VistaGen Therapeutics, Inc.
Form 10-Q
February 14, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2012

or

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

For the transition period from to _____ to _____.

Commission File Number: 000-54014

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

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

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

(650) 244-9990
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	[ ]	Accelerated filer	[ ]
Non-Accelerated filer	[ ]	Smaller reporting company	[X]

(do not check if a smaller reporting company)

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

As of February 12, 20,091,787 shares of the registrant's common stock, $0.001 par value, were issued and outstanding.

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VistaGen Therapeutics, Inc.
Quarterly Report on Form 10-Q
for the Quarter Ended December 31, 2012

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

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

	December 31, 2012 (Unaudited)	March 31, 2012 (Note 2)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 24,200	$ 81,000
Unbilled contract payments receivable	-	106,200
Prepaid expenses	82,800	50,900
Total current assets	107,000	238,100
Property and equipment, net	189,200	74,500
Security deposits and other assets	29,800	29,000
Total assets	$ 326,000	$ 341,600
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 1,252,300	$ 1,750,800
Accrued expenses	382,300	657,300
Notes payable and accrued interest	822,100	582,500
Notes payable and accrued interest to related parties	112,000	168,200
Capital lease obligations	7,300	10,500
Deferred revenue	-	13,200
Total current liabilities	2,576,000	3,182,500
Non-current liabilities:		
Senior secured convertible promissory notes, net of discount of $985,500 at December 31, 2012 and accrued interest	1,337,500	-
Convertible promissory notes, net of discount of $499,300 at March 31, 2012 and accrued interest	-	6,000
Notes payable, net of discount of $1,205,000 at December 31, 2012 and $228,900 at March 31, 2012	1,907,800	2,684,300
Notes payable to related parties, net of discount of $157,900 at December 31, 2012 and $24,300 at March 31, 2012 and accrued interest	1,051,700	107,700
Warrant liability	3,910,400	-
Accrued officers' compensation	57,000	57,000
Capital lease obligations	8,000	9,700
Total non-current liabilities	8,272,400	2,864,700
Total liabilities	10,848,400	6,047,200

Commitments and contingencies		
Stockholders' deficit:		
Preferred stock, $0.001 par value; 500,000 shares authorized at December 31, 2012 and March 31, 2012; 500,000 and 437,055 Series A shares issued and outstanding at December 31, 2012 and March 31, 2012, respectively	500	400
Common stock, $0.001 par value; 200,000,000 shares authorized at December 31, 2012 and March 31, 2012; 22,065,095 and 18,704,267 shares issued at December 31, 2012 and March 31, 2012, respectively	22,100	18,700
Additional paid-in capital	57,578,200	52,539,500
Treasury stock, at cost, 2,713,308 and 2,083,858 shares of common stock held at December 31, 2012 and March 31, 2012, respectively	(3,968,100)	(3,231,700)
Notes receivable from sale of common stock	(256,000)	(250,000)
Deficit accumulated during development stage	(63,899,100)	(54,782,500)
Total stockholders' deficit	(10,522,400)	(5,705,600)
Total liabilities and stockholders' deficit	$ 326,000	$ 341,600

See accompanying notes to Condensed Consolidated Financial Statements.

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VISTAGEN THERAPEUTICS, INC.

(a development stage company)

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Unaudited)

(Amounts in $100's, except share and per share amounts)

