the date of conversion of the 2011 Convertible Note in full, or the date of conversion of the Convertible Note by the investor in the greatest number of shares of the Company’s common stock not to exceed 9.99% beneficial ownership of Company outstanding common stock and terminating on March 22, 2016.

The 2011 Convertible Note is a hybrid financial instruments that blends characteristics of both debt and equity securities. The note embodies settlement alternatives to the holder providing for either redemption of principal and interest in cash (forward component) or conversion into the Company’s common stock (embedded conversion feature). The forward component was valued using the present value of discounted cash flows arising from the contractual principal and interest payment terms and the embedded conversion feature was valued using the Monte Carlo simulation method. The fair value of the 2011 Convertible Note was estimated to be \$1,964,905 on the date of the exchange, which resulted in a loss on extinguishment of debt of \$964,905. Further, in accordance with ASC 470-20-25 and ASC 470-50-40, the net premium of \$964,905 associated with the 2011 Convertible Note was reclassified to capital in excess of par value under the presumption that such net premium represented a capital contribution. Consequently, the 2011 Convertible Note is being carried at face value. The fair value of the additional warrant to purchase 1,000,000 shares and the value associated with the previously issued warrants that were amended was determined to be \$716,890 using the Black-Scholes option model and is included in the aggregate loss on extinguishment of \$1,681,795. Since the loan is held by a related party, the loss on extinguishment has been treated as a capital transaction and, as a result, this transaction had no net effect on capital in excess of par value.

#### Secured Note

Also, on March 22, 2011, the Company entered into a 10% note and warrant purchase agreement, secured convertible promissory note and Patent Security Agreement (“Financing Agreements”) with the investor. Pursuant to the terms and subject to the conditions set forth in the Financing Agreements, the investor provided a loan in the principal amount of \$1,500,000 to the Company, which was secured by all patents, patent applications and similar protections of the Company and all rents, royalties, license fees and “accounts” with respect to such intellectual property assets. Pursuant to this secured convertible promissory note (“Secured Note”), interest in the amount of 10% per annum, calculated on a 365 day year, and the principal amount of \$1,500,000 was due and payable on March 22, 2012, subsequently extended to May 7, 2012, but repayment is accelerated upon a qualified offering (as defined in the note). The initial conversion price was \$0.26 per share. All interest and principal due and owing pursuant to this Secured Note was paid on July 13, 2012. On July 13, 2012, the Patent Security Agreement was terminated coincident with payment of the Secured Note.

On March 22, 2011, in connection with the Financing Agreements, the Company issued a Stock Purchase Warrant to the investor to purchase 3,000,000 shares of the Company's common stock at \$0.45 per share, exercisable until March 22, 2016. The Warrant was fair valued on the date of issuance, which amounted to \$1,204,787. The warrant value was recorded as a debt discount based on the relative fair value of the warrant to the total proceeds received, which amounted to \$435,240. The Warrant was fair valued using the Black-Scholes-Merton valuation model. In addition, the debt contained a beneficial conversion feature, which was valued at the date of issuance at \$1,762,163; however, since this amount is in excess of the net value of the debt less the warrant discount, the beneficial conversion feature will be limited to \$1,064,760 and recorded as a discount on the loan. The total debt discount of \$1,500,000 is being amortized using the effective interest method over the 12-month term of the Secured Note. For the three and nine months ended September 30, 2012, the Company recognized \$0 and \$358,555, respectively, in additional interest expense representing amortization of this debt discount. For the three and nine months ended September 30, 2011, the Company recognized \$341,138 and \$791,706, respectively, in additional interest expense representing amortization of this debt discount.

The fair value of warrants issued in 2011 related to the above debt transaction were calculated using the Black-Scholes model with the following assumptions: Expected life in years: 5-10 years; Estimated volatility 115%-117%, Risk-free interest rate: 1.89%-2.07%; Dividend yield: 0%.

#### Forbearance Agreement

On June 15, 2012, we entered into a forbearance agreement (the "Forbearance Agreement"), with the investor. Under the Forbearance Agreement, the investor agreed to forebear from disposing of or selling any collateral secured by the Patent Security Agreement until the earliest of: (i) July 15, 2012; (ii) two business days after our receipt of a written notice after any subsequent event of default, (iii) two business days after our receipt of a written notice that any representations, warranties or information we provided to the investor in any document or instrument in connection with the Forbearance Agreement is materially false, incomplete or misleading, (iv) two business days after our receipt of a written notice that a proceeding or other action has been commenced by any creditor against us, other than the investor (v) the date on which a court enters an order for relief or take any similar action in respect of us in an involuntary case under any applicable bankruptcy law, or (vi) the date on which a petition for relief under any applicable bankruptcy, is filed by or against us, each as further described in the Forbearance Agreement.

