ELITE PHARMACEUTICALS INC /DE/
Form 10-Q
November 15, 2010

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

---

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

For the quarterly period ended September 30, 2010

or

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

For the transition period ended to

Commission File Number: 333-45241

ELITE PHARMACEUTICALS, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 22-3542636 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 165 Ludlow Avenue, Northvale, New Jersey | 07647 |
| (Address of principal executive offices) | (Zip Code) |

(201) 750-2646
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 ¨ The registrant is not yet subject to this requirement.

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

Large Accelerated filer ¨ Accelerated Filer ¨ Non-Accelerated Filer ¨ Smaller Reporting Company x

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of November 12, 2010 the issuer had outstanding 97,949,973 shares of common stock, $0.001 par value (exclusive of 100,000 shares held in treasury).

ELITE PHARMACEUTICALS, INC. AND SUBSIDIARIES

INDEX


| | | Page No. |
|---|---|---|
| PART I - FINANCIAL INFORMATION | | |
| Item 1. | Financial Statements | |
| | Condensed Consolidated Balance Sheets as of September 30, 2010 (unaudited) and March 31, 2010 (audited) | F-1 – F-2 |
| | Condensed Consolidated Statements of Operations for the three and six months ended September 30, 2010 (unaudited) and September 30, 2009 (unaudited) | F-3 |
| | Condensed Consolidated Statement of Changes in Stockholders' Equity for the six months ended September 30, 2010 (unaudited) | F-4 |
| | Condensed Consolidated Statements of Cash Flows for the six months ended September 30, 2010 (unaudited) and September 30, 2009 (unaudited) | F-5 |
| | Notes to Condensed Consolidated Financial Statements | F-6 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 1 |
| Item 3. | Quantitative and Qualitative Disclosures about Market Risk | 8 |
| Item 4 | Controls and Procedures | 8 |
| PART II - OTHER INFORMATION | | |
| Item 1. | Legal Proceedings | 9 |
| Item 1A. | Risk Factors | 9 |
| Item 2 | Unregistered Sales of Equity Securities and Use of Proceeds | 9 |
| Item 3. | Defaults upon Senior Securities | 10 |
| Item 4. | Removed and reserved | 10 |
| Item 5. | Other Information | 10 |
| Item 6. | Exhibits | 11 |
| SIGNATURES | | 15 |

ELITE PHARMACEUTICALS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

| | September 30, 2010 (Unaudited) | March 31, 2010 (Audited) |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 593,853 | $ 578,187 |
| Accounts receivable (net of allowance for doubtful accounts of -0-) | 441,330 | 404,961 |
| Inventories (net of reserve of $494,425 and $494,425, respectively) | 1,331,173 | 1,371,292 |
| Prepaid expenses and other current assets | 100,639 | 131,507 |
| Total Current Assets | 2,466,995 | 2,485,947 |
| | | |
| PROPERTY AND EQUIPMENT, net of accumulated depreciation of $3,954,837 and $3,840,279, respectively | 3,910,418 | 4,095,814 |
| | | |
| INTANGIBLE ASSETS – net of accumulated amortization of $-0- and $76,434, respectively | 554,872 | 96,407 |
| | | |
| OTHER ASSETS | | |
| Investment in Novel Laboratories, Inc. | 3,329,322 | 3,329,322 |
| Security deposits | 28,377 | 14,652 |
| Restricted cash – debt service for EDA bonds | 292,416 | 294,836 |
| EDA bond offering costs, net of accumulated amortization of 71,832 and 64,767, respectively | 282,619 | 289,685 |
| Total Other Assets | 3,932,734 | 4,024,902 |
| | | |
| TOTAL ASSETS | $ 10,865,019 | $ 10,606,663 |

The accompanying notes are an integral part of the condensed consolidated financial statements