	Three Months Ended December 31,		Nine Months Ended December 31,		May 26, 1998 (Inception) Through December 31,
	2012	2011	2012	2011	2012
Revenues:					
Grant revenue	$ -	$ 2,400	$ 200,400	$ 873,300	$ 12,963,100
Collaboration revenue	-	-	-	-	2,283,600
Other	-	-	-	-	1,123,500
Total revenues	-	2,400	200,400	873,300	16,370,200
Operating expenses:					
Research and development	1,119,600	1,305,600	3,092,200	3,561,000	29,217,100
Acquired in-process research and development	-	-	-	-	7,523,200
General and administrative	799,000	1,547,900	2,430,200	3,569,100	29,548,600
Total operating expenses	1,918,600	2,853,500	5,522,400	7,130,100	66,288,900
Loss from operations	(1,918,600)	(2,851,100)	(5,322,000)	(6,256,800)	(49,918,700)
Other expenses, net:					
Interest expense, net	(235,400)	(455,500)	(611,700)	(1,637,600)	(10,053,200)
Change in put and note extension option and warrant liabilities	357,800	-	357,800	(78,000)	776,300
Loss on early extinguishment of debt	(3,537,000)	(1,193,500)	(3,537,000)	(1,193,500)	(4,730,500)
Other income	-	-	-	-	47,500
Loss before income taxes	(5,333,200)	(4,500,100)	(9,112,900)	(9,165,900)	(63,878,600)
Income taxes	(1,800)	-	(3,700)	(1,600)	(20,500)
Net loss	(5,335,000)	(4,500,100)	(9,116,600)	(9,167,500)	(63,899,100)
Deemed dividend on Series A Preferred stock	(7,125,000)	-	(7,125,000)	-	(7,125,000)
Net loss attributable to common stockholders	$ (12,460,000)	$ (4,500,100)	$ (16,241,600)	$ (9,167,500)	$ (71,024,100)
Basic and diluted net loss attributable to common	$ (0.68)	$ (0.28)	$ (0.93)	$ (0.65)	

stockholders per common share					
Weighted average shares used in computing basic and diluted net loss attributable to common stockholders per common share	18,292,301	16,035,861	17,411,993	14,139,007	
Comprehensive loss	$ (5,335,000)	$ (4,500,100)	$ (9,116,600)	$ (9,167,500)	$ (63,899,100)

See accompanying notes to Condensed Consolidated Financial Statements.

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VISTAGEN THERAPEUTICS, INC.
(a development stage company)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Amounts in $100's)

	Nine Months Ended December 31,		Period From May 26, 1998 (Inception) Through December 31,
	2012	2011	2012
Cash flows from operating activities:			
Net loss	$ (9,116,600)	$ (9,167,500)	$ (63,899,100)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	21,000	33,500	764,700
Acquired in-process research and development	-	-	7,523,200
Amortization of imputed discount on non-interest bearing notes	-	-	45,000
Amortization of discounts on 7%, 7.5% and 10% notes	320,800	57,200	580,000
Amortization of discounts on Platinum notes	4,500	908,900	3,553,200
Amortization of discounts on August 2010 short-term notes	-	14,300	572,000
Amortization of discounts on February 2012 12% convertible notes	26,900	-	22,700
Loss on early extinguishment of debt	3,537,000	1,193,500	4,730,500
Loss on settlements of accounts payable	78,300	-	78,300
Change in warrant and put and note term extension option liabilities	(357,800)	77,900	(776,400)
Stock-based compensation	962,000	1,447,400	5,316,300
Expense related to modification of warrants	440,700	741,700	1,182,400
Fair value of Series C preferred stock, common stock, and warrants granted for services prior to the Merger	-	131,300	1,056,600
Fair value of common stock granted for services following the Merger	340,000	-	792,000
Fair value of warrants granted for services and interest following the Merger	150,000	-	714,500
Fair value of additional warrants granted pursuant to exercises of modified			

