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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number: 001-36439

PRECIPIO, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

4 Science Park, New Haven, CT
(Address of principal executive offices)

91-1789357
(I.R.S. Employer
Identification No.)

06511
(Zip Code)

(203) 787-7888
(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 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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input checked="" type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

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

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

As of August 10, 2018, the number of shares of common stock outstanding was 23,155,872.

PRECIPIO, INC.

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PART 1. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

**PRECIPIO, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share data)**

	June 30, 2018	December 31, 2017
	(unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash	\$ 71	\$ 421
Accounts receivable, net	752	730
Inventories, net	171	161
Other current assets	164	430
Total current assets	<u>1,158</u>	<u>1,742</u>
PROPERTY AND EQUIPMENT, NET	498	353
OTHER ASSETS:		
Goodwill	4,391	4,685
Intangibles, net	19,817	20,458
Other assets	25	22
Total assets	<u>\$ 25,889</u>	<u>\$ 27,260</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 831	\$ 587
Convertible bridge notes, less debt discounts and debt issuance costs	9	-
Accounts payable	5,020	5,103
Current maturities of capital leases	55	50
Accrued expenses	1,141	1,248
Deferred revenue	116	66
Other current liabilities	2,110	2,982
Total current liabilities	<u>9,282</u>	<u>10,036</u>
LONG TERM LIABILITIES:		
Long-term debt, less current maturities and discounts	2,659	2,829
Common stock warrant liabilities	1,006	841
Derivative liability	143	-
Capital leases, less current maturities	184	113
Deferred tax liability	349	349
Other long-term liabilities	67	67
Total liabilities	<u>13,690</u>	<u>14,235</u>
STOCKHOLDERS' EQUITY:		
Preferred stock - \$0.01 par value, 15,000,000 shares authorized at June 30, 2018 and December 31, 2017, respectively, 47 and 4,935 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	-	-
Common stock, \$0.01 par value, 150,000,000 shares authorized at June 30, 2018 and December 31, 2017, 22,559,572 and 10,196,620 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	226	102
Additional paid-in capital	49,245	44,465

Accumulated deficit	<u>(37,272)</u>	<u>(31,542)</u>
Total stockholders' equity	<u>12,199</u>	<u>13,025</u>
	<u>\$ 25,889</u>	<u>\$ 27,260</u>

See notes to unaudited condensed consolidated financial statements.

PRECIPIO, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share data)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
SALES				
Service revenue, net	\$ 899	\$ 316	\$ 1,690	\$ 619
Clinical research grants	62	-	62	-
Other	(2)	-	3	-
Revenue, net of contractual allowances and adjustments	959	316	1,755	619
less allowance for doubtful accounts	(142)	(56)	(226)	(111)
Net sales	817	260	1,529	508
COST OF SALES				
Service revenue	585	284	1,273	466
Clinical research grants	57	-	57	-
Total cost of sales	642	284	1,330	466
Gross profit	175	(24)	199	42
OPERATING EXPENSES:				
Operating expenses	2,358	777	4,536	1,440
Impairment of goodwill	-	-	294	-
TOTAL OPERATING EXPENSES	2,358	777	4,830	1,440
OPERATING LOSS	(2,183)	(801)	(4,631)	(1,398)
OTHER INCOME (EXPENSE):				
Interest expense, net	(48)	(220)	(56)	(382)
Warrant revaluation	323	(3)	584	(3)
Derivative revaluation	(1)	-	(1)	-
Gain on settlement of liability, net	6	-	147	-
Loss on extinguishment of debt	-	(53)	-	(53)
Loss on issuance of convertible notes	(928)	-	(928)	-
Merger advisory fees	-	(2,603)	-	(2,603)
Loss on settlement of equity instruments	-	-	(385)	-
	(648)	(2,879)	(639)	(3,041)
LOSS BEFORE INCOME TAXES	(2,831)	(3,680)	(5,270)	(4,439)
INCOME TAX EXPENSE	-	-	-	-
NET LOSS	(2,831)	(3,680)	(5,270)	(4,439)
Deemed dividends related to beneficial conversion feature of preferred stock and fair value of consideration issued to induce conversion of preferred stock				
	(334)	(5,248)	(3,848)	(5,248)
TOTAL DIVIDENDS	(334)	(5,248)	(3,848)	(5,248)
NET LOSS AVAILABLE TO COMMON STOCKHOLDERS	\$ (3,165)	\$ (8,928)	\$ (9,118)	\$ (9,687)
BASIC AND DILUTED LOSS PER COMMON SHARE				
	\$ (0.15)	\$ (15.35)	\$ (0.55)	\$ (18.77)

BASIC AND DILUTED WEIGHTED-AVERAGE SHARES OF COMMON STOCK OUTSTANDING	<u>20,737,789</u>	<u>581,481</u>	<u>16,679,459</u>	<u>515,968</u>
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See notes to unaudited condensed consolidated financial statements.

PRECIPIO, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(unaudited)

	Six Months Ended June 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (5,270)	\$ (4,439)
Adjustments to reconcile net loss to net cash flows used in operating activities:		
Depreciation and amortization	680	48
Amortization of deferred financing costs and debt discount	10	57
Loss on extinguishment of debt	-	53
Gain on settlement of liability, net	(147)	-
Loss on settlement of equity instrument	385	-
Loss on issuance of convertible notes	928	-
Stock-based compensation	220	23
Impairment of goodwill	294	-
Merger advisory fees	-	2,603
Provision for losses on doubtful accounts	224	111
Warrant revaluation	(584)	3
Derivative revaluation	1	-
Changes in operating assets and liabilities:		
Accounts receivable, net	(246)	(136)
Inventories, net	(10)	7
Other assets	263	(1)
Accounts payable	(27)	290
Accrued expenses and other liabilities	(332)	484
Net cash used in operating activities	<u>(3,611)</u>	<u>(897)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash acquired in business combination	-	101
Purchase of property and equipment	(44)	-
Net cash (used in) provided by investing activities	<u>(44)</u>	<u>101</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on capital lease obligations	(31)	(23)
Issuance of preferred stock	-	400
Payment of deferred financing costs	(138)	(25)
Issuance of common stock, net of issuance costs	618	-
Proceeds from exercise of warrants	1,092	25
Proceeds from long-term debt	300	315
Proceeds from convertible bridge notes	1,660	1,365
Principal payments on long-term debt	(196)	(345)
Net cash flows provided by financing activities	<u>3,305</u>	<u>1,712</u>
NET CHANGE IN CASH	<u>(350)</u>	<u>916</u>
CASH AT BEGINNING OF PERIOD	<u>421</u>	<u>51</u>
CASH AT END OF PERIOD	<u>\$ 71</u>	<u>\$ 967</u>
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid during the period for interest	\$ 26	\$ 30
SUPPLEMENTAL DISCLOSURE OF NON-CASH INFORMATION		

Purchases of equipment financed through accounts payable	34	-
Equipment financed through capital leases	107	-
Deferred debt issuance cost financed through accounts payable	57	64
Discount of 9% on issuance of convertible bridge notes	164	-
Other current liabilities canceled in exchange for common shares	1,897	-
Conversion of bridge loans plus interest into common stock	-	877
Conversion of senior and junior notes plus interest into preferred stock and common stock	-	4,771
Beneficial conversion feature on issuance of convertible notes	1,076	1,856
Accrued merger cost	-	10
Issuance of warrants in conjunction with issuance of side agreement	-	414
Initial valuation of derivative liability recorded in conjunction with issuance of convertible notes	142	-
Initial valuation of warrant liability recorded in conjunction with issuance of convertible notes	1,205	-
Liability recorded related to equity purchase agreement repricing	460	-
Warrant liability canceled due to settlement of equity instruments	456	-

See notes to unaudited condensed consolidated financial statements.

PRECIPIO, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the Three and Six Months Ended June 30, 2018 and 2017

1. BUSINESS DESCRIPTION

Business Description.

Precipio, Inc., and Subsidiary, (“we”, “us”, “our”, the “Company” or “Precipio”) is a cancer diagnostics company providing diagnostic products and services to the oncology market. We have built and continue to develop a platform designed to eradicate the problem of misdiagnosis by harnessing the intellect, expertise and technology developed within academic institutions and delivering quality diagnostic information to physicians and their patients worldwide. We operate a cancer diagnostic laboratory located in New Haven, Connecticut and have partnered with the Yale School of Medicine to capture the expertise, experience and technologies developed within academia so that we can provide a better standard of cancer diagnostics and solve the growing problem of cancer misdiagnosis. We also operate a research and development facility in Omaha, Nebraska which will focus on further development of ICE-COLD-PCR (“ICP”), the patented technology which was exclusively licensed by us from Dana-Farber Cancer Institute, Inc. (“Dana-Farber”) at Harvard University (“Harvard”). The research and development center will focus on the development of this technology, which we believe will enable us to commercialize other technologies developed by our current and future academic partners. Our platform connects patients, physicians and diagnostic experts residing within academic institutions. Launched in 2017, the platform facilitates the following relationships:

Patients: patients may search for physicians in their area and consult directly with academic experts that are on the platform. Patients may also have access to new academic discoveries as they become commercially available.

Physicians: physicians can connect with academic experts to seek consultations on behalf of their patients and may also provide consultations for patients in their area seeking medical expertise in that physician’s relevant specialty. Physicians will also have access to new diagnostic solutions to help improve diagnostic accuracy.

Academic Experts: academic experts on the platform can make themselves available for patients or physicians seeking access to their expertise. Additionally, these experts have a platform available to commercialize their research discoveries.

We intend to continue updating our platform to allow for patient-to-patient communications and allow individuals to share stories and provide support for one another, to allow physicians to consult with their peers to discuss and share challenges and solutions, and to allow academic experts to interact with others in academia on the platform to discuss their research and cross-collaborate.

ICP was developed at Harvard and is licensed exclusively by us from Dana-Farber. The technology enables the detection of genetic mutations in liquid biopsies, such as blood samples. The field of liquid biopsies is a rapidly growing market, aimed at solving the challenge of obtaining genetic information on disease progression and changes from sources other than a tumor biopsy.

Gene sequencing is performed on tissue biopsies taken surgically from the tumor site in order to identify potential therapies that will be more effective in treating the patient. There are several limitations to this process. First, surgical procedures have several limitations, including:

- **Cost:** surgical procedures are usually performed in a costly hospital environment. For example, according to a recent study the mean cost of lung biopsies is greater than \$14,000; surgery also involves hospitalization and recovery time.

- Surgical access: various tumor sites are not always accessible (e.g. brain tumors), in which cases no biopsy is available for diagnosis.
- Risk: patient health may not permit undergoing an invasive surgery; therefore a biopsy cannot be obtained at all.
- Time: the process of scheduling and coordinating a surgical procedure often takes time, delaying the start of patient treatment.

Second, there are several tumor-related limitations that provide a challenge to obtaining such genetic information from a tumor:

- Tumors are heterogeneous by nature: a tissue sample from one area of the tumor may not properly represent the tumor's entire genetic composition; thus, the diagnostic results from a tumor may be incomplete and non-representative.
- Metastases: in order to accurately test a patient with metastatic disease, ideally an individual biopsy sample should be taken from each site (if those sites are even known). These biopsies are very difficult to obtain; therefore physicians often rely on biopsies taken from the primary tumor site.

The advent of technologies enabling liquid biopsies as an alternative to tumor biopsy and analysis is based on the fact that tumors (both primary and metastatic) shed cells and fragments of DNA into the blood stream. These blood samples are called "liquid biopsies" that contain circulating tumor DNA, or ctDNA, which hold the same genetic information found in the tumor(s). That tumor DNA is the target of genetic analysis. However, since the quantity of tumor DNA is very small in proportion to the "normal" (or "healthy") DNA within the blood stream, there is a need to identify and separate the tumor DNA from the normal DNA.