ELITE PHARMACEUTICALS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

| | September 30, 2010 (Unaudited) | March 31, 2010 (Audited) |
|---|---|---|
| LIABILITIES AND STOCKHOLDERS DEFICIT | | |
| CURRENT LIABILITIES | | |
| EDA bonds payable | $ 3,385,000 | $ 3,385,000 |
| Short term loans and current portion of long-term debt | 12,335 | 82,302 |
| Accounts payable and accrued expenses | 1,342,094 | 986,777 |
| Preferred share derivative interest payable | 306,439 | 306,440 |
| Total Current Liabilities | 5,045,868 | 4,760,519 |
| | | |
| LONG TERM LIABILITIES | | |
| Deferred revenues | 198,889 | — |
| Long term debt, less current portion | 56,173 | 19,823 |
| Derivative liability - preferred shares | 12,595,402 | 7,924,763 |
| Derivative liability – warrants | 5,775,676 | 8,499,423 |
| Total Long Term Liabilities | 18,626,140 | 16,444,009 |
| | | |
| TOTAL LIABILITIES | 23,672,008 | 21,204,528 |
| | | |
| STOCKHOLDERS DEFICIT | | |
| Common stock – par value $0.001, Authorized 355,516,558 Issued and outstanding – 92,656,745 shares and 83,950,168 shares, respectively | 92,657 | 83,950 |
| | | |
| Additional paid-in-capital | 91,591,236 | 90,903,896 |
| | | |
| Accumulated deficit | (104,184,041) | (101,278,870) |
| | | |
| Treasury stock at cost (100,000 common shares) | (306,841) | (306,841) |
| | | |
| TOTAL STOCKHOLDERS DEFICIT | (12,806,989) | (10,597,865) |
| | | |
| TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT | $ 10,865,019 | $ 10,606,663 |

The accompanying notes are an integral part of the condensed consolidated financial statements

ELITE PHARMACEUTICALS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

| | THREE MONTHS ENDED SEPTEMBER 30, 2010 | THREE MONTHS ENDED SEPTEMBER 30, 2009 | SIX MONTHS ENDED SEPTEMBER 30, 2010 | SIX MONTHS ENDED SEPTEMBER 30, 2009 |
|---|---|---|---|---|
| REVENUES | | | | |
| Manufacturing Fees | $ 767,341 | $ 538,941 | $ 1,334,410 | $ 1,204,005 |
| Royalties | 169,901 | 237,275 | 350,935 | 386,086 |
| Lab Fee Revenues | 57,404 | — | 141,221 | — |
| Total Revenues | 994,646 | 776,216 | 1,826,566 | 1,590,091 |
| Costs of Revenues | 565,624 | 453,029 | 977,295 | 1,315,029 |
| Gross Profit | 429,022 | 323,187 | 849,271 | 275,062 |
| OPERATING EXPENSES | | | | |
| Research and Development | 150,436 | 259,326 | 315,444 | 510,418 |
| General and Administrative | 379,104 | 392,100 | 635,345 | 788,637 |
| Non-cash compensation through issuance of stock options | 10,329 | 29,190 | 25,687 | 84,553 |
| Depreciation and amortization | 25,960 | 49,230 | 104,291 | 174,772 |
| Total Operating Expenses | 565,829 | 729,846 | 1,080,767 | 1,558,380 |
| LOSS FROM OPERATIONS | (136,807) | (406,659) | (231,496) | (1,283,318) |
| | | | | |
| OTHER INCOME (EXPENSES) | | | | |
| Interest expense, net | (57,737) | (61,208) | (115,806) | (131,188) |
| Change in fair value of warrant derivatives | 900,047 | (1,520,822) | 2,723,747 | (1,366,496) |
| Change in fair value of preferred share derivatives | 1,505,333 | (1,383,231) | (4,569,005) | 1,178,296 |
| Interest expense attributable to preferred share derivatives | (306,440) | (299,352) | (670,359) | (658,373) |
| Discount in Series E issuance attributable to beneficial conversion features | (39,132) | — | (39,132) | (258,700) |
| Total Other Income (Expense) | 2,002,071 | (3,264,613) | (2,670,555) | (1,236,461) |
| | | | | |
| INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES | 1,865,264 | (3,671,272) | (2,902,051) | (2,519,779) |
| Provision for income taxes | 1,040 | 1,040 | 3,120 | 1,040 |
| | | | | |
| NET INCOME (LOSS) ATTRIBUTABLE TO COMMON SHAREHOLDERS | $ 1,864,224 | $ (3,672,312) | $ (2,905,171) | $ (2,520,819) |
| | | | | |
| NET INCOME (LOSS) PER SHARE | | | | |
| Basic | $ 0.02 | $ (0.05) | $ (0.03) | $ (0.04) |
| Diluted | $ 0.01 | $ (0.05) | $ (0.03) | $ (0.04) |
| | | | | |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING | | | | |
| Basic | 92,367,680 | 74,075,307 | 89,760,532 | 70,232,854 |
| Diluted | 299,999,783 | 74,075,307 | 89,760,532 | 70,232,854 |