warrants (May-August 2012) and under Discounted Warrant Exercise Program (2011)	35,900	-	174,000
Fair value of common stock issued for note term modification	-	-	22,400
Interest income on note receivable for stock purchase	(26,800)		(26,800)
Consulting services by related parties settled by issuing promissory notes	-	-	44,600
Gain on sale of assets	-	-	(16,800)
Changes in operating assets and liabilities:			
Unbilled contract payments receivable	106,200	34,400	-
Prepaid expenses and other current assets	(16,500)	458,100	(21,000)
Security deposits and other assets	-	-	(29,000)
Accounts payable and accrued expenses	1,014,400	1,267,800	17,595,000
Deferred revenues	(13,200)	(45,700)	-
Net cash used in operating activities	(2,493,200)	(2,847,200)	(20,001,700)
Cash flows from investing activities:			
Purchases of equipment, net	(131,100)	(13,400)	(811,900)
Net cash used in investing activities	(131,100)	(13,400)	(811,900)
Cash flows from financing activities:			
Net proceeds from issuance of common stock and warrants, including units	480,600	2,528,400	3,280,600
Net proceeds from issuance of preferred stock and warrants	-	-	4,198,600
Proceeds from exercise of modified warrants (May-August 2012) and under Discounted Warrant Exercise Program (2011)	262,100	1,037,100	1,428,400
Proceeds from issuance of notes under line of credit	-	-	200,000
Proceeds from issuance of 7% note payable to founding stockholder	-	-	90,000
Net proceeds from issuance of 7% convertible notes	-	-	575,000
Net proceeds from issuance of 10% convertible notes and warrants	-	-	1,655,000
Net proceeds from issuance of Platinum notes and warrants	2,222,100	-	5,922,100
Net proceeds from issuance of 2008/2010 notes and warrants	-	-	2,971,800

Net proceeds from issuance of 2006/2007 notes and warrants	-	-	1,025,000
Net proceeds from issuance of 7% notes payable	-	-	55,000
Net proceeds from issuance of August 2010 short-term notes and warrants	-	-	800,000
Net proceeds from issuance of February 2012 12% convertible notes and warrants	-	-	466,500
Repayment of capital lease obligations	(15,300)	(24,300)	(115,800)
Repayment of notes	(382,000)	(653,500)	(1,714,400)
Net cash provided by financing activities	2,567,500	2,887,700	20,837,800
Net increase in cash and cash equivalents	(56,800)	27,100	24,200
Cash and cash equivalents at beginning of period	81,000	139,300	-
Cash and cash equivalents at end of period	$ 24,200	$ 166,400	$ 24,200

See accompanying notes to Condensed Consolidated Financial Statements.

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

Note 1. History and Organization

VistaGen Therapeutics, Inc., a Nevada corporation ("VistaGen" or the "Company"), is a biotechnology company applying human pluripotent stem cell technology for drug rescue and novel pharmaceutical assays for predictive heart and liver toxicology and drug metabolism screening. VistaGen's drug rescue activities are focused on combining its human pluripotent stem cell technology platform, Human Clinical Trials in a Test Tube™, with modern medicinal chemistry to generate new chemical variants (Drug Rescue Variants) of once-promising small molecule drug candidates. These are drug candidates discontinued due to heart or liver toxicity or drug metabolism issues after substantial investment and development by large pharmaceutical companies, the U.S. National Institutes of Health (NIH) or university laboratories. VistaGen uses its pluripotent stem cell technology and novel bioassay systems to generate early indications, or predictions, of how humans will ultimately respond to new drug candidates, including Drug Rescue Variants, before they are ever tested in humans, bringing human biology to the front end of the conventional drug development process.

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

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

The Merger

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

Each of the prior directors of VistaGen California was appointed as a director of the Company;
The prior directors and officers of Excaliber resigned as officers and directors of the Company;
VistaGen California's prior officers were appointed as officers of like tenor of the Company;
The Company's directors approved a two-for-one (2:1) forward stock split of the Company's common stock;
The Company's directors approved an increase in the number of shares of common stock the Company was authorized to issue from 200 million to 400 million shares;
The Company changed its name to "VistaGen Therapeutics, Inc.";

The Company’s common stock began trading on the OTC Bulletin Board under the symbol “VSTA” effective on June 21, 2011; and

The Company adopted VistaGen California's fiscal year-end of March 31st, with VistaGen California as the accounting acquirer.