On July 13, 2012 we paid in full all principal and interest due pursuant to the Secured Note. On October 29, 2012 we paid in full all principal and interest due pursuant to the 2011 Convertible Note. Upon payment of the 2011 Convertible Note the Forbearance Agreement was terminated.

#### 2012 Secured Convertible Promissory Note

On July 13, 2012, the Company issued a Secured Convertible Promissory Note and Patent Security Agreement (collectively, the "Agreements") to an investor ("Investor"). Pursuant to the terms and subject to the conditions set forth in the Agreements, the Investor provided a loan in the amount of \$2,000,000 to the Company, which will be secured by all current and future patents, patent applications and similar protections of the Company and all rents, royalties, license fees and "accounts" with respect to such intellectual property assets ("Collateral"). Pursuant to the Secured Convertible Promissory Note (the "2012 Note"), interest in the amount of 6% per annum, calculated on a 365 day year, and the principal amount of \$2,000,000 and accrued interest will be paid on or before October 15, 2012, subsequent extended to October 26, 2012. The Investor has the right to convert principal and accrued interest into the Company's common stock at \$0.26 per share. The initial conversion price may be adjusted pursuant to standard anti-dilution provisions.. The proceeds of this 2012 Note were used in part to pay, in full, all outstanding principal and interest due pursuant to the Secured Note issued March 22, 2011.

Pursuant to the Patent Security Agreement, the Company shall not, without the Investor's prior consent, sell, dispose or otherwise transfer all or any portion of the Collateral, except for license grants in the ordinary course of business. In addition, the Company will take all actions reasonably necessary to prosecute to allowance applications for patents and maintain all patents, and to seek to recover damages for infringement, misappropriation or dilution of the Collateral with limited exceptions.

On October 30, 2012, the Company and MG Energy LLC, a Delaware limited liability company ("MG Energy"), entered into the License and Supply Agreement (the "Agreement"), effective October 26, 2012, pursuant to which the Company licensed certain intellectual property and improvements thereto to MG Energy, for use in the manufacture and sale of energy recovery ventilators ("ERV") and certain other HVAC systems for installation in commercial, residential or industrial buildings in North America and South America. MG Energy also agreed to purchase its requirements of the Company's moisture transfer material from the Company for MG Energy's use, pursuant to the terms and conditions of the Agreement. Energy recovery ventilators are mechanical equipment, of which an energy recovery ventilator air to air exchanger core is a component, that assists in the recovery of energy from the exhaust air expelled by an HVAC system for the purpose of pre-conditioning the incoming outdoor air's components prior to supplying the conditioned air to a residential or commercial building, either directly or as part of an air-conditioning

system.

Under the Agreement, MG Energy has agreed to retire the 2012 Note, dated July 13, 2012, including all interest accrued thereon, issued by the Company to the Investor, who assigned the Secured Promissory Note. This retirement is nonrefundable and noncreditable. MG Energy has also agreed to pay a royalty on the net sales price on products sold using the Company's intellectual property. Coincident with the retirement of the 2012 Note, the related Patent Security Agreement was terminated.

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#### Other Notes

During the nine months ended September 30, 2012, the Company entered into an agreement with a related party to borrow \$50,000 which is due on demand and bears interest at 4%. We paid all interest and principal due under this note on August 1, 2012.

Any future financing may result in substantial dilution to existing shareholders, and future debt financing, if available, may include restrictive covenants or may require us to grant a lender a security interest in any of our assets not already subject to an existing security interest. To the extent that we attempt to raise additional funds through third party collaborations and/or licensing arrangements, we may be required to relinquish some rights to our technologies or products currently in various stages of development, or grant licenses or other rights on terms that are not favorable to us. Any failure by us to timely procure additional financing or investment adequate to fund our ongoing operations, including planned product development initiatives and commercialization efforts, will have material adverse consequences on our financial condition, results of operations and cash flows.