The accompanying notes are an integral part of the condensed consolidated financial statements

ELITE PHARMACEUTICALS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIT

(Unaudited)

| | Common Stock | | | Treasury Stock | | | |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Additional Paid-In Capital | Shares | Amount | Accumulated Deficit | Stockholders' Deficit |
| Balance at March 31, 2010 | 83,950,168 | $ 83,950 | $ 90,903,896 | 100,000 | $ (306,841) | $ (101,278,870) | $ (10,597,865) |
| Net Income | | | | | | (2,905,171) | (2,905,171) |
| Common shares issued in lieu of cash in payment of preferred share derivative interest expense | 8,706,577 | 8,707 | 661,653 | | | | 670,360 |
| Non-cash compensation through the issuance of stock options | | | 25,687 | | | | 25,687 |
| Balance at September 30, 2010 | 92,656,745 | $ 92,657 | $ 91,591,236 | 100,000 | $ (306,841) | $ (104,184,041) | $ (12,806,989) |

The accompanying notes are an integral part of the condensed consolidated financial statements

ELITE PHARMACEUTICALS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | SIX MONTHS ENDED SEPTEMBER 30, 2010 (Unaudited) | 2009 (Unaudited) |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net Loss | $ (2,905,171) | $ (2,520,819) |
| Adjustments to reconcile net loss to cash used in operating activities : | | |
| Depreciation and amortization | 241,626 | 251,936 |
| Inventory adjustment | — | 311,986 |
| Change in fair value of warrant derivative liability | (2,723,747) | 1,366,496 |
| Change in fair value of preferred share derivative liability | 4,569,005 | (1,178,296) |
| Discount in Series E issuance attributable to embedded beneficial conversion feature | 39,132 | 258,700 |
| Preferred share derivative interest satisfied by the issuance of common stock | 670,360 | 658.373 |
| Non-cash compensation satisfied by the issuance of common stock and options | 25,687 | 84,553 |
| Non-cash lease accretion | 298 | — |
| Changes in assets and liabilities : | | |
| Accounts receivable | (36,372) | (357,348) |
| Inventories | 40,120 | (63,109) |
| Prepaid expenses and other current assets | 30,868 | 12,211 |
| Security deposit | (13,725) | 12,909 |
| Accounts payable, accrued expenses and other current liabilities | 217,817 | 105,224 |
| Deferred Revenues | 198,889 | — |
| NET CASH PROVIDED BY / (USED IN) OPERATING ACTIVITIES | 354,788 | (1,057,184) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases of property and equipment | (23,779) | — |
| Cost of capital leasehold improvements | (35,610) | — |
| Costs incurred for intellectual property assets | (258,464) | — |
| Proceeds from sale of retired equipment | 30,000 | — |
| Withdrawals from restricted cash, net | 2,420 | 214,002 |
| NET CASH PROVIDED BY / (USED IN) INVESTING ACTIVITIES | (285,433) | 214,002 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Other loan payments | (53,689) | (48,953) |
| NJEDA bond principal payments | — | (210,000) |
| Proceeds from issuance of Series E Convertible Preferred Stock and Warrants | — | 1,000,000 |
| NET CASH PROVIDED BY / (USED IN) FINANCING ACTIVITIES | (53,869) | 741,047 |

| | | | | |
|---|---|---|---|---|
| NET CHANGE IN CASH AND CASH EQUIVALENTS | | 15,666 | | (102,135) |
| | | | | |
| CASH AND CASH EQUIVALENTS – beginning of period | | 578,187 | | 282,578 |
| CASH AND CASH EQUIVALENTS – end of period | $ | 593,853 | $ | 180,443 |
| | | | | |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | | | |
| Cash paid for interest | | 115,524 | | 133,200 |
| Cash paid for taxes | | 3,120 | | 1,040 |
| | | | | |
| SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES | | | | |
| Non-Cash acquisition of Naltrexone ANDA | $ | 200,000 | | — |

The accompanying notes are an integral part of the condensed consolidated financial statements

F - 5

ELITE PHARMACEUTICALS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
THREE AND SIX MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION AND LIQUIDITY

The information in this quarterly report on Form 10-Q includes the results of operations of Elite Pharmaceuticals, Inc. and its consolidated subsidiaries (collectively the "Company") for the three and six months ended September 30, 2010 and 2009. The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission in accordance with accounting principles generally accepted for interim financial statement presentation. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("GAAP") for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the condensed consolidated financial position, results of operations and cash flows of the Company for the periods presented have been included.