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VistaGen California, as the accounting acquirer in the Merger, recorded the Merger as the issuance of common stock for the net monetary assets of the Company, accompanied by a recapitalization. This accounting for the transaction was identical to that resulting from a reverse acquisition, except that no goodwill or other intangible assets were recorded. A total of 1,569,000 shares of common stock, representing the shares held by stockholders of Excaliber immediately prior to the Merger and effected for the post-Merger two-for-one (2:1) stock split noted above, have been retroactively reflected as outstanding for all periods presented in the accompanying Condensed Consolidated Financial Statements of the Company.

In October 2011, the Company's stockholders amended the Company's Articles of Incorporation to (1) reduce the number of shares of common stock the Company is authorized to issue from 400 million shares to 200 million shares; (2) authorize the Company to issue up to 10 million shares of preferred stock; and (3) authorize the Company's Board of Directors to prescribe the classes, series and the number of each class or series of preferred stock and the voting powers, designations, preferences, limitations, restrictions and relative rights of each class or series of preferred stock. In December 2011, the Company's Board of Directors authorized the creation of a series of up to 500,000 shares of Series A Preferred Stock, par value $0.001 ("Series A Preferred"). Pursuant to the Note Exchange and Purchase Agreement of October 12, 2012 (the "October 2012 Agreement") between the Company and Platinum Long Term Growth VII, LLC ("Platinum"), the Company's largest institutional investor, Platinum has the right and option to exchange all 500,000 shares of the Company's Series A Preferred held by Platinum for (i) a total of 15,000,000 shares of the Company's common stock, and (ii) a five-year warrant to purchase 7,500,000 shares of the Company's common stock at an exercise price of $1.50 per share (see Note 9, Capital Stock).

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

Note 2. Basis of Presentation and Going Concern

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

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

The accompanying Condensed Consolidated Financial Statements have been prepared assuming the Company will continue as a going concern. As a development stage company without sustainable revenues, the Company has

experienced recurring losses and negative cash flows from operations. From inception through December 31, 2012, the Company has accumulated a deficit of $63.9 million during its development stage. The Company expects these conditions to continue for the foreseeable future as it expands its Human Clinical Trials in a Test Tube™ platform and executes its drug rescue, predictive toxicology and cell therapy business programs.

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At December 31, 2012, the Company had $24,200 in cash and cash equivalents. The Company's principal source of financing during the quarter ended December 31, 2012 was proceeds from certain financing transactions between the Company and Platinum. On July 2, 2012 and on August 31, 2012, the Company issued to Platinum 10% senior secured convertible promissory notes in the principal amount of $500,000 (the "July 2012 Platinum Note") and $750,000 (the "August 2012 Platinum Note"), respectively, (see Note 7, Convertible Promissory Notes and Other Notes Payable). On October 11, 2012, the Company and Platinum entered into the October 2012 Agreement, wherein Platinum agreed to purchase additional 10% senior secured convertible promissory notes in the aggregate principal amount of $2.0 million, issuable over four $500,000 tranches between October 2012 and December 2012. The first and second $500,000 tranches, in the aggregate principal amount of $1.0 million, were purchased by Platinum on October 11, 2012 and October 19, 2012, respectively. The final two $500,000 tranches, were combined into a single senior secured promissory note in the aggregate principal amount of $1.0 million (the "$1.0 Million Note"), pursuant to amendments to the October 2012 Agreement entered into by the Company and Platinum on November 14, 2012 and January 31, 2013 (the "NEPA Amendments"). Under the terms of the NEPA Amendments, Platinum agreed to purchase the $1.0 Million Note within five (5) business days of the Company's notice to Platinum of the consummation of a debt or equity financing, or combination of financings, prior to February 15, 2013, resulting in gross proceeds to the Company of at least $1.0 million, (see Note 7, Convertible Promissory Notes and Other Notes Payable, and Note 12, Subsequent Events.)