ICP is an enrichment technology that enables the laboratory to focus its analysis on the tumor DNA by enriching, and thereby "multiplying" the presence of, tumor DNA, while maintaining the normal DNA at its same level. Once the enrichment process has been completed, the laboratory genetic testing equipment is able to identify genetic abnormalities presented in the ctDNA, and an analysis can be conducted at a higher level of sensitivity, to enable the detection of such genetic abnormalities. The technology is encapsulated into a chemical that is provided in the form of a kit and sold to other laboratories who wish to conduct these tests in-house. The chemical within the kit is added to the specimen preparation process, enriching the sample for the tumor DNA so that the analysis will detect those genetic abnormalities.

Merger Transaction

On June 29, 2017, the Company (then known as "Transgenomic, Inc.," or "Transgenomic"), completed a reverse merger (the "Merger") with Precipio Diagnostics, LLC, a privately held Delaware limited liability company ("Precipio Diagnostics") in accordance with the terms of the Agreement and Plan of Merger (the "Merger Agreement"), dated October 12, 2016, as amended on February 2, 2017 and June 29, 2017, by and among Transgenomic, Precipio Diagnostics and New Haven Labs Inc. ("Merger Sub") a wholly-owned subsidiary of Transgenomic. Pursuant to the Merger Agreement, Merger Sub merged with and into Precipio Diagnostics, with Precipio Diagnostics surviving the Merger as a wholly-owned subsidiary of the combined company. Upon the consummation of the Merger, the historical financial statements of Precipio Diagnostics become the Company's historical financial statements. Accordingly, the historical financial statements of Precipio Diagnostics are included in the comparative prior periods. As a result of the Merger, historical preferred stock, common stock, restricted units, warrants and additional paid-in capital, including share and per share amounts, have been retroactively adjusted to reflect the equity structure of the combined company, including the effect of the Merger exchange ratio. Pursuant to the Merger Agreement, each outstanding unit of Precipio Diagnostics was exchanged for 10.2502 pre-reverse stock split shares of Company Common Stock.

Going Concern.

The condensed consolidated financial statements have been prepared using accounting principles generally accepted in the United States of America (“GAAP”) applicable for a going concern, which assume that the Company will realize its assets and discharge its liabilities in the ordinary course of business. The Company has incurred substantial operating losses and has used cash in its operating activities for the past few years. As of June 30, 2018, the Company had a net loss of \$5.3 million, negative working capital of \$8.1 million and net cash used in operating activities of \$3.6 million. The Company’s ability to continue as a going concern over the next twelve months from the date of issuance of this Form 10-Q is dependent upon a combination of achieving its business plan, including generating additional revenue, and raising additional financing to meet its debt obligations and paying liabilities arising from normal business operations when they come due.

Notwithstanding the aforementioned circumstances, there remains substantial doubt about the Company’s ability to continue as a going concern over the next twelve months from the date of issuance of the Form 10-Q. There can be no assurance that the Company will be able to successfully achieve its initiatives summarized above in order to continue as a going concern over the next twelve months from the date of issuance of the Form 10-Q. The accompanying financial statements have been prepared assuming the Company will continue as a going concern and do not include any adjustments that might result should the Company be unable to continue as a going concern as a result of the outcome of this uncertainty.

Nasdaq Delisting Notice

On March 26, 2018, Precipio, Inc. received written notice (the “Notice”) from The Nasdaq Stock Market LLC (“Nasdaq”) indicating that, based on the closing bid price of the Company’s common stock for the preceding 30 consecutive business days, the Company is not in compliance with the \$1.00 minimum bid price requirement for continued listing on the Nasdaq Capital Market (the “Minimum Bid Price Requirement”). The Notice has no immediate effect on the listing of Precipio’s common stock, and its common stock will continue to trade on the Nasdaq Capital Market under the symbol “PRPO” at this time. In accordance with Nasdaq Listing Rule 5810(c)(3)(A), Precipio has a period of 180 calendar days, or until September 24, 2018 to regain compliance with the Minimum Bid Price Requirement. The Company intends to monitor the closing bid price of its common stock and consider its available options to resolve its noncompliance with the Minimum Bid Price Requirement.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation.

The accompanying condensed consolidated financial statements are presented in conformity with GAAP. We have evaluated events occurring subsequent to June 30, 2018 for potential recognition or disclosure in the condensed consolidated financial statements and concluded that, other than what is disclosed within the notes to unaudited condensed consolidated financial statements and in Note 12 - Subsequent Events, there were no other subsequent events that required recognition or disclosure.

The condensed consolidated balance sheet as of December 31, 2017 was derived from our audited balance sheet as of that date. There has been no change in the balance sheet from December 31, 2017. The accompanying condensed consolidated financial statements as of and for the three and six months ended June 30, 2018 and 2017 are unaudited and reflect all adjustments (consisting of only normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. These unaudited condensed consolidated financial statements and notes should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2017 contained in our Annual Report Form 10-K, filed with the Securities and Exchange Commission (the “SEC”) on April 13, 2018. The results of operations for the interim periods presented are not necessarily indicative of the results for fiscal year 2018.

Recent Accounting Pronouncements.

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers and has subsequently issued supplemental and/or clarifying ASUs (collectively “ASC 606”). ASC 606 outlines a five-step framework that intends to clarify the principles for recognizing revenue and eliminate industry-specific guidance. In addition, ASC 606 revises current disclosure requirements in an effort to help financial statement users better understand the nature, amount, timing, and uncertainty of revenue that is recognized. ASC 606 may be applied either retrospectively to each prior reporting period presented or use the modified retrospective transition method with the cumulative effect of initial adoption recognized at the date of initial application. We adopted this new standard as of January 1, 2018, by using the modified-retrospective method. An adjustment was not required and a change to the prior revenue recognition process and policy to adopt the new standard was not necessary. See Note 11 – Sales Service Revenue, Net and Accounts Receivable for further details.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. The new standard amends the recognition of lease assets and lease liabilities by lessees for those leases currently classified as operating leases and amends disclosure requirements associated with leasing arrangements. The new standard is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2018. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition, and provides for certain practical expedients. Transition will require application of the new guidance at the beginning of the earliest comparative period presented. We are currently assessing the impact that the adoption of this ASU will have on our consolidated financial statements.

In January 2017, FASB issued ASU No. 2017-01, *Business Combinations* (Topic 805): Clarifying the Definition of a Business. ASU No. 2017-01 adds guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The new guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The adoption of ASU No. 2017-01 did not have a material effect on the Company’s financial position and results of operations.

In May 2017, the FASB issued ASU 2017-09 “*Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting*”, which provides clarity and reduces both diversity in practice and cost and complexity when applying guidance in Topic 718. This amendment provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The amendments are effective for all entities for annual periods, and interim periods within those periods, beginning after December 15, 2017. The adoption of ASU No. 2017-09 did not have a material effect on the Company’s financial position and results of operations.

Property and Equipment, net.

Depreciation expense was \$0.1 million for the three and six months ended June 30, 2018 and 2017. Depreciation expense during each year includes depreciation related to equipment acquired under capital leases.

Goodwill and Intangible Assets.

As a result of the Merger, the Company recorded goodwill and intangible assets as part of its allocation of the purchase consideration.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets of the business acquired. Goodwill is tested for impairment annually. We perform this impairment analysis during the fourth quarter of each year or when a significant event occurs that may indicate that the assets might be impaired.

During the six months ended June 30, 2018, the Company experienced a decline in its share price and a reduction in its market capitalization, as such the Company determined that an assessment of goodwill should be performed using the qualitative approach. Based on the qualitative assessment, the Company concluded that it was more likely than not that the fair value of the Company was less than its carry value. As part of its analysis, the Company considered triggering events and compared its fair value with its carrying value. The analysis of the fair value of the Company involved using the discounted cash flow model. Based on the analysis, the Company concluded that its carrying value exceeded its fair value and goodwill impairment in the amount of \$0.3 million was recorded for the six months ended June 30, 2018. There was no impairment for the three months ended June 30, 2018.

Intangibles

Amortization expense for intangible assets was \$0.3 million and zero for the three months ended June 30, 2018 and 2017, respectively, and \$0.6 million and zero during the six months ended June 30, 2018 and 2017, respectively. Amortization expense for intangible assets is expected to be \$1.2 million, \$1.0 million, \$1.0 million, \$0.9 million and \$0.9 million for each of the years ending December 31, 2018, 2019, 2020, 2021 and 2022, respectively.

Debt Issuance Costs and Debt Discounts.

Debt issuance costs and debt discounts are being amortized over the lives of the related financings on a basis that approximates the effective interest method. Both are presented as a reduction of the related debt in the accompanying condensed consolidated balance sheets. See Note 4 – Long-Term Debt and Convertible Bridge Notes for further information.

Revenue Recognition.

Revenue recognition occurs when a customer obtains control of the promised goods and service. Revenue assigned to the goods and services reflects the consideration which the Company expects to receive in exchange for those goods and services.

The Company derives its revenues from Diagnostic Testing - histology, flow cytometry, cytology and molecular testing; Clinical Research from bio-pharma customers, state and federal grant programs; and from Biomarker Testing from bio-pharma customers. All sources of revenue are recorded net of accruals for estimated chargebacks, rebates, cash discounts, other allowances, and returns. Due to differences in the substance of these revenue types, the transactions require, and the Company utilizes, different revenue recognition policies for each. See more detailed information on revenue in Note 11 – Sales Service Revenue, Net And Accounts Receivable.

The Company recognizes revenue utilizing the five-step framework of ASC 606. Control of the laboratory testing services is transferred to the customer at a point in time. As such, the Company recognizes revenue for diagnostic testing at a point in time based on the delivery method (web-portal access or fax) for a patient's laboratory report. Diagnostic testing service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including retroactive adjustment under reimbursement agreements with third-party payors. Revenue under third-party payor agreements is subject to audit and retroactive adjustment. Provisions for third-party payor settlements are provided in the period in which the related services are rendered and adjusted in the future periods, as final settlements are determined. For clinical research and biomarker services, the Company utilizes an "effort based" method of assessing performance and measures progress towards satisfaction of the performance obligation based upon the delivery of results per the contract.

When we receive payment in advance, we initially defer the revenue and recognize it when we deliver the service. Deferred net sales included in the balance sheet as deferred revenue was \$0.1 million as of June 30, 2018 and December 31, 2017, respectively.

Taxes collected from customers and remitted to government agencies for specific net sales producing transactions are recorded net with no effect on the income statement.

Loss Per Share.

Basic loss per share is calculated based on the weighted-average number of common shares outstanding during each period. Diluted loss per share includes shares issuable upon exercise of outstanding stock options, warrants or conversion rights that have exercise or conversion prices below the market value of our common stock. Options, warrants and conversion rights pertaining to 14,128,219 and 2,545,463 shares of our common stock have

been excluded from the computation of diluted loss per share at June 30, 2018 and 2017, respectively, because the effect is anti-dilutive due to the net loss.

The following table summarizes the outstanding securities not included in the computation of diluted net loss per share:

	June 30,	
	2018	2017
Stock options	3,410,059	24,917
Warrants	6,913,141	268,379
Preferred stock	156,667	1,712,901
Convertible notes	3,648,352	539,266
Total	14,128,219	2,545,463

3. REVERSE MERGER

Unaudited pro forma information

The operating results of Transgenomic have been included in the Company's consolidated financial statements for all periods after June 29, 2017.