The financial results for the interim periods are not necessarily indicative of the results to be expected for the full year or future interim periods.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended March 31, 2010. There have been no changes in significant accounting policies since March 31, 2010.

The Company does not anticipate being profitable for the fiscal year ending March 31, 2011; therefore a current provision for income tax was not established for the three and six months ended September 30, 2010. Only the minimum liability required for state corporation taxes was considered.

The accompanying unaudited condensed consolidated financial statements were prepared on the assumption that the Company will continue as a going concern. As of September 30, 2010, the Company had a working capital deficit of $2.6 million, losses from operations totaling $0.2 million for the six months ended September 30, 2010, other expenses totaling $2.7 million for the six months ended and a net loss of $2.9 million for the six months ended September 30, 2010.

In addition, the Company has received Notice of Default from the Trustee of the NJED Bonds as a result of the utilization of the debt service reserve being used to pay interest payments due on September 1, 2009, March 1, 2010 and September 1, 2010 totaling $121k, $113k and $113k, respectively, and principal payments due on September 1, 2009 totaling $210k. The debt service reserve was utilized to make such payments as a result of the Company's not having sufficient funds available to make such payments when due.

The Company did not have sufficient funds available to make the principal payments due on September 1, 2010, totaling $200k and requested that the Trustee withdraw such funds from the debt service reserve. The Company's request was denied and accordingly the principal payment due on September 1, 2010, totaling $200k was not made.

The Company has requested a postponement of principal payments due on September 1, 2010, 2011 and 2012, with an aggregate of all such postponed principal payments being added to the principal payments due on September 1, 2013. Resolution of the Company's default on the NJEDA Bonds and our request for postponement of principal payments will have a significant effect on our ability to operate in the future.

Please refer to Note 5 to our financial statements for a more detailed discussion of the NJEDA Bonds and Notice of Default. Please also note that the working capital deficit of $2.6 million as of September 30, 2010, includes the entire principal amount due in relation to the NJEDA Bonds. This amount, totaling $3.4 million was first classified as a current liability as of March 31, 2010, due to the Notice of Default received from the Trustee in relation to the NJEDA Bonds.

As of September 30, 2010, we had cash reserves of $593,853. The completion of all transactions contemplated by the Epic Strategic Alliance Agreement, including the consummation of the third closing thereof, is expected to provide additional funds to permit us to continue development of our product pipeline for more than two years. Beyond two years, we anticipate that, with growth of Lodrane and the launch of the generic Hydromorphone 8mg and Naltrexone 50mg recently acquired pursuant to asset purchase agreements with Mikah Pharma LLC, Elite could be profitable. In addition, the commercialization of the products developed at the Facility under the Epic Strategic Alliance Agreement is expected to add a new revenue source for Elite. However, there can be no assurances as to the growth, success of development or commercialization of these products.

Despite the successful completion of the initial and second closings of the Epic Strategic Alliance Agreement, there can be no assurances that we will be able to consummate the third closing pursuant to the terms and conditions of the Epic Strategic Alliance Agreement. If such transactions are consummated, we will receive additional cash proceeds of $1.6875 million (which will include quarterly payments of $62,500 for a period of 11 quarters). Even if we were able to successfully complete the third closing of the Epic Strategic Alliance Agreement, we still may be required to seek additional capital in the future and there can be no assurances that we will be able to obtain such additional capital on favorable terms, if at all. For additional information regarding the Epic Strategic Alliance Agreement, please see our disclosures under "Epic Strategic Alliance Agreement" in Item 7 of Part II of our Annual Report on Form 10-K, and in our Current Reports on Form 8-K, filed with the SEC on March 23, 2009, May 6, 2009, June 5, 2009 and July 1, 2010, which disclosures are incorporated herein by reference.

NOTE 2 - CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents consist of cash on deposit with banks and money market instruments. The Company places its cash and cash equivalents with high-quality, U.S. financial institutions and, to date, has not experienced losses on any of its balances.

NOTE 3 - INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out basis) or market (net realizable value).