Through December 31, 2012, the Company issued 951,256 Units in private placements to accredited investors and received cash proceeds of $475,600. The Units were sold for $0.50 per Unit and each Unit consisted of one share of the Company's common stock and a five year warrant to purchase one half (1/2) of one share of the Company's common stock at an exercise price of $1.50 per share. At December 31, 2012, the proceeds of these private placements have reduced the remaining amount of financing the Company is required to secure from $1.0 million to $524,400 to be entitled to sell the $1.0 Million Note to Platinum as described above. (See Note 12, Subsequent Events.)

The Company anticipates that its cash expenditures during the next twelve months will be approximately $4.0 million to $6.0 million and it plans to meet its cash needs and fund its working capital requirements through a combination of additional private placements of its securities, which may include both debt and equity securities issued to Platinum and other investors, stem cell technology-based research and development collaborations, stem cell technology and drug candidate license fees and government grant awards. If the Company is unable to obtain sufficient financing, it may be required to reduce, defer, or discontinue certain of its research and development activities or it may not be able to continue as a going concern.

Note 3. Summary of Significant Accounting Policies

Use of Estimates

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

Revenue Recognition

The Company generates revenue principally from collaborative research and development arrangements, technology access fees and government grants. Revenue arrangements with multiple components are divided into separate units of

accounting if certain criteria are met, including whether the delivered component has stand-alone value to the customer. Consideration received is allocated among the separate units of accounting based on their respective selling prices. The selling price for each unit is based on vendor-specific objective evidence, or VSOE, if available, third party evidence if VSOE is not available, or estimated selling price if neither VSOE nor third party evidence is available. The applicable revenue recognition criteria are then applied to each of the units.

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

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

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

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

Research and Development Expenses

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

Stock-Based Compensation

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

The Company recorded share-based compensation costs of $813,700 and $962,000 for the three and nine month periods ended December 31, 2012, respectively and $468,100 and $1,447,400 for the three and nine month periods ended December 31, 2011, respectively. At December 31, 2012, there were options outstanding to purchase 4,966,771 shares of the Company's common stock at a weighted average exercise price of $1.33 per share. See Note 10, Stock Based Compensation, for additional information regarding stock-based compensation.

Comprehensive Loss

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

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Loss per Common Share

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

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

	December 31,	
	2012	2011
Series A preferred stock issued and outstanding (1)	15,000,000	4,370,550
Warrant shares issuable to Platinum upon exercise of common stock warrants by Platinum upon exchange of Series A preferred stock under the terms of the October 11, 2012 Note Purchase and Exchange Agreement	7,500,000	-
Outstanding options under the 2008 and 1999 Stock Incentive Plans	4,966,771	4,806,114
Outstanding warrants to purchase common stock	9,873,034	3,451,728
October 2012 10% convertible Exchange Note and Investment Notes issued to Platinum including accrued interest through December 31, 2012 (2)	4,645,198	-
Total	41,895,003	12,628,392

(1) at December 31, 2012, assumes exchange under the terms of the October 11, 2012 Note Exchange and Purchase Agreement with Platinum
(2) assumes conversion under the terms of the October 11, 2012 Note Exchange and Purchase Agreement with Platinum and the terms of the individual notes

Recent Accounting Pronouncements

There have been no recent accounting pronouncements or changes in accounting pronouncements during the nine months ended December 31, 2012, as compared to the recent accounting pronouncements described in the Company's Form 10-K for the fiscal year ended March 31, 2012, that are of significance or potential significance to the Company.

Note 4. Fair Value Measurements

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

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

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

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

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

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

The fair value hierarchy for liabilities measured at fair value on a recurring basis is as follows:

		Fair Value Measurements at Reporting Date Using		
	Total Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2012:				
Warrant liability	$ 3,910,400	$ -	$ -	$ 3,910,400
March 31, 2012:				
Warrant liability	$ -	$ -	$ -	$ -

During the three month periods ended December 31, 2012, there were no significant changes to the valuation models used for purposes of determining the fair value of the Level 3 warrant liability.