The following unaudited pro forma information presents the Company's financial results as if the acquisition of Transgenomic had occurred on January 1, 2017 and combines Transgenomic's unaudited condensed consolidated statement of operations for the three and six months ended June 30, 2017 with Precipio's unaudited condensed statement of operations for the three and six months ended June 30, 2017:

Dollars in thousands, except per share amounts

	June 30, 2017	
	Three Months Ended	Six Months Ended
Net sales	\$ 565	\$ 1,472
Net loss available to common stockholders	(11,086)	(13,864)
Loss per common share	\$ (1.73)	\$ (2.16)

4. LONG-TERM DEBT AND CONVERTIBLE BRIDGE NOTES

Long-term debt consists of the following:

	Dollars in Thousands	
	June 30, 2018	December 31, 2017
Department of Economic and Community Development (DECD)	\$ 286	\$ -
DECD debt issuance costs	(29)	-
Secured debt obligations	3,233	3,233
Financed insurance loan	-	183
Total long-term debt	3,490	3,416
Current portion of long-term debt	(831)	(587)
Long-term debt, net of current maturities	\$ 2,659	\$ 2,829

Department of Economic and Community Development.

On January 8, 2018, the Company received gross proceeds of \$400,000 when it entered into an agreement with the Department of Economic and Community Development ("DECD") by which the Company received a grant of \$100,000 and a loan of \$300,000 secured by substantially all of the Company's assets (the "DECD 2018 Loan"). The grant is included in deferred revenue in the accompanying condensed consolidated balance sheet.

Debt issuance costs associated with the DECD 2018 Loan were approximately \$31,000. Amortization of the debt issuance cost was approximately \$1,000 for the six months ended June 30, 2018. Net debt issuance costs were \$29,000 at June 30, 2018 and are presented as a reduction of the related debt in the accompanying condensed consolidated balance sheet.

Secured Debt Obligations

In 2017, the Company entered into Debt Settlement Agreements (the “Settlement Agreements”) with certain of its accounts payable and accrued liability vendors (the “Creditors”) pursuant to which the Creditors, who were owed \$6.3 million (the “Debt Obligations”) by the Company, agreed to reduce and exchange the Debt Obligations for a secured obligation in the amount of \$3.2 million, \$1.9 million in shares of the Company’s common stock and 108,112 warrants to purchase shares of the Company’s common stock.

The Debt Obligations were restructured as follows:

- The Company entered into a scheduled long-term debt repayment agreement of approximately \$3.2 million, which includes interest of approximately \$0.6 million, to be paid in forty-eight equal monthly installments beginning in July 2018 (the “Secured Debt Obligations”).
- Debt Obligations of \$1.9 million were canceled in exchange for 1,814,754 shares of the Company’s common stock with a weighted average price per share of \$1.04 (the “Settlement Common Shares”). The stock was issued in February 2018.
- Warrants to purchase 108,112 shares of the Company’s common stock at an exercise price of \$7.50 per share (the “Creditor Warrants”) were issued to certain Creditors. The Creditor Warrants were issued in February 2018.

Financed Insurance Loan.

During 2017, the Company financed certain of its insurance premiums (the “Financed Insurance Loan”). The original amount financed in July 2017 was \$0.4 million with a 4.99 % interest rate. The Company will make monthly payments through May 2018. As of June 30, 2018 and December 31, 2017, the Financed Insurance Loan outstanding balance of zero and \$0.2 million, respectively, was included in current maturities of long-term debt in the Company’s condensed consolidated balance sheet. A corresponding prepaid asset was included in other current assets.

Convertible bridge notes consist of the following:

	Dollars in Thousands	
	June 30, 2018	December 31, 2017
Convertible bridge notes	\$ 1,824	\$ -
Convertible bridge notes discount and debt issuance costs	(1,815)	-
Total convertible bridge notes	9	-
Current portion of convertible bridge notes	(9)	-
Convertible bridge notes, net of current maturities	\$ -	\$ -

Convertible Bridge Notes.

On April 20, 2018, the Company entered into a securities purchase agreement (the “2018 Note Agreement”) with certain investors (the “April 2018 Investors”), pursuant to which the Company will issue up to approximately \$3,296,702 in Senior Secured Convertible Promissory Notes along with warrants. (the “Transaction”). The number of warrants will be equal to the number of shares of common stock issuable upon conversion of the notes based on the conversion price at the time of issuance. Half of the warrants will have a one-year term and half will have a five-year term (the “Transaction”). The 2018 Note Agreement includes customary representations, warranties and covenants by the Company and customary closing conditions.

The Transaction consists of unregistered Senior Secured Convertible Notes (the “Bridge Notes”), bearing interest at a rate of 8% annually and an original issue discount of 9%. The initial Senior Secured Convertible Notes shall be convertible at a price of \$0.50 per share, provided that if the notes are not repaid within 180 days, the conversion price shall be adjusted to 80% of the lowest volume weighted average price during the prior 10 days, subject to a minimum conversion price of \$0.30 per share. The Transaction consists of a number of drawdowns. The initial closing on April 20, 2018 provided the Company with proceeds of \$1,660,000, net of an original issue discount of 9% and before debt issuance costs, for the issuance of notes with an aggregate principal of \$1,824,176 (the “April 2018 Bridge Notes”). Subject to prior stockholder approval, which was obtained in July 2018, the April 2018 Investors funded an additional \$348,099 in July 2018 for Bridge Notes with an aggregate principal of \$382,526 and the Company shall have the option to draw down two additional tranches of \$495,950 each (\$545,000 principal amount of Bridge Notes), 120 days following the initial closing and 150 days following the initial closing.

The Bridge Notes are payable by the Company on the earlier of (i) the one year anniversary after the initial closing date or (ii) upon the closing of a qualified offering, namely the Company raising gross proceeds of at least \$7,000,000 (the “Maturity Date”). At any time, provided that the Company gives 5 business days written notice, the Company has the right to redeem the outstanding principal amount of the Bridge Notes, including accrued but unpaid interest, all liquidated damages and all other amounts due under the Bridge Notes, for cash as follows: (i) an amount which is equal to the sum of 105% if the Company exercises its right to redeem the Bridge Notes within 90 days of the initial closing, (ii) 110% if the Company exercises its right to redeem the Bridge Notes within 180 days of the initial closing, or (iii) 115% if the Company exercises its right to redeem 180 days from the initial closing.

The terms of the 2018 Note Agreement also stipulates that upon written demand by one of the April 2018 Investors after August 22, 2018, the Company shall file a registration statement within thirty (30) days after written demand covering the resale of all or such portion of the conversion shares for an offering to be made on a continuous basis pursuant to Rule 415. The registration statement filed shall be on Form S-3 or Form S-1, at the option of the Company. If the Company does not file a registration statement in accordance with the terms of the 2018 Note Agreement, then on the business day following the applicable filing date and on each monthly anniversary of the business day following the applicable filing date (if no registration statement shall have been filed by the Company in accordance herewith by such date), the Company shall pay to the April 2018 Investors an amount in cash, as partial liquidated damages, equal to 1% per month (pro-rata for partial months) based upon the gross purchase price of the Bridge Notes (calculated on a daily basis) under the 2018 Note Agreement.

The obligations under the Bridge Notes are secured, subject to certain exceptions and other permitted payments by a perfected security interest on the assets of the Company.

The 9% discount associated with the April 2018 Bridge Notes was approximately \$164,000 and was recorded as a debt discount. The Company also incurred legal and advisory fees associated with the April 2018 Bridge Notes of approximately \$164,000 and these were recorded as debt issuance costs.

As part of the initial closing, the April 2018 Investors received 3,648,352 warrants to purchase shares of common stock of the Company (the “April 2018 Warrants”) exercisable at a 150% premium to the April 2018 Bridge Notes conversion price or \$0.75. Half of such April 2018 Warrants have a five-year term and half have a one-year term. The Company reviewed the provisions of the April 2018 Warrants to determine the balance sheet classification of the April 2018 Warrants. The Company concluded that there is an obligation to repurchase the April 2018 Warrants by transferring assets and accordingly the warrants will be classified as a liability. The April 2018 Warrants were valued using a Black-Scholes option pricing model with an initial value of approximately \$1.1 million at the date of issuance and were recorded as a liability with an offset to debt discount. See Note 9 –Fair Value for further discussion.

Pursuant to a letter agreement, dated as of April 20, 2018 (the “Letter Agreement”), the Company engaged a registered broker dealer as a financial advisor (the “Financial Advisor”). Pursuant to the Letter Agreement, the Company paid the Financial Advisor a fee of \$116,000, approximately 7% of the proceeds from the sale of the April 2018 Bridge Notes. This is included in the debt issuance costs discussed above. Per the Letter Agreement, the Company also issued to the Financial Advisor 232,000 warrants to purchase shares of common stock of the Company with an exercise price of \$0.75 (the “Advisor Warrants”). The Advisor Warrants are exercisable at any time and from time to time, in whole or in part, during the four-year period commencing six months from the date of the Letter Agreement. Like the April 2018 Warrants, the Advisor Warrants met the criteria to be classified as a liability. The Advisor Warrants were valued using a Black-Scholes option pricing model with an initial value of approximately \$0.1 million at the date of issuance and were recorded as a liability with an offset to debt discount. See Note 9 –Fair Value for further discussion.

The Company reviewed the conversion option of the April 2018 Bridge Notes and determined that there was a beneficial conversion feature in connection with the issuance of the April 2018 Bridge Notes since the calculated effective conversion price was at a discount to the fair market value of the Company's common stock at issuance date. For purposes of calculating the beneficial conversion feature, the proceeds of \$1.7 million from the April 2018 Bridge Notes were allocated to the notes and warrants based on their relative fair values at the date of issuance. The portion allocated to the April 2018 Bridge Notes was \$0.6 million with the remaining \$1.1 million allocated to the April 2018 Warrants. As a result of the allocation of the proceeds, the Company calculated a beneficial conversion feature of approximately \$1.1 million which was recorded as a debt discount with an offset to additional paid in capital.

The Company reviewed the redemption features of the April 2018 Bridge Notes and determined that there is a redemption feature that qualifies as an embedded derivative instrument which is required to be separated from the debt host contract and accounted for separately as a derivative. The Company determined the initial fair value of the derivative to be approximately \$0.1 which was recorded as a debt discount with an offset to derivative liability. The valuation was performed using the “with and without” approach, whereby the April 2018 Bridge Notes were valued both with the embedded derivative and without, and the difference in values was recorded as the derivative liability. See Note 9 –Fair Value for further discussion

As detailed above, the debt discounts and debt issuance costs related to the April 2018 Bridge Notes total \$2.7 million. Since the costs exceeded the \$1.8 million face amount of the debt, the Company recorded \$1.8 million of debt discount and debt issuance costs as a reduction of the related debt in the accompanying condensed consolidated balance sheet with the excess \$0.9 million expensed as a loss on issuance of convertible notes in the condensed consolidated statements of operations. The debt discount and debt issuance costs will be amortized to interest expense over the life of the April 2018 Bridge Notes on a basis that approximates the effective interest method. Amortization of the discount was approximately \$9,000 for the three and six months ended June 30, 2018 and is included in interest expense in the unaudited condensed consolidated statements of operations.

5. OTHER CURRENT LIABILITIES.

Other current liabilities are as follows:

(dollars in thousands)	June 30, 2018	December 31, 2017
Obligation to issue common shares	\$ -	\$ 1,897
Liability related to equity purchase agreement	460	-
Liability for settlement of equity instrument	1,650	1,085
	<u>\$ 2,110</u>	<u>\$ 2,982</u>

As of December 31, 2017, the Company had recorded a liability related to its obligation to issue shares of its common stock in the future. On February 12, 2018, the Company issued 1,814,754 Settlement Common Shares with a fair value of approximately \$1.9 million.

On February 20, 2018, Crede Capital Group LLC (“Crede”) filed a lawsuit against the Company in the Supreme Court of the State of New York for Summary Judgment in Lieu of Complaint requiring the Company to pay cash owed to Crede. Crede claimed that Precipio had breached a Securities Purchase Agreement and Warrant that Crede entered into in connection with an investment in Transgenomic and that pursuant to those agreements, Precipio owed Crede approximately \$2.2 million. On March 12, 2018, Precipio entered into a settlement agreement (the “Crede Agreement”) with Crede pursuant to which Precipio agreed to pay Crede a total sum of \$1.925 million over a period of 16 months payable in cash, or at the Company’s discretion, in stock, in accordance with terms contained in the Crede Agreement. In accordance with the terms of the agreement and in addition to the agreement to pay, we have also executed and delivered to Crede an affidavit of confession of judgment. As of December 31, 2017, the Company had recorded liabilities relating to Crede of \$1.1 million included in other current liabilities on the accompanying condensed consolidated balance sheets and \$0.6 million included in common stock warrant liability on the accompanying condensed consolidated balance sheets related to warrants classified as liabilities that Crede is the holder of.