We will be dependent upon our existing cash of \$80,993 at September 30, 2012, product sales and additional debt and equity issuances to finance our operations through the next 12 months, including debt service of \$3,335,090 and other contractual obligations of approximately \$178,100 as of September 30, 2012. We must raise additional capital in the amount of approximately \$6.9 million, net of expenses, during the next eighteen months in order to pay down existing debt, secure new patents for innovative applications of our core technology, purchase equipment, and fund our working capital requirements in accordance with our existing plans through July 2013. This additional capital could be provided by a successful completion of an offering of equity securities and or by licensing agreements. If we are unable to raise these funds, we may be required to delay our development plans, curtail our expenditures, and attempt to renegotiate the terms of our outstanding promissory notes.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred significant losses since inception. As of September 30, 2012, the Company has an accumulated deficit of \$38,020,102, negative working capital of \$4,836,503 and a stockholders' deficit of \$4,941,697. The Company used \$636,008 and \$787,910 of cash in operations during the nine months ended September 30, 2012 and 2011, respectively, which was funded by proceeds from debt and equity financings. There is no assurance that such financing will be available in the future. In view of these matters, there is substantial doubt that the Company will continue as a going concern. The Company is currently pursuing the following sources of short and long-term working capital:

1. We are currently holding preliminary discussions with parties who are interested in licensing, purchasing the rights to, or establishing a joint venture to commercialize certain applications of our technology.
2. We are seeking growth capital from certain strategic and/or government (grant) related sources. In addition to said capital, these sources may, pursuant to any agreements that may be developed in conjunction with such funding, assist in the product definition and design, roll-out, and channel penetration of our products.
3. We are seeking growth capital from the sale of our public securities.

The Company's ability to continue as a going concern is highly dependent on our ability to obtain additional sources of cash flow sufficient to fund our working capital requirements. However, there can be no assurance that the Company will be successful in its efforts to secure such cash flow. Any failure by us to timely procure additional financing or investment adequate to fund our ongoing operations, including planned product development initiatives and commercialization efforts, will have material adverse consequences on our financial condition, results of operations and cash flows.

On October 17, 2012, the Company entered into a Securities Purchase Agreement (the “SPA”) with Green Valley International Investment Management Company Limited (the “Equity Investor”) pursuant to which the Company will offer up to \$7.0 million of the Company’s common stock, \$0.01 par value per share (the “Common Stock”), and warrants (the “Warrants”) to purchase up to 17,500,000 shares of Common Stock (such offer being the “Offering”).

The Company will issue the Common Stock and Warrants in three tranches. Upon the receipt of the funds for the first tranche on or about October 26, 2012, the Company issued \$2 million of newly issued Common Stock for \$0.10 per share and issued 5,000,000 warrants. Upon the receipt of the funds for the second tranche on or about November 20, 2012, the Company will issue \$2 million of newly issued Common Stock for \$0.10 per share and issue 5,000,000 warrants. Upon the receipt of the funds for the third tranche on or about December 28, 2012, the Company will issue \$3 million of newly issued Common Stock for \$0.10 per share and issue 7,500,000 warrants.



The financial statements of the Company do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classifications of liabilities that might be necessary should the Company be unable to continue as a going concern.

On November 14, 2012, in connection with a private offering, the Company sold and issued 17,500,000 shares to one purchaser for \$1,750,000 in cash. In addition, under the terms of the private placement offering, the Equity Investor also received a warrant to purchase 4,375,000 shares of the Company's common stock with an exercise period of five years from the date of issue at an exercise price of \$.30 per share.

#### Statement of Cash Flows

The following table sets forth, for the periods indicated, selected cash flow information:

	Nine Months Ended September 30,	
	2012	2011
Cash flows used in operating activities	\$ (636,008)	\$ (787,910)
Cash flows used in investing activities	(30,739)	(92,442)
Cash flows provided by financing activities	485,000	999,604
Net (decrease) increase in cash and cash equivalents	\$ (181,747)	\$ 119,252

Cash and cash equivalents as of September 30, 2012 was \$80,993 compared to \$262,740 as of December 31, 2011. Cash is primarily used to fund our working capital requirements.

As of September 30, 2012, the Company had a working capital deficit of \$4,836,503 compared to \$3,222,163 of working capital deficit as of December 31, 2011. During the nine months ended September 30, 2012 we used approximately \$636,000 of cash from our operations, used approximately \$24,700 in support of patent applications and patent issuances and provided approximately \$485,000 of proceeds from notes payable net of payments and loan costs.

Net cash used by operating activities was approximately \$636,000 for the nine months ended September 30, 2012 compared to approximately \$787,900 of cash used by operations for the same period in 2011.

Net cash used in investing activities was approximately \$30,700 for the nine months ended September 30, 2012 compared to approximately \$92,400 for the same period in 2011. During the nine months ended September 30, 2012, we used cash for the patents and the purchase of property and equipment.