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

	Warrant Liability	Total
Balance at March 31, 2012	$ -	$ -
Recognition of warrant liability upon issuance of warrants to Platinum under October 2012 Agreement	1,200,000	1,200,000
Recognition of warrant liability in connection with Series A Exchange Warrant potentially issuable to Platinum under October 2012 Agreement	3,068,200	3,068,200

Mark to market gain included in net loss		(357,800)		(357,800)
Balance at December 31, 2012	$	3,910,400	$	3,910,400

No assets or other liabilities were carried at fair value at December 31, 2012 or March 31, 2012.

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

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

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

Note 5. Prepaid Expenses

Prepaid expenses consist of the following at December 31, 2012 and March 31, 2012 (amounts in 100's).

	December 31, 2012	March 31, 2012
Investor relations and awareness services paid by issuance of common stock or warrants	$ -	$ 19,700
Insurance	42,300	19,000
Legal fees	28,900	6,100
All other	11,600	6,100
	$ 82,800	$ 50,900

Note 6. Accrued Expenses

Accrued expenses consist of the following at December 31, 2012 and March 31, 2012 (amounts in 100's).

	December 31, 2012	March 31, 2012
Accrued professional services	$ 68,300	$ 107,400
Accrued research and development expenses	-	237,500
Accrued vacation pay and other compensation	223,400	229,900
Accrued placement agent fees	50,000	50,000
Accrued royalties and license fees	29,700	5,000
All other	10,900	27,500
	$ 382,300	$ 657,300

Note 7. Convertible Promissory Notes and Other Notes Payable

The following table summarizes the components of the company’s secured and unsecured promissory notes and other notes payable at December 31, 2012 and March 31, 2012 (amounts in 100’s).

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	December 31, 2012			March 31, 2012		
	Principal Balance	Accrued Interest	Total	Principal Balance	Accrued Interest	Total
Senior Secured 10% Convertible Promissory Notes issued to Platinum:						
Exchange Note issued on October 11, 2012	$1,272,600	$28,900	$1,301,500	$-	$-	$-
Investment Note issued on October 11, 2012	500,000	11,300	511,300	-	-	-
Investment Note issued on October 19, 2012	500,000	10,200	510,200	-	-	-
	2,272,600	50,400	2,323,000	-	-	-
Aggregate note discount	(985,500)	-	(985,500)	-	-	-
Total Senior notes (non-current)	$1,287,100	$50,400	$1,337,500	$-	$-	$-
Convertible Promissory Notes:						
February 2012 12% convertible promissory notes	$-	$-	$-	$500,000	$5,300	$505,300
Note discount	-	-	-	(499,300)	-	(499,300)
Total 12% convertible notes, net (non-current)	$-	$-	$-	$700	$5,300	$6,000
Notes Payable to unrelated parties:						
7.0% Notes payable (April 2011)	$11,500	$100	$11,600	$63,800	$400	$64,200
7.0% Notes payable (August 2012)	60,000	1,400	61,400	-	-	-
	71,500	$1,500	$73,000	63,800	$400	$64,200
less: current portion	(18,100)	(1,500)	(19,600)	(63,800)	(400)	(64,200)
7.0% Notes payable - non-current portion	$53,400	$-	$53,400	$-	$-	$-
7.5% Notes payable to service providers for accounts payable converted to notes payable:						
Burr, Pilger, Mayer	$91,800	$900	$92,700	$93,400	$1,100	$94,500
Desjardins	211,700	2,000	213,700	224,300	2,800	227,100
McCarthy Tetrault	435,900	200	436,100	459,400	5,700	465,100
May 2011 Morrison Foerster	-	-	-	2,420,100	37,900	2,458,000
August 2012 Morrison & Foerster Note A	964,700	-				