As of the date of the Crede Agreement, the fair value of the common stock warrant liability related to Crede was revalued to approximately \$0.4 million, resulting in a gain of \$0.2 million included in warrant revaluation in the unaudited condensed consolidated statement of operations during the six months ended June 30, 2018. See Note 9 – Fair Value for further discussion. At the time of the Crede Agreement, the Company recorded \$1.3 million in other current liabilities and \$0.4 million in other long-term liabilities, thus replacing its \$1.1 million liability for settlement of equity instrument and \$0.4 million common stock warrant liability. This resulted in the Company recording an additional loss of \$0.4 million, which is included in loss on settlement of equity instruments in the unaudited condensed consolidated statement of operations. During the six months ended June 30, 2018, the Company paid approximately \$0.3 million to Crede. The remaining amount due to Crede will be paid per the Crede Agreement payment schedule with the final installment due in May 2019.

As of June 30, 2018, the Company had recorded a liability of approximately \$0.5 million related to an equity purchase agreement. The Company is currently in negotiations with the investor with regards to this liability. See Note 8 Stockholders’ Equity for further discussion.

6. CONTINGENCIES

The Company is involved in legal proceedings related to matters, which are incidental to its business. The Company has also assumed a number of claims as a result of the Merger. See below for a discussion on these matters.

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirement, reimbursement for patient services and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers.

Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Company is in compliance with fraud and abuse regulations, as well as other applicable government laws and regulations. While no material regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

The outcome of legal proceedings and claims brought against us are subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against us in the same reporting period for amounts in excess of management’s expectations, our financial statements for such reporting period could be materially adversely affected. In general,

the resolution of a legal matter could prevent us from offering our services or products to others, could be material to our financial condition or cash flows, or both, or could otherwise adversely affect our operating results.

LITIGATIONS

The Company is delinquent on the payment of outstanding accounts payable for certain vendors and suppliers who have taken or have threatened to take legal action to collect such outstanding amounts.

On June 23, 2016, the Icahn School of Medicine at Mount Sinai (“Mount Sinai”) filed a lawsuit against Transgenomic in the Supreme Court of the State of New York, County of New York, alleging, among other things, breach of contract and, alternatively, unjust enrichment and quantum merit, and seeking recovery of \$0.7 million owed by us to Mount Sinai for services rendered. We and Mount Sinai entered into a settlement agreement dated October 27, 2016, which included, among other things, a mutual general release of claims, and our agreement to pay approximately \$0.7 million to Mount Sinai in installments over a period of time. Effective as of October 31, 2017, we and Mount Sinai agreed to enter into a new settlement agreement to restructure these liabilities into a secured, long-term debt obligation of \$0.5 million which includes accrued interest at 10% with monthly principal and interest payments of \$9,472 beginning in July 2018 and continuing over 48 months and we issued warrants in the amount of 24,900 shares, that are exercisable for shares of our common stock, on a 1-for-1 basis, with an exercise price of \$7.50 per share, exercisable on the date of issuance with a term of 5 years. We do not plan to apply to list the warrants on the NASDAQ Capital Market, any other national securities exchange or any other nationally recognized trading system. A \$0.5 million liability has been recorded and is reflected in long-term debt within the accompanying condensed consolidated balance sheet at June 30, 2018 and December 31, 2017.

On February 21, 2017, XIFIN, Inc. (“XIFIN”) filed a lawsuit against us in the District Court for the Southern District of California alleging breach of written contract and seeking recovery of approximately \$0.27 million owed by us to XIFIN for damages arising from a breach of our obligations pursuant to a Systems Services Agreement between us and XIFIN, dated as of February 22, 2013, as amended and restated on September 1, 2014. On April 5, 2017, the court clerk entered default against the Company. On May 5, 2017, XIFIN filed an application for entry of default judgment against us. A liability of \$0.1 million and \$0.2 million is reflected in accounts payable within the accompanying condensed consolidated balance sheet at June 30, 2018 and December 31, 2017, respectively.

CPA Global provides us with certain patent management services. On February 6, 2017, CPA Global claimed that we owe approximately \$0.2 million for certain patent maintenance services rendered. CPA Global has not filed claims against us in connection with this allegation. A liability of approximately less than \$0.1 million has been recorded and is reflected in accounts payable within the accompanying condensed consolidated balance sheet at June 30, 2018 and December 31, 2017.

On February 17, 2017, Jesse Campbell (“Campbell”) filed a lawsuit individually and on behalf of others similarly situated against us in the District Court for the District of Nebraska alleging we had a materially incomplete and misleading proxy relating to a potential merger and that the merger agreement’s deal protection provisions deter superior offers. As a result, Campbell alleges that we have violated Sections 14(a) and 20(a) of the Exchange Act and Rule 14a-9 promulgated thereafter. The Company filed a motion to dismiss all claims, which motion was fully briefed on November 27, 2017. The Court granted the Company’s motion in full on May 3, 2018 and dismissed the lawsuit.

On March 21, 2018, Bio-Rad Laboratories filed a lawsuit against us in the Superior Court Judicial Branch of the State of Connecticut for Summary Judgment in Lieu of Complaint requiring us to pay cash owed to Bio-Rad in the amount of \$39,000. We are currently in discussions with Bio-Rad to reach payment conditions. A liability of less than \$0.1 million has been recorded in accounts payable within the accompanying condensed consolidated balance sheet at June 30, 2018 and December 31, 2017.

7. INCOME TAXES

Income tax expense for the three and six months ended June 30, 2018 and 2017 was zero as a result of recording a full valuation allowance against the deferred tax asset generated during the periods, which are predominantly net operating losses.

We had no material interest or penalties during fiscal 2018 or fiscal 2017, and we do not anticipate any such items during the next twelve months. Our policy is to record interest and penalties directly related to uncertain tax positions as income tax expense in the condensed consolidated statements of operations.

8. STOCKHOLDERS’ EQUITY

Common Stock.

Pursuant to our Third Amended and Restated Certificate of Incorporation, as amended, we currently have 150,000,000 shares of common stock authorized for issuance.

On February 8, 2018 the Company entered into an equity purchase agreement (the “2018 Purchase Agreement”) with Leviston Resources LLC (“Leviston” or the “Investor”) for the purchase of up to \$8,000,000 (the “Aggregate Amount”) of shares (the “Shares”) of the Company’s common stock from time to time, at the Company’s option. Shares offered and sold prior to February 13, 2018 were issued pursuant to the Company’s shelf registration statement on Form S-3 (and the related prospectus) that the Company filed with the Securities and Exchange Commission (the “SEC”) and which was declared effective by the SEC on February 13, 2015 (the “Shelf Registration Statement”).

Sales of the Company’s common stock, if any, may be made in sales deemed to be “at-the-market” equity offerings as defined in Rule 415 promulgated under the Securities Act of 1933, as amended (the “Securities Act”), at a purchase price equal to 97.25% of the volume weighted average sales price of the common stock reported on the date that Leviston receives a capital call from the Company.

Leviston purchased 721,153 shares (the “Investor Shares”) of the Company’s common stock following the close of business on February 9, 2018, subject to customary closing conditions, at a price per share of \$1.04. The shares were sold pursuant to the Shelf Registration Statement. The net proceeds to the Company from this sale were approximately \$744,000. In addition to the \$6,000 fee (0.75% fee discussed below), the Company incurred approximately \$136,000 of additional costs, both of which have been treated as issuance costs within additional paid-in capital in the accompanying unaudited condensed consolidated balance sheet.

In consideration of Leviston’s agreement to enter into the 2018 Purchase Agreement, the Company agreed to pay to Leviston a commitment fee in shares of the Company’s common stock equal in value to 5.25% of the total Aggregate Amount (the “Commitment Shares”), payable as follows: 1.75% on or before February 12, 2018. This amount, of \$140,000, was paid to Leviston through the issuance of 170,711 shares of the Company’s common stock on February 12, 2018; 1.75% on the third calendar day after the date on which the registration statement on Form S-1 filed on April 16, 2018 is declared effective by the SEC; and 1.75% on the thirtieth calendar day after the date on which such registration statement on Form S-1 is declared effective by the SEC.

In accordance with the terms of the 2018 Purchase Agreement, the Company provided the Investor with a price protection against their initial investment of Investor Shares at the \$1.04 price and the commitment fee at a price of \$0.82. The provision states that until the effective date of a registration statement, on the occasion the Company sells, or agrees in writing to issue any common stock or common stock equivalents and any of the terms and conditions appurtenant to such issuance or sale are more favorable to the new investors than are the terms and conditions granted the Investor for less than the purchase price at any time, the Company shall amend the terms of the 2018 Purchase Agreement so as to give the Investor the benefit of such more favorable terms or conditions. Due to the Company entering into the 2018 Note Agreement and accepting the exercise of warrants outstanding at a conversion price of \$0.30, the Company is required to reprice the initial investment and the commitment fee at \$0.30. As such, at the triggering date of April 20, 2018, the total number of shares that the Company is required to issue to the Investor in relation to the repricing of their initial investment and commitment fee is approximately 3.0 million shares of which 0.9 million were issued at the time of the 2018 Purchase Agreement. As of June 30, 2018, the Company has not issued the additional 2.1 million shares to the Investor and at the time of issuance would record the additional issuance of stock against additional paid in capital.

In addition, within the price protection provision, if the Company issues any warrants in connection with issuances, sales or an agreement in writing to issue common stock or common stock equivalents by the Company, the Investor will have the right to receive a proportionate amount of such warrants, cash or shares, at Investor’s sole election, valued using the Black Scholes formula. As a result of 2018 Note Agreement and the April 2018 Warrants issued, the Company is required to provide the Investor with a proportionate and equivalent coverage in the form of warrants, stock or cash in the amount of approximately \$460,000. As the Investor has the ability to elect the form of compensation, the Company has recorded the \$460,000 as a liability within the other current liabilities line of the accompanying condensed consolidated balance sheet and has recorded a corresponding dividend. The Company is

collectively negotiating the two amounts resulting from the price protection provision, with the Investor, to agree on a mutually acceptable settlement.

The Company agreed to pay to Leviston, on each day that Leviston receives a capital call from the Company, all expenses associated with depositing, clearing, selling and mailing of the stock certificates, a fee of 0.75% of any amount purchased by Leviston. Also, the Company paid \$35,000 to Leviston for a documentation fee for preparing the 2018 Purchase Agreement. This was recorded in additional paid-in-capital as an off-set to the proceeds received. Leviston will refund the Company \$15,000 if certain future conditions are met. Such conditions have not been met as of the date of issuance of this Form 10-Q.

Because the Company's existing registration statement on Form S-3 expired on February 13, 2018 and, due to the timing of the filing of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, the Company will not be eligible to file a new Form S-3 registration statement until September 1, 2018, the Company agreed to prepare and file with the SEC a registration statement on Form S-1 the ("S-1 Registration Statement"), by April 15, 2018 and to use reasonable best efforts to cause the S-1 Registration Statement to be declared effective by the SEC within ninety days thereafter. The Company filed the S-1 Registration Statement with the SEC on April 16, 2018, which was in a timely manner since the SEC was not open for filings on April 15, 2018. On August 10, 2018, the Company filed with the SEC, on Form RW, to withdraw the S-1 Registration Statement because the Company is seeking to re-negotiate the terms of the 2018 Purchase Agreement in order to comply with the requirements of the SEC pursuant to a letter from the SEC dated August 7, 2018. Accordingly, as of the date of issuance of this form 10-Q, the Company is awaiting an order from the SEC granting withdrawal of the S-1 Registration Statement. The Company is also required to pay liquidated damages of \$100,000 on each event of default under the 2018 Purchase Agreement, of which there were none as of June 30, 2018. The Company has provided Leviston with customary indemnification rights under the 2018 Purchase Agreement.