Net cash provided by financing activities was approximately \$485,000 for the nine months ended September 30, 2012 compared to cash provided by financing activities of approximately \$999,600 for the same period in 2011. During the nine months ended September 30, 2012, we received net proceeds of \$2,050,000 from the issuance of debt and repaid \$1,565,000 of existing debt.

#### ECONOMY AND INFLATION

Except as disclosed herein, we have not experienced any significant cancellation of orders due to the downturn in the economy and only a small number of customers requested delays in delivery or production of orders in process. Our management believes that inflation has not had a material effect on our results of operations.



## OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off balance sheet arrangements that are reasonably likely to have a current or future effect on our financial condition, revenues, and results of operations, liquidity or capital expenditures.

## ITEM QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

3.

Not applicable.

## ITEM CONTROLS AND PROCEDURES

4T.

### Evaluation of disclosure controls and procedures

Our Chief Executive Officer and Chief Financial Officer (collectively the “Certifying Officers”) maintain a system of disclosure controls and procedures that is designed to provide reasonable assurance that information, which is required to be disclosed, is accumulated and communicated to management timely. The Certifying Officers have concluded that the disclosure controls and procedures are effective at the “reasonable assurance” level. Under the supervision and with the participation of management, as of the end of the period covered by this report, the Certifying Officers evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act). Furthermore, the Certifying Officers concluded that our disclosure controls and procedures in place are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported on a timely basis in accordance with applicable Commission rules and regulations; and (ii) accumulated and communicated to our management, including our Certifying Officers and other persons that perform similar functions, if any, to allow us to make timely decisions regarding required disclosure in our periodic filings.

### Changes in Internal Control Over Financial Reporting

During the nine months ended September 30, 2012, the Company has not made any changes to our internal control processes.

## PART II—OTHER INFORMATION

### Item 1. Legal Proceedings

We are not currently a party to any pending legal proceedings. In the ordinary course of business, we may become a party to various legal proceedings generally involving contractual matters, infringement actions, product liability claims and other matters.

From time to time, claims are made against us in the ordinary course of our business, which could result in litigation. Claims and associated litigation are subject to inherent uncertainties and unfavorable outcomes could occur, such as monetary damages, fines, penalties or injunctions prohibiting us from selling one or more products or engaging in other activities. The occurrence of an unfavorable outcome in any specific period could have a material adverse effect on our results of operations for that period or future periods.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended September 30, 2012, the Company did not issue any equity securities.

On November 14, 2012, in connection with a private offering, the Company sold and issued 17,500,000 shares to one purchaser for \$1,750,000 in cash. In addition, under the terms of the private placement offering, the Equity Investor also received a warrant to purchase 4,375,000 shares of the Company's common stock with an exercise period of five years from the date of issue at an exercise price of \$.30 per share.

The issuance was not a public offering based upon the following factors: (i) the issuance of the securities was an isolated private transaction; (ii) there was no public solicitation; (iii) the investment intent of the offerees; and (iv) the restriction on transferability of the securities issued. There was no underwriter used in the transaction. The proceeds from the private offering will be used for the repayment of an unsecured note, working capital and general corporate expenses. All of the foregoing securities were issued in reliance upon the exemption from registration pursuant to Rule 903 of Regulation S.

### Item 3. Default Upon Senior Securities

As of the date of this filing, the Company is not in default with respect to any of its promissory notes payable.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None

Item 6. Exhibits

- |            |  |
|------------|--|
| 10.33      | Securities Purchase Agreement by and between the Company and Green Valley International Investment Management Company Limited dated October 17, 2012 (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed October 23, 2012) |
| 10.34      | License and Supply Agreement by and between Company and MG Energy LLC dated October 26, 2012 (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed November 5, 2012)   |
| 31.1       | Certification of Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002   |
| 31.2       | Certification of Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002   |
| 32.1       | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 32.2       | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 99.1       | Resignation of S. Ehrenberg (Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K, filed September 6, 2012)   |
| 101.INS ** | XBRL Instance Document   |
| 101.SCH ** | XBRL Taxonomy Extension Schema Document  |
| 101.CAL ** | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF ** | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB ** | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE ** | XBRL Taxonomy Extension Presentation Linkbase Document   |

\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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.

DAIS ANALYTIC CORPORATION  
(Registrant)

/s/ TIMOTHY N. TANGREDI  
Timothy N. Tangredi  
President and Chief Executive Officer  
(Principal Executive Officer)

Dated: November 14, 2012

/s/ JUDITH C. NORSTRUD  
Judith C. Norstrud  
Chief Financial Officer and Treasurer  
(Principal Financial and Accounting  
Officer)

Dated: November 14, 2012