NOTE 4 - INTANGIBLE ASSETS

Costs to acquire intangible assets, such as asset purchases of Abbreviated New Drug Applications ("ANDA's") which are approved by the FDA or costs incurred in the application of patents are capitalized and amortized on the straight-line method, based on their estimated useful lives ranging from five to fifteen years, commencing upon approval of the patent or site transfers required for commercialization of an acquired ANDA. Such costs are charged to expense if the patent application or ANDA site transfer is unsuccessful.

As of September 30, 2010, the following costs were recorded as intangible assets on the Company's balance sheet:

| | |
|---|---|
| Intangible assets at March 31, 2010 (audited) | |
| Patent application costs | 96,407 |
| ANDA acquisitions | — |
| | |
| Intangible asset costs capitalized during the six months ended September 30, 2010 | |
| Patent application costs | 33,465 |
| ANDA acquisition costs | 425,000 |
| | |
| Amortization of intangible assets during the six months ended September 30, 2010 | |
| Patent application costs | — |
| ANDA acquisition costs | — |
| | |
| Intangible assets at September 30, 2010 (unaudited) | |
| Patent application costs | 129,872 |
| ANDA acquisition costs | 425,000 |

| | | |
|---|---|---|
| Total | $ | 554,872 |

The costs incurred in patent applications totaling $16,753 and $33,465 for the three and six months ended September 30, 2010, respectively, were all related to our abuse resistant and extended release opioid product lines. The Company is continuing its efforts to achieve approval of such patents. Additional costs incurred in relation to such patent applications will be capitalized as intangible assets, with amortization of such costs to commence upon approval of the patents.

The ANDA acquisition costs of $425,000 incurred during the six months ended September 30, 2010, are related to our acquisition of the ANDA's for Hydromorphone 8mg and Naltrexone 50mg. Please refer to the current reports on Form 8-K filed with the SEC on May 24, 2010 for the Hydromorphone ANDA acquisition and September 1, 2010 for the Naltrexone ANDA acquisition, such filings being herein incorporated by this reference for further details on this acquisition. In addition, please refer to exhibits 10.4 and 10.5 of the quarterly report on Form 10-Q filed with the SEC on November 15, 2010 for the purchase agreements for Hydromorphone and Naltrexone, respectively, such filings being herein incorporated by this reference. The Company is in the process of complying with all FDA and DEA requirements which are a prerequisite to achieving our manufacture and commercialization of the Hydromorphone 8mg ANDA. Amortization of the costs incurred to acquire the ANDA is to commence upon the Company's commercialization of such.

NOTE 5 - NJEDA BONDS

On August 31, 2005, the Company successfully completed a refinancing of a prior 1999 bond issue through the issuance of new tax-exempt bonds (the "Bonds"). The refinancing involved borrowing $4,155,000, evidenced by a 6.5% Series A Note in the principal amount of $3,660,000 maturing on September 1, 2030 and a 9% Series B Note in the principal amount of $495,000 maturing on September 1, 2012. The net proceeds, after payment of issuance costs, were used (i) to redeem the outstanding tax-exempt Bonds originally issued by the Authority on September 2, 1999, (ii) refinance other equipment financing and (iii) for the purchase of certain equipment to be used in the manufacture of pharmaceutical products.

Interest is payable semiannually on March 1 and September 1 of each year. The Bonds are collateralized by a first lien on the Company's facility and equipment acquired with the proceeds of the original and refinanced Bonds. The related Indenture requires the maintenance of a $415,500 Debt Service Reserve Fund consisting of $366,000 from the Series A Notes proceeds and $49,500 from the Series B Notes proceeds. The Debt Service Reserve is maintained in restricted cash accounts that are classified in Other Assets. $1,274,311 of the proceeds had been deposited in a short-term restricted cash account to fund the purchase of manufacturing equipment and development of the Company's facility. As of September 30, 2010, all of these proceeds were utilized to upgrade the Company's manufacturing facilities and for the purchase of manufacturing and laboratory equipment.

Bond issue costs of $354,000 were paid from the bond proceeds and are being amortized over the life of the bonds. Amortization of bond issuance costs amounted to $3,533 and $7,065 for the three and six months ended September 30, 2010, respectively. Amortization of bond issuance costs amounted to $3,533 and $7,065 for the three and six months ended September 30, 2009, respectively.