During the six months ended June 30, 2018, the Company issued 3,120,000 shares of its common stock in connection with conversions of its Series B Preferred Stock and 3,345,334 shares of its common stock in connection with conversions of its Series C Preferred Stock. Aside from 60,000 shares of common stock issued in connection with conversions of its Series C Preferred Stock, all of the shares of common stock issued in the six months ended June 30, 2018 in connection with conversions of its Series B Preferred Stock and Series C Preferred Stock (together the "Preferred Stock") were issued after the Company induced the holders of its Preferred Stock to convert their shares of Preferred Stock to shares of the company's common stock (see below - Preferred Stock induced conversions).

During the six months ended June 30, 2018, the Company issued 3,191,000 shares of its common stock in connection with the exercise of 3,191,000 warrants. The warrant exercises resulted in net cash proceeds to the Company of approximately \$1.1 million during the six months ended June 30, 2018.

Preferred Stock.

The Company's Board of Directors is authorized to issue up to 15,000,000 shares of preferred stock in one or more series, from time to time, with such designations, powers, preferences and rights and such qualifications, limitations and restrictions as may be provided in a resolution or resolutions adopted by the Board of Directors.

Series B Preferred Stock.

On August 25, 2017, the Company filed a Certificate of Designation of Preferences, Rights and Limitations of Series B Convertible Preferred Stock ("Series B Preferred Stock") with the State of Delaware which designates 6,900 shares of our preferred stock as Series B Preferred Stock. The Series B Preferred Stock has a stated value of \$1,000 per share and a par value of \$0.01 per share. The Series B Preferred Stock includes a beneficial ownership blocker but has no dividend rights (except to the extent dividends are also paid on the common stock).

On August 28, 2017, the Company completed the August 2017 Offering of 6,000 units consisting of one share of the Company's Series B Preferred Stock, which was initially convertible into 400 shares of common stock, par value \$0.01 per share, at a conversion price of \$2.50 per share, and one warrant to purchase up to 400 shares of common stock (the "August 2017 Offering Warrants") at a combined public offering price of \$1,000 per unit. The August 2017 Offering included the sale of 280,000 August 2017 Offering Warrants pursuant to the over-allotment option exercised by Aegis Capital Corp. ("Aegis") for \$0.01 per share or \$2,800.

In November 2017, the down round feature of the Series B Preferred Stock was triggered at the time of the Company's issuance of its Series C Preferred Stock and, as a result, the conversion price of the Series B Preferred Stock was reduced from \$2.50 per share to \$1.40 per share.

The 2018 Purchase Agreement triggered the down round feature of the Series B Preferred Stock and, as a result, the conversion price of the Company's Series B Convertible Preferred Stock was automatically adjusted from the reduced \$1.40 per share price, related to the 2017 Series C issuance, to \$1.04 per share. In connection with the down round adjustment, the Company calculated an incremental beneficial conversion feature of approximately \$1.4 million which was recognized as a deemed dividend at time of the down round adjustment.

The 2018 Inducement Agreement, discussed below, triggered the down round feature of the Series B Preferred Stock and, as a result, the conversion price of the Company's Series B Convertible Preferred Stock was automatically adjusted from \$1.04 per share to \$0.75 per share. In connection with the down round adjustment, the Company calculated an incremental beneficial conversion feature of approximately \$40,000 which was recognized as a deemed dividend at time of the down round adjustment.

The 2018 Note Agreement, see Note 4 – Long-Term Debt And Convertible Bridge Notes, triggered the down round feature of the Series B Preferred Stock and, as a result, the conversion price of the Company's Series B Convertible Preferred Stock was automatically adjusted from \$0.75 per share to \$0.30 per share. In connection with the down round adjustment, the Company calculated an incremental beneficial conversion feature of approximately \$216,000 which was recognized as a deemed dividend at time of the down round adjustment.

During the six months ended June 30, 2018, 2,340 shares of Series B Preferred Stock that were outstanding at December 31, 2017 were converted into 3,120,000 shares of our common stock.

At June 30, 2018, the Company had 6,900 shares of Series B designated and 47 shares of Series B issued and outstanding.

Series C Preferred Stock

On November 6, 2017, the Company filed a Certificate of Designation of Preferences, Rights and Limitations of Series C Convertible Preferred Stock (“Series C Preferred Stock”) with the State of Delaware which designates 2,748 shares of our preferred stock as Series C Preferred Stock. The Series C Preferred Stock has a stated value of \$1,000 per share and a par value of \$0.01 per share.

On November 2, 2017, the Company entered into a Placement Agency Agreement (the “Placement Agreement”) with Aegis Capital Corp. for the sale on a reasonable best efforts basis of 2,748 units, each consisting of one share of the Company’s Series C Preferred Stock, convertible into a number of shares of the Company’s common stock equal to \$1,000 divided by \$1.40 and warrants to purchase up to 1,962,857 shares of common stock with an exercise price of \$1.63 per share (the “Series C Warrants”) at a combined offering price of \$1,000 per unit, in a registered direct offering (the “Series C Preferred Offering”). The Series C Preferred Stock includes a beneficial ownership blocker but has no dividend rights (except to the extent dividends are also paid on the common stock). The securities comprising the units are immediately separable and were issued separately.

The conversion price of the Series C Preferred Stock contains a down round feature. The 2018 Purchase Agreement triggered the down round feature of the Series C Preferred Stock and, as a result, the conversion price of the Company’s Series C Convertible Preferred Stock was automatically adjusted from \$1.40 per share to \$1.04 per share. In connection with the down round adjustment, the Company calculated an incremental beneficial conversion feature of approximately \$0.8 million which was recognized as a deemed dividend at time of the down round adjustment. The 2018 Note Agreement did not trigger any down round adjustment to the conversion price of the Series C Preferred stock because all of the Series C Preferred Stock had been converted by March 31, 2018.

During the six months ended June 30, 2018, 2,548 shares of Series C Preferred Stock that were outstanding at December 31, 2017 were converted into 3,345,334 shares of our common stock.

At June 30, 2018, the Company had 2,748 shares of Series C designated and zero shares of Series C issued and outstanding.

Preferred Stock induced conversions

On March 21, 2018, the Company entered into a letter agreement (the “2018 Inducement Agreement”) with certain holders (the “Investors”) of shares of the Company’s Series B Preferred Stock and Series C Preferred Stock (together the “Preferred Stock”), and warrants (the “Warrants”) to purchase shares of the Company’s common stock, par value \$0.01 per share (“Common Stock”), issued in the Company’s public offering in August 2017 and registered direct offering in November 2017. Pursuant to the 2018 Inducement Agreement, the Company and the Investors agreed that, as a result of the issuance of shares of Common Stock pursuant to that Purchase Agreement, dated February 8, 2018, by and between the Company and the investor named therein, and effective as of the time of execution of the 2018 Inducement Agreement, the exercise price of the Warrants was reduced to \$0.75 per share (the “Exercise Price Reduction”) and the conversion price of the Preferred Stock was reduced to \$0.75 (the “Conversion Price Reduction”). As consideration for the Company’s agreement to the Exercise Price Reduction and the Conversion Price Reduction, (i) each Investor agreed to convert the shares of Preferred Stock held by such Investor into shares of Common Stock in increments of up to 4.99% of the shares of Common Stock outstanding as of the date of the 2018 Inducement Agreement and (ii) one Investor agreed to exercise 666,666 Warrants and another Investor agreed to exercise 500,000 Warrants in increments of up to 4.99% of the shares of Common Stock

outstanding as of the date of the 2018 Inducement Agreement, in each case in accordance with the beneficial ownership limitations set forth in the Company's Certificate of Designation of Preferences, Rights and Limitations of Series B Convertible Preferred Stock, the Company's Certificate of Designation of Preferences, Rights and Limitations of Series C Convertible Preferred Stock and the Warrants. As discussed above, as of June 30, 2018, all shares of Preferred Stock, except 47 shares of Series B Preferred Stock, were converted to shares of our common stock pursuant to the terms of the 2018 Inducement Agreement and 300,000 Warrants were exercised at the \$0.75 exercise price.

The 2018 Inducement Agreement represented an inducement by the Company to convert shares of the Preferred Stock. The conversion price of the Preferred Stock was reduced from \$1.04 per share to \$0.75 per share and the exercise price of the Warrants was reduced from \$1.04 per share to \$0.75 per share. The Company calculated the fair value of the additional securities and consideration to be approximately \$1.2 million. This amount was recorded as a charge to additional paid-in-capital and as a deemed dividend resulting in a reduction of income available to common shareholders in our basic earnings per share calculation. The \$1.2 million is comprised of two components: 1) \$1.1 million related to the fair value of the additional common shares issued upon conversion of the Preferred Stock due to the reduced conversion price and 2) \$0.1 million in incremental fair value of the Warrants resulting from the reduction of the exercise price.

Common Stock Warrants.

The following represents a summary of the warrants outstanding as of June 30, 2018:

	<u>Issue Year</u>	<u>Expiration</u>	<u>Underlying Shares</u>	<u>Exercise Price</u>
<i>Warrants Assumed in Merger</i>				
(1)	2014	April 2020	12,487	\$ 120.00
(2)	2015	February 2020	23,826	\$ 67.20
(3)	2015	December 2020	4,081	\$ 49.80
(4)	2016	January 2021	8,952	\$ 36.30
<i>Warrants</i>				
(5)	2017	June 2022	45,600	\$ 2.75
(6)	2017	June 2022	91,429	\$ 7.00
(7)	2017	August 2022	559,000	\$ 0.30
(8)	2017	August 2022	60,000	\$ 3.125
(9)	2017	August 2022	856,446	\$ 10.00
(10)	2017	August 2022	359,999	\$ 0.30
(11)	2017	October 2022	10,000	\$ 0.30
(12)	2017	May 2023	892,857	\$ 0.30
(13)	2018	October 2022	108,112	\$ 7.50
(14)	2018	April 2019	1,824,176	\$ 0.75
(14)	2018	April 2023	1,824,176	\$ 0.75
(15)	2018	October 2022	232,000	\$ 0.75
			6,913,141	

- (1) These warrants were issued in connection with a private placement which was completed in October 2014.
- (2) These warrants were issued in connection with an offering which was completed in February 2015.
- (3) These warrants were issued in connection with an offering which was completed in July 2015.
- (4) These warrants were issued in connection with an offering which was completed in January 2016. Of the remaining outstanding warrants as of March 31, 2018, 5,368 warrants are recorded as a liability, See Note 9 – Fair Value for further discussion, and 3,584 are treated as equity.
- (5) These warrants were issued in connection with the Merger and are the 2017 New Bridge Warrants.
- (6) These warrants were issued in connection with the Merger and are considered Side Warrants.
- (7) These warrants were issued in connection with the August 2017 Offering and are the August 2017 Offering

Warrants discussed below.

- (8) These warrants were issued in connection with the August 2017 Offering and are considered Representative Warrants.
- (9) These warrants were issued in connection with the conversion of our Series A Senior stock, at the time of the closing of the August 2017 Offering, and are the Series A Conversion Warrants discussed below.
- (10) These warrants were issued in connection with the conversion of convertible bridge notes, at the time of the closing of the August 2017 Offering, and are the Note Conversion Warrants discussed below.

- (11) These warrants were issued in connection with the waiver of default the Company received in the fourth quarter of 2017 in connection with the Convertible Promissory Notes and are the Convertible Promissory Note Warrants discussed below.
- (12) These warrants were issued in connection with the Series C Preferred Offering and are the Series C Warrants discussed below.
- (13) These warrants were issued in connection with the Debt Obligation settlement agreements and are the Creditor Warrants discussed below.
- (14) These warrants were issued in connection with the April 2018 Bridge Notes and are the April 2018 Warrants discussed below.
- (15) These warrants were issued in connection with the 2018 Note Agreement and are the Advisor Warrants discussed below.

Warrants Assumed in Merger

At the time of the Merger, Transgenomic had a number of outstanding warrants related to various financing transactions that occurred between 2013-2016. Details related to year issued, expiration date, amount of underlying common shares and exercise price are included in the table above.

During the six months ended June 30, 2018, 23,055 of the warrants assumed in the Merger expired and are no longer outstanding.

August 2017 Offering Warrants

In connection with the August 2017 Offering, the Company issued 2,680,000 warrants at an exercise price of \$3.00, which contain a down round provision. As a result of the Series C Preferred Offering, the exercise price of the August 2017 Offering Warrants was adjusted to \$1.40 per share.

In February 2018, as a result of 2018 Purchase Agreement, the exercise price of the August 2017 Offering Warrants was adjusted to \$1.04. At the time the exercise price was adjusted, the Company calculated the fair value of the down round provision on the warrants to be approximately \$62,000 and recorded this as a deemed dividend. In addition, as a result of the 2018 Inducement Agreement, the exercise price of the August 2017 Offering Warrants was further adjusted to \$0.75 as a result of the Exercise Price Reduction discussed above.

In April 2018, as a result of the 2018 Note Agreement, the exercise price of the August 2017 Offering Warrants was adjusted to \$0.30. At the time the exercise price was adjusted, the Company calculated the fair value of the down round provision on the warrants to be approximately \$63,000 and recorded this as a deemed dividend.

There were 1,821,000 and 2,121,000 August 2017 Offering Warrants exercised during the three and six months ended June 30, 2018, respectively.

Series A Conversion Warrants

The Company issued Series A Conversion Warrants to purchase an aggregate of 856,446 shares of the Company's common stock at an exercise price of \$10.00 per share, which have a term of 5 years.

Note Conversion Warrants

Upon the closing of the August 2017 Offering, the Company issued 359,999 warrants to purchase the Company's common stock (the "Note Conversion Warrants"). The Note Conversion Warrants have an exercise price of \$3.00 per share and contain a down round provision. As a result of the Series C Preferred Offering, the exercise price of the Note Conversion Warrants was adjusted to \$1.40 per share.

In February 2018, as a result of 2018 Purchase Agreement, the exercise price of the Note Conversion Warrants was adjusted to \$1.04. At the time the exercise price was adjusted, the Company calculated the fair value of the down round provision on the warrants to be approximately \$8,000 and recorded this as a deemed dividend. In addition, as a result of the 2018 Inducement Agreement, the exercise price of the Note Conversion Warrants was further adjusted to \$0.75. At the time the exercise price was adjusted, the Company calculated the fair value of the down round provision on the warrants to be approximately \$5,000 and recorded this as a deemed dividend.

In April 2018, as a result of the 2018 Note Agreement, the exercise price of the Note Conversion Warrants was adjusted to \$0.30. At the time the exercise price was adjusted, the Company calculated the fair value of the down round provision on the warrants to be approximately \$10,000 and recorded this as a deemed dividend.

Convertible Promissory Note Warrants

The Convertible Promissory Note Warrants had an original exercise price of \$3.00 per share and contain a down round provision. As a result of the Series C Preferred Offering, the exercise price of the Convertible Promissory Note Warrants was adjusted to \$1.40 per share.

In February 2018, as a result of 2018 Purchase Agreement, the exercise price of the Convertible Promissory Note Warrants was adjusted to \$1.04. At the time the exercise price was adjusted, the Company calculated the fair value of the down round provision on the warrants to be less than \$1,000 and recorded this as a deemed dividend. In addition, as a result of the 2018 Inducement Agreement, the exercise price of the Convertible Promissory Note Warrants was further adjusted to \$0.75. At the time the exercise price was adjusted, the Company calculated the fair value of the down round provision on the warrants to be less than \$1,000 and recorded this as a deemed dividend.

In April 2018, as a result of the 2018 Note Agreement, the exercise price of the Convertible Promissory Note Warrants was adjusted to \$0.30. At the time the exercise price was adjusted, the Company calculated the fair value of the down round provision on the warrants to be less than \$1,000 and recorded this as a deemed dividend.

Series C Warrants

In connection with the Series C Preferred Offering, the Company issued 1,962,857 warrants at an exercise price of \$1.63, which contain a down round provision.

In February 2018, as a result of 2018 Purchase Agreement, the exercise price of the Series C Warrants was adjusted to \$1.04. At the time the exercise price was adjusted, the Company calculated the fair value of the down round provision on the warrants to be approximately \$58,000 and recorded this as a deemed dividend. In addition, as a result of the 2018 Inducement Agreement, the exercise price of the Series C Warrants was further adjusted to \$0.75 as a result of the Exercise Price Reduction discussed above.

In April 2018, as a result of the 2018 Note Agreement, the exercise price of the Series C Warrants was adjusted to \$0.30. At the time the exercise price was adjusted, the Company calculated the fair value of the down round provision on the warrants to be approximately \$45,000 and recorded this as a deemed dividend.

There were 1,070,000 Series C Warrants exercised during both the three and six months ended June 30, 2018.

Creditor Warrants

In the fourth quarter of 2017, the Company entered into Settlement Agreements with certain of its accounts payable and accrued liability vendors (the "Creditors") pursuant to which the Company agreed to issue, to certain of its Creditors, 108,112 warrants to purchase 108,112 shares of the Company's common stock at an exercise price of \$7.50 per share. The warrants were issued in February 2018. See Note 4 – Long-Term Debt.

April 2018 Warrants

In connection with the issuance of the April 2018 Bridge notes, the Company issued 3,648,352 warrants at an exercise price of \$0.75. Half of these April 2018 Warrants have a five-year term and half have a one-year term. At the time of issuance, as discussed in Note 4 Long-Term Debt And Convertible Bridge Notes, the April 2018 Warrants had a fair value of approximately \$1.1 million and were recorded as a liability with an offset to debt discount.

Advisor Warrants

At the time of the 2018 Note Agreement, the Company issued 232,000 warrants with an exercise price of \$0.75 to a financial advisor. At the time of issuance, as discussed in Note 4 Long-Term Debt And Convertible Bridge Notes, the Advisor Warrants had a fair value of approximately \$0.1 million and were recorded as a liability with an offset to debt discount

9. FAIR VALUE

FASB guidance on fair value measurements, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements for our financial assets and liabilities, as well as for other assets and liabilities that are carried at fair value on a recurring basis in our condensed consolidated financial statements.

FASB guidance establishes a three-level fair value hierarchy based upon the assumptions (inputs) used to price assets or liabilities. The three levels of inputs used to measure fair value are as follows:

Level 1—Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2—Observable inputs other than those included in Level 1, such as quoted prices for similar assets and liabilities in active markets or quoted prices for identical assets or liabilities in inactive markets; and

Level 3—Unobservable inputs reflecting our own assumptions and best estimate of what inputs market participants would use in pricing the asset or liability.

Common Stock Warrant Liabilities.

Certain of our issued and outstanding warrants to purchase shares of common stock do not qualify to be treated as equity and, accordingly, are recorded as a liability. We are required to record these instruments at fair value at each reporting date and changes are recorded as a non-cash adjustment to earnings. The gains or losses included in earnings are reported in other income (expense) in our condensed consolidated statement of operations.

2016 Warrant Liability

The Company assumed the 2016 Warrant Liability in the Merger and it represents the fair value of Transgenomic warrants issued in January 2016, of which, 5,368 warrants remain outstanding as of June 30, 2018.

In March 2018, a portion of the 2016 Warrant Liability was part of a settlement agreement pursuant to a lawsuit that was filed against the Company by one of the warrant holders. As such, approximately \$0.4 million of the warrant liability, representing 20,216 warrants, was canceled on the date of the settlement agreement and replaced by and amounts now recorded as other current liabilities or other long-term liabilities. For further detail, see discussion of the Crede Agreement in Note 5 – Other Current Liabilities.

The 2016 Warrant Liability is considered a Level 3 financial instrument and was valued using the Monte Carlo methodology. As of June 30, 2018, assumptions and inputs used in the valuation of the 2016 Warrant Liability include: remaining life to maturity of 2.50 years; annual volatility of 173%; and a risk-free interest rate of 2.57%.

2018 Warrant Liabilities

At the time of the April 2018 Bridge Note issuance, the Company issued 3,648,352 of the April 2018 Warrants and 232,000 of the Advisor Warrants and both warrant issuances were classified as a warrant liability (the

“2018 Warrant Liabilities”). See Note 4 Long-Term Debt And Convertible Bridge Notes for further discussion of each warrant.

The 2018 Warrant Liabilities are considered Level 3 financial instruments and were valued using the Black Scholes model. As of June 30, 2018, assumptions used in the valuation of the 2018 Warrant Liabilities include: remaining life to maturity of 0.8 to 4.8 years; annual volatility of 140% to 163%; and risk free rate of 2.33% to 2.73%

During the three and six months ended June 30, 2018, the change in the fair value of the liabilities measured using significant unobservable inputs (Level 3) were comprised of the following:

Dollars in Thousands

	Three Months Ended June 30, 2018		
	2016 Warrant Liability	2018 Warrant Liabilities	Total Warrant Liabilities
Beginning balance at April 1	\$ 124	\$ -	\$ 124
Additions:	-	1,205	1,205
Total gains:			
Recognized in earnings	-	(323)	(323)
Deductions – warrant liability settlement	-	-	-
Balance at June 30	<u>\$ 124</u>	<u>\$ 882</u>	<u>\$ 1,006</u>

Dollars in Thousands

	Six Months Ended June 30, 2018		
	2016 Warrant Liability	2018 Warrant Liabilities	Total Warrant Liabilities
Beginning balance at January 1	\$ 841	\$ -	\$ 841
Additions:	-	1,205	1,205
Total gains:			
Recognized in earnings	(261)	(323)	(584)
Deductions – warrant liability settlement	(456)	-	(456)
Balance at June 30	<u>\$ 124</u>	<u>\$ 882</u>	<u>\$ 1,006</u>

Derivative Liability.

At the time of the April 2018 Bridge Note issuance, the Company recorded a derivative instrument as a liability with an initial fair value of approximately \$0.1 million. The valuation was performed using the “with and without” approach, whereby the April 2018 Bridge Notes were valued both with the embedded derivative and without, and the difference in values was recorded as the derivative liability. See Note 4 Long-Term Debt And Convertible Bridge Notes for further discussion.

The estimated fair value of the derivative will be remeasured at each reporting date and any change in estimated fair value of the derivative will be recorded as a non-cash adjustment to earnings. The gains or losses included in earnings are reported in other income (expense) in our condensed consolidated statement of operations.

As of June 30, 2018 the calculated fair value of the derivative liability was approximately \$0.1 million and for the three and six months ended June 30, 2018, the Company recorded a loss of approximately \$1,000 which is included in derivative revaluation in the condensed consolidated statement of operations.

10. EQUITY INCENTIVE PLAN

The Company's 2006 Equity Incentive Plan (the "2006 Plan") was terminated as to future awards on July 12, 2016. The Company's 2017 Stock Option and Incentive Plan (the "2017 Plan") was adopted by the Company's stockholders on June 5, 2017 and there were 666,666 shares of common stock reserved for issuance under the 2017 Plan. The 2017 Plan will expire on June 5, 2027.