The NJED Bonds require the Company to make an annual principal payment on September 1st of varying amounts as specified in the loan documents and semi-annual interest payments on March 1st and September 1st, equal to interest due on the outstanding principal at the applicable rate for the semi-annual period just ended.

The interest payments due on September 1, 2009, March 31, 2010 and September 1, 2010, totaling $120,775, $113,075 and $113,075, respectively were paid from the debt service reserve held in the restricted cash account, due to the Company not having sufficient funds to make such payments when due.

The principal payment due on September 1, 2009, totaling $210,000 was paid from the debt service reserve held in the restricted cash account, due to the Company not having sufficient funds to make the payment when due. The Company did not have sufficient funds available to make the principal payments due on September 1, 2010 totaling $200,000, and requested the Trustee to withdraw the funds from debt service reserve held in the restricted cash account and to utilize such funds to make the principal payment due. The Company's request was denied by the Trustee. Accordingly, the principal payment due on September 1, 2010, totaling $200,000 was not made.

Pursuant to the terms of the NJED Bonds, the Company is required to replenish any amounts withdrawn from the debt service reserve and used to make principal or interest payments in six monthly installments, each being equal to one-sixth of the amount withdrawn and with the first installment due on the 15th of the month in which the withdrawal from debt service reserve occurred and the remaining five monthly payments being due on the 15th of the five immediately subsequent months. The Company has, to date, made all payments required in relation to the withdrawals made from the debt service reserve on September 1, 2009, March 1, 2010 and September 1, 2010. The Company is required to make four additional monthly payments of $19,330 during the period November 15, 2010 through February 15, 2011, in order to fully replenish the September 1, 2010 withdrawal from the debt service reserve.

The Company does not expect to have sufficient available funds to make the interest payment of $113,075 due on March 1, 2011 as well as the principal payment of $200,000 which was due, but not paid, on September 1, 2010

The Company has received Notice of Default from the Trustee of the NJED Bonds in relation to the withdrawals from the debt service reserve, and has requested a postponement of principal payments due on September 1st of 2010, 2011 and 2012, with an aggregate of all such postponed principal payments being added to the principal payments due on September 1, 2013. Resolution of the Company's default under the NJED Bonds and our request for postponement of principal payments will have a significant effect on our ability to operate in the future.

Due to issuance of a Notice of Default being received from the Trustee of the NJED Bonds, and until the event of default is waived or rescinded, the Company has classified the entire principal due, an amount aggregating $3.385 million, as a current liability.

NOTE 6 - DERIVATIVE LIABILITIES

Accounting Standard Codification "ASC" 815 – Derivatives and Hedging, which provides guidance on determining what types of instruments or embedded features in an instrument issued by a reporting entity can be considered indexed to its own stock for the purpose of evaluating the first criteria of the scope exception in the pronouncement on accounting for derivatives. These requirements can affect the accounting for warrants and convertible preferred instruments issued by the Company. As the conversion features within, and the detachable warrants issued with the Company's Series B, Series C, Series D and Series E Preferred Stock, do not have fixed settlement provisions because their conversion and exercise prices may be lowered if the Company issues securities at lower prices in the future, we have concluded that the instruments are not indexed to the Company's stock and are to be treated as derivative liabilities.

Preferred Stock Derivative Liabilities

| | Series B | Series C | Series D | Series E | Total |
|---|---|---|---|---|---|
| Preferred shares Outstanding | 896 | 5,418 | 9,008 | 2,062.5 | 17,384.5 |
| Underlying common shares into which Preferred may convert | 574,076 | 3,365,217 | 128,692,014 | 77,292,061 | 209,923,369 |
| Closing price on valuation date | $ 0.06 | $ 0.06 | $ 0.06 | $ 0.06 | $ 0.06 |
| Preferred stock derivative liability at September 30, 2010 | $ 34,445 | $ 201,913 | $ 7,721,521 | $ 4,637,524 | $ 12,595,402 |
| Preferred stock derivative liability at June 30, 2010 | $ 39,037 | $ 228,835 | $ 8,751,057 | $ 4,980,172 | $ 13,999,102 |
| Preferred stock derivative liability at March 31, 2010 | $ 48,796 | $ 286,043 | $ 3,828,587 | $ 3,761,761 | $ 7,925,187 |

| | | |
|---|---|---|
| Change in preferred stock derivative liability for the three months ended September 20, 2010 | $ | (1,505,333) |