Amendment of the 2017 Stock Option and Incentive Plan

On January 31, 2018, at a special meeting of the stockholders of the Company, the stockholders approved an amendment and restatement of the Company's 2017 Stock Option and Incentive Plan (the "2017 Plan") to:

- increase the aggregate number of shares authorized for issuance under the 2017 Plan by 5,389,500 shares to 6,056,166 shares and cumulatively increased on January 1, 2019 and on each January 1 thereafter by the lesser of the annual increase for such year or 500,000 shares;
- increase the maximum number of shares that may be granted in the form of stock options or stock appreciation rights to any one individual in any one calendar year and the maximum number of shares underlying any award intended to qualify as performance-based compensation to any one individual in any performance cycle, in each case to 1,000,000 shares of Common Stock; and
- add an "evergreen" provision, pursuant to which the aggregate number of shares authorized for issuance under the 2017 Plan will be automatically increased each year beginning on January 1, 2019 by 5% of the number of shares of Common Stock issued and outstanding on the immediately preceding December 31, or such lesser number of shares determined by the Company's Board of Directors or Compensation Committee.

Stock Options.

During the six months ended June 30, 2018, the Company granted stock options to employees and directors to purchase up to 3,286,528 shares of common stock at a weighted average exercise price of \$0.71. These awards have vesting periods of one to four years and had a weighted average grant date fair value of \$0.65. The fair value calculation of options granted during the six months ended June 30, 2018 used the follow assumptions: risk free interest rate of 2.63% based on the U.S. Treasury yield in effect at the time of grant; expected life of six years; and volatility of 135%.

The following table summarizes stock option activity under our plans during the six months ended June 30, 2018:

	Number of Options	Weighted-Average Exercise Price
Outstanding at January 1, 2018	236,484	\$ 7.12
Granted	3,286,528	0.71
Forfeited	(112,953)	2.84
Outstanding at June 30, 2018	<u>3,410,059</u>	<u>\$ 1.07</u>
Exercisable at June 30, 2018	<u>131,906</u>	<u>\$ 8.07</u>

As of June 30, 2018, there were 2,590,409 options that were vested or expected to vest with an aggregate intrinsic value of zero and a remaining weighted average contractual life of 9.6 years.

For the three and six months ended June 30, 2018, we recorded compensation expense for all stock awards of \$0.1 million and \$0.2 million, respectively, within operating expense in the accompanying statements of operations. For both the three and six months ended June 30, 2017, we recorded compensation expense for all stock awards of less than \$0.1 million. As of June 30, 2018, the unrecognized compensation expense related to unvested stock awards was \$2.3 million, which is expected to be recognized over a weighted-average period of 3.4 years.

11. SALES SERVICE REVENUE, NET AND ACCOUNTS RECEIVABLE

Adoption of ASC Topic 606. "Revenue from contracts with customers"

On January 1, 2018, the Company adopted ASC 606 that amends the guidance for the recognition of revenue from contracts with customers to transfer goods and services by using the modified-retrospective method applied to any contracts that were not completed as of January 1, 2018. The Company performed a comprehensive review of its existing revenue arrangements following the five-step model:

Step 1: Identification of the contract with the customer. Sub-steps include determining the customer in a contract; Initial contract identification and determine if multiple contracts should be combined and accounted for as a single transaction.

Step 2: Identify the performance obligation in the contract. Sub-steps include identifying the promised goods and services in the contract and identifying which performance obligations within the contract are distinct.

Step 3: Determine the transaction price. Sub-steps include variable consideration, constraining estimates of variable consideration, the existence of a significant financing component in the contract, noncash consideration and consideration payable to a customer.

Step 4: Allocate transaction price. Sub-steps include assessing the amount of consideration to which the Company expects to be entitled in exchange for transferring the promised goods or services to the customer.

Step 5: Satisfaction of performance obligations. Sub-steps include ascertaining the point in time when an asset is transferred to the customer and the customer obtains control of the asset upon which time the Company recognizes revenue.

Based on the Company's analysis, there were no changes identified that impacted the amount or timing of revenues recognized under the new guidance as compared to the previous guidance (ASC 605). Additionally, the Company's analysis indicated that there were no changes to how costs to obtain and fulfill our customer contracts would be recognized under the new guidance as compared to the previous guidance. Accordingly, the initial application of the new revenue standard did not result in the recognition of a cumulative effect adjustment to the opening balance of accumulated deficit as of January 1, 2018.

Nature of Contracts and Customers

The Company's contracts and related performance obligations are similar for its customers and the sales process for all customers start upon the receipt of requisition forms from the customers for patient diagnostic testing and the execution of contracts for biomarker testing and clinical research. Payment terms for the services provided are 30 days, unless separately negotiated.

Diagnostic testing

Control of the laboratory testing services is transferred to the customer at a point in time. As such, the Company recognizes revenue for laboratory testing services at a point in time based on the delivery method (web-portal access or fax) for the patient's laboratory report, per the contract.

Clinical research grants

Control of the clinical research services are transferred to the customer over time. The Company will recognize revenue utilizing the "effort based" method, measuring its progress toward complete satisfaction of the performance obligation.

Biomarker testing and clinical project services

Control of the biomarker testing and clinical project services are transferred to the customer over time. The Company utilizes an "effort based" method of assessing performance and measures progress towards satisfaction of the performance obligation based upon the delivery of results.

The Company generates revenue from the provision of diagnostic testing provided to patients, biomarker testing provided to bio-pharma customers and clinical research grants funded by both bio-pharma customers and government health programs.

Disaggregation of Revenues by Transaction Type

We operate in one business segment and, therefore, the results of our operations are reported on a consolidated basis for purposes of segment reporting, consistent with internal management reporting. Revenues, net of contractual allowances and adjustments for the three and six months ended June 30, 2018 and 2017 were as follows (prior-period amounts are not adjusted under the modified-retrospective method of adoption):

(dollars in thousands)	For the Three Months Ended June 30,					
	Diagnostic Testing		Biomarker Testing		Total	
	2018	2017	2018	2017	2018	2017
Medicaid	\$ 11	\$ 8	\$ -	\$ -	\$ 11	\$ 8
Medicare	281	131	-	-	281	131
Self-pay	20	34	-	-	20	34
Third party payers	219	143	-	-	219	143
Contract diagnostics	-	-	368	-	368	-
Revenues, net of contractual allowances	<u>\$ 531</u>	<u>\$ 316</u>	<u>\$ 368</u>	<u>\$ -</u>	<u>\$ 899</u>	<u>\$ 316</u>

(dollars in thousands)	For the Six Months Ended June 30,					
	Diagnostic Testing		Biomarker Testing		Total	
	2018	2017	2018	2017	2018	2017
Medicaid	\$ 23	\$ 20	\$ -	\$ -	\$ 23	\$ 20
Medicare	415	289	-	-	415	289
Self-pay	46	54	-	-	46	54
Third party payers	350	256	-	-	350	256
Contract diagnostics	-	-	856	-	856	-
Revenues, net of contractual allowances	<u>\$ 834</u>	<u>\$ 619</u>	<u>\$ 856</u>	<u>\$ -</u>	<u>\$ 1,690</u>	<u>\$ 619</u>

Revenue from the Medicare and Medicaid programs account for a portion of the Company's patient diagnostic service revenue. Laws and regulations governing those programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Revenue Recognition

Revenue is recognized when a customer obtains control of promised goods or services, in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. To the extent the transaction price includes variable consideration, the Company estimates the amount of variable consideration that should be included in the transaction price using the expected value method based on historical experience. The Company does not typically enter arrangements where multiple contracts can be combined as the terms regarding services are generally found within a single agreement/requisition form. The Company derives its revenues from three types of transactions: diagnostic testing, clinical research grants from state and federal research programs, and other revenues from the Company's ICP technology and bio-pharma projects encompassing genetic diagnostics.

Deferred revenue

Deferred revenue, or unearned revenue, refers to advance payments for products or services that are to be delivered in the future. The Company records such prepayment of unearned revenue as a liability, as revenue that has not yet been earned, but represents products or services that are owed to a customer. As the product or service is

delivered over time, the Company recognizes the appropriate amount of revenue from deferred revenue. For the period ended June 30, 2018 and December 31, 2017, the deferred revenue was \$116,000 and \$66,000, respectively.

Contractual Allowances and Adjustments

We are reimbursed by payors for services we provide. Payments for services covered by payors average less than billed charges. We monitor revenue and receivables from payors and record an estimated contractual allowance for certain revenue and receivable balances as of the revenue recognition date to properly account for anticipated differences between amounts estimated in our billing system and amounts ultimately reimbursed by payors. Accordingly, the total revenue and receivables reported in our financial statements are recorded at the amounts expected to be received from these payors. For service revenue, the contractual allowance is estimated based on several criteria, including unbilled claims, historical trends based on actual claims paid, current contract and reimbursement terms and changes in customer base and payor/product mix. The billing functions for the remaining portion of our revenue are contracted and fixed fees for specific services and are recorded without an allowance for contractual discounts. The following table presents our revenues initially recognized for each associated payor class during the three and six months ended June 30, 2018 and 2017.

	For the Three Months Ended June 30,					
	Gross Revenues		Contractual Allowances and adjustments		Revenues, net of Contractual Allowances and adjustments	
	2018	2017	2018	2017	2018	2017
Medicaid	\$ 26	\$ 41	\$ (15)	\$ (33)	\$ 11	\$ 8
Medicare	292	128	(11)	3	281	131
Self-pay	20	58	-	(24)	20	34
Third party payers	531	300	(312)	(157)	219	143
Contract diagnostics	368	-	-	-	368	-
	1,237	527	(338)	(211)	899	316
Clinical research grants and other	60	-	-	-	60	-
	<u>\$ 1,297</u>	<u>\$ 527</u>	<u>\$ (338)</u>	<u>\$ (211)</u>	<u>\$ 959</u>	<u>\$ 316</u>

	For the Six Months Ended June 30,					
	Gross Revenues		Contractual Allowances and adjustments		Revenues, net of Contractual Allowances and adjustments	
	2018	2017	2018	2017	2018	2017
Medicaid	\$ 41	\$ 65	\$ (18)	\$ (45)	\$ 23	\$ 20
Medicare	429	294	(14)	(5)	415	289
Self-pay	46	78	-	(24)	46	54
Third party payers	848	595	(498)	(339)	350	256
Contract diagnostics	856	-	-	-	856	-
	2,220	1,032	(530)	(413)	1,690	619
Clinical research grants and other	65	-	-	-	65	-
	<u>\$ 2,285</u>	<u>\$ 1,032</u>	<u>\$ (530)</u>	<u>\$ (413)</u>	<u>\$ 1,755</u>	<u>\$ 619</u>

Allowance for Doubtful Accounts

The Company provides for a general allowance for collectability of services when recording net sales. The Company has adopted the policy of recognizing net sales to the extent it expects to collect that amount. Reference FASB 954-605-45-5 and ASU 2011-07, Health Care Entities: Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debt, and the Allowance for Doubtful Accounts. The change in the allowance for doubtful accounts is directly related to the increase in patient service revenues. The following table presents our reported revenues net of the collection allowance and adjustments for the three and six months ended June 30, 2018 and 2017.

(dollars in thousands)	For the Three Months Ended June 30,					
	Revenues, net of Contractual Allowances and adjustments		Allowances for doubtful accounts		Total	
	2018	2017	2018	2017	2018	2017
Medicaid	\$ 11	\$ 8	\$ (12)	\$ (2)	\$ (1)	\$ 6
Medicare	281	131	(42)	(23)	239	108
Self-pay	20	34	-	(6)	20	28
Third party payers	219	143	(88)	(25)	131	118
Contract diagnostics	368	-	-	-	368	-
	899	316	(142)	(56)	757	260
Clinical research grants and other	60	-	-	-	60	-
	<u>\$ 959</u>	<u>\$ 316</u>	<u>\$ (142)</u>	<u>\$ (56)</u>	<u>\$ 817</u>	<u>\$ 260</u>

(dollars in thousands)	For the Six Months Ended June 30,					
	Revenues, net of					
	Contractual Allowances and adjustments		Allowances for doubtful accounts		Total	
	2018	2017	2018	2017	2018	2017
Medicaid	\$ 23	\$ 20	\$ (23)	\$ (4)	\$ -	\$ 16
Medicare	415	289	(62)	(53)	353	236
Self-pay	46	54	-	(10)	46	44
Third party payers	350	256	(141)	(44)	209	212
Contract diagnostics	856	-	-	-	856	-
	1,690	619	(226)	(111)	1,464	508
Clinical research grants and other	65	-	-	-	65	-
	<u>\$ 1,755</u>	<u>\$ 619</u>	<u>\$ (226)</u>	<u>\$ (111)</u>	<u>\$ 1,529</u>	<u>\$ 508</u>

Costs to Obtain or Fulfill a Customer Contract

Sales commissions are expensed when incurred because the amortization period would have been one year or less. These costs are recorded in operating expenses in the condensed consolidated statements of operations.

Shipping and handling costs are comprised of inbound and outbound freight and associated labor. The Company accounts for shipping and handling activities related to contracts with customers as fulfillment costs which are included in cost of sales in the condensed consolidated statements of operations.

Accounts Receivable

The Company has provided an allowance for potential credit losses, which has been determined based on management's industry experience. The Company grants credit without collateral to its patients, most of who are insured under third party payer agreements.

The following summarizes the mix of receivables:

	June 30, 2018	December 31, 2017
Medicaid	\$ 37	\$ 37
Medicare	774	256
Self-pay	103	53
Third party payers	797	1,066
Contract diagnostic services	392	445
Other	-	-
	<u>\$ 2,103</u>	<u>\$ 1,857</u>
Less allowance for doubtful accounts	(1,351)	(1,127)
Accounts receivable, net	<u>\$ 752</u>	<u>\$ 730</u>

The following table presents the roll-forward of the allowance for doubtful accounts for the six months ended June 30, 2018.

(dollars in thousands)	Allowance for Doubtful Accounts
Balance, January 1, 2018	\$ (1,127)
Collection Allowance:	
Medicaid	\$ (23)

Medicare	(62)	
Third party payers	<u>(141)</u>	
Service revenue, net	(226)	
Bad debt expense	<u>\$ 2</u>	
Total charges		(224)
Balance, June 30, 2018		<u>\$ (1,351)</u>

12. SUBSEQUENT EVENTS

Issuance of Convertible Notes

On July 11, 2018, the Company closed on a second round of notes pursuant to the 2018 Note Agreement. This closing provided the Company with \$348,099 of proceeds for the issuance of notes with an aggregate principal of \$382,526. The notes are payable by the Company on the earlier of (i) the one year anniversary after the initial closing date or (ii) upon the closing of a qualified offering, namely the Company raising gross proceeds of at least \$7,000,000. The obligations under the notes are secured, subject to certain exceptions and other permitted payments by a perfected security interest on the assets of the Company. As part of this closing, the Company issued to the investors 765,052 warrants to purchase shares of common stock of the Company with an exercise price of \$0.75. Half of these warrants have a five-year term and half have a one-year term.

Registration Withdrawal Request

On August 10, 2018, the Company filed with the SEC, on Form RW, to withdraw the S-1 Registration Statement initially filed with the SEC on April 16, 2018 because the Company is seeking to re-negotiate the terms of the 2018 Purchase Agreement in order to comply with the requirements of the SEC pursuant to a letter from the SEC dated August 7, 2018. Accordingly, as of the date of issuance of this form 10-Q, the Company is awaiting an order from the SEC granting withdrawal of the S-1 Registration Statement.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Information

This Quarterly Report on Form 10-Q, including this Management’s Discussion and Analysis, contains forward-looking statements. These statements are based on management’s current views, assumptions or beliefs of future events and financial performance and are subject to uncertainty and changes in circumstances. Readers of this report should understand that these statements are not guarantees of performance or results. Many factors could affect our actual financial results and cause them to vary materially from the expectations contained in the forward-looking statements. These factors include, among other things: our expected revenue, income (loss), receivables, operating expenses, supplier pricing, availability and prices of raw materials, insurance reimbursements, product pricing, sources of funding operations and acquisitions, our ability to raise funds, sufficiency of available liquidity, future interest costs, future economic circumstances, business strategy, industry conditions, our ability to execute our operating plans, the success of our cost savings initiatives, competitive environment and related market conditions, expected financial and other benefits from our organizational restructuring activities, actions of governments and regulatory factors affecting our business, retaining key employees and other risks as described in our reports filed with the Securities and Exchange Commission. In some cases these statements are identifiable through the use of words such as “anticipate,” “believe,” “estimate,” “expect,” “intend,” “plan,” “project,” “target,” “can,” “could,” “may,” “should,” “will,” “would” or the negative versions of these terms and other similar expressions.

You are cautioned not to place undue reliance on these forward-looking statements. The forward-looking statements we make are not guarantees of future performance and are subject to various assumptions, risks and other factors that could cause actual results to differ materially from those suggested by these forward-looking statements. Actual results may differ materially from those suggested by the forward-looking statements that we make for a number of reasons, including those described in Part II, Item 1A, “Risk Factors,” of this Quarterly Report on Form 10-Q and our prior filings with the Securities and Exchange Commission.

We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

The following discussion should be read together with our financial statements and related notes contained in this Quarterly Report on Form 10-Q and with the financial statements, related notes and Management's Discussion and Analysis included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, which we filed with the Securities and Exchange Commission on April 13, 2018. Results for the three and six months ended June 30, 2018 are not necessarily indicative of results that may be attained in the future.

Overview

Precipio, Inc., and Subsidiary, (“we”, “us”, “our”, the “Company” or “Precipio”) is a cancer diagnostics company providing diagnostic products and services to the oncology market. We have built and continue to develop a platform designed to eradicate the problem of misdiagnosis by harnessing the intellect, expertise and technology developed within academic institutions and delivering quality diagnostic information to physicians and their patients worldwide. We operate a cancer diagnostic laboratory located in New Haven, Connecticut and have partnered with the Yale School of Medicine to capture the expertise, experience and technologies developed within academia so that we can provide a better standard of cancer diagnostics and solve the growing problem of cancer misdiagnosis. We also operate a research and development facility in Omaha, Nebraska which will focus on further development of ICE-COLD-PCR, or ICP, the patented technology which was exclusively licensed by us from Dana-Farber Cancer Institute, Inc., or Dana-Farber, at Harvard University. The research and development center will focus on the development of this technology, which we believe will enable us to commercialize other technologies developed by our current and future academic partners. Our platform connects patients, physicians and diagnostic experts residing within academic institutions.

Recent Developments

During the second quarter of 2018, we continued the development of ICP. Our ICP sales growth plan remains focused on hospitals, large contract research organizations (CRO), OEM’s and national scale labs. In June 2018, we announced that we had eight ICP trials underway with three reference laboratories, one hospital laboratory, two CRO’s and two diagnostic equipment companies. We also have agreements for twelve additional ICP kit trials in the third quarter of 2018.

Going Concern

The condensed consolidated financial statements have been prepared using accounting principles generally accepted in the United States of America (“GAAP”) applicable for a going concern, which assume that the Company will realize its assets and discharge its liabilities in the ordinary course of business. The Company has incurred substantial operating losses and has used cash in its operating activities for the past several years. As of June 30, 2018, the Company had a net loss of \$5.3 million, negative working capital of \$8.1 million and net cash used in operating activities of \$3.6 million. The Company’s ability to continue as a going concern over the next twelve months from the date of issuance of this form 10-Q is dependent upon a combination of achieving its business plan, including generating additional revenue, and raising additional financing to meet its debt obligations and paying liabilities arising from normal business operations when they come due.

Notwithstanding the aforementioned circumstances, there remains substantial doubt about the Company’s ability to continue as a going concern over the next twelve months from the date of issuance of this form 10-Q. There can be no assurance that the Company will be able to successfully achieve its initiatives summarized above in order to continue as a going concern over the next twelve months from the date of issuance of the form 10-Q. The accompanying financial statements have been prepared assuming the Company will continue as a going concern and do not include any adjustments that might result should the Company be unable to continue as a going concern as a result of the outcome of this uncertainty.

Results of Operations for the Three Months Ended June 30, 2018 and 2017

Net Sales. Net sales were as follows:

Dollars in Thousands			
Three Months Ended		Change	
June 30,		\$	%
2018	2017		

Service revenue, net	\$	757	\$	260	\$	497	191%
Clinical research grants		62		-		62	-
Other		(2)		-		(2)	-
Net Sales		<u>817</u>		<u>260</u>		<u>557</u>	<u>214%</u>

Net sales for the three months ended June 30, 2018 were \$0.8 million, an increase of \$0.6 million, or 214%, as compared to the same period in 2017. This increase was a result of increases in contract diagnostic service revenue, patient diagnostic service revenue and clinical research grants. Contract diagnostic service revenue increased as a result of the Merger and was \$0.4 million and zero for the three months ended June 30, 2018 and 2017, respectively. Patient diagnostic service revenue had an increase of \$0.1 million for the three months ended June 30, 2018 as compared to the same period in 2017 due to an increase in cases processed. We processed 383 cases during the three months ended June 30, 2018 as compared to 230 cases during the same period in 2017, or a 67% increase in cases. The increase in volume is the result of increased sales personnel in the second quarter of 2018 as compared to 2017. Grant revenue increased by approximately \$0.1 million. There was one grant program that had revenue recognition during the three months ended June 30, 2018 and none during the three months ended June 30, 2017.

Cost of Sales. Cost of sales includes material and supply costs for the patient tests performed and other direct costs (primarily personnel costs and rent) associated with the operations of our laboratory and the costs of projects related to clinical research grants (personnel costs and operating supplies). Cost of sales increased by \$0.4 million for the three months ended June 30, 2018 as compared to the same period in 2017. The increase is due to increased biomarker subcontracted processing fees, increased professional medical fees involved with the processing of patient tests, increased operating supplies in our diagnostic laboratory and increased costs related to clinical research grants. These increases were mainly a result of the increased revenues discussed above.

Gross Profit. Gross profit and gross margins were as follows:

	Dollars in Thousands			
	Three Months Ended		Margin %	
	June 30,			
	2018	2017	2018	2017
Gross Profit	\$ 175	\$ (24)	21%	(9)%

Gross margin was 21% of total net sales, for the three months ended June 30, 2018, compared to a negative 9% of total net sales for the same period in 2017. The gross profit increased by \$0.2 million during the three months ended June 30, 2018 as compared to the same period in 2017 and was due to the increased revenues during the current year.

Operating Expenses. Operating expenses primarily consist of personnel costs, professional fees, travel costs, facility costs and depreciation and amortization. Our operating expenses increased by \$1.6 million to \$2.4 million for the three months ended June 30, 2018 as compared to the same period in 2017. This increase is impacted by the Merger and other costs associated with operating as a public company which did not exist in the second quarter of 2017. The increase in operating expenses reflects increased personnel costs of \$0.5 million associated with increased headcount, increased expenses of \$0.3 million related to professional fees and other costs associated with operating as a public company, increased amortization of \$0.3 million related to acquired intangibles from the Merger, increased taxes and insurances of \$0.2 million, increased stock compensation costs of \$0.1 and increased other costs of \$0.2 million.

Other Income (Expense). Other expense for the three months ended June 30, 2018 and 2017 included interest expense of \$0.1 million and \$0.2 million, respectively. Other expense for the three months ended June 30, 2018 and 2017, also included \$0.3 million of income and \$3,000 of expense, respectively, for the change in fair value of common stock warrant liabilities. The current year three month period also included an expense of \$0.9 million related to a loss on issuance of convertible notes which resulted from debt discounts that were recorded in excess of the face value of the related debt. In the prior year, during the three months ended June 30, 2017, we had \$2.6 million of advisory fees related to the Merger and we had no such charges during the three months ended June 30, 2018.

Results of Operations for the Six Months Ended June 30, 2018 and 2017

Net Sales. Net sales were as follows:

	Dollars in Thousands			
	Six Months Ended		Change	
	June 30,		\$	%
	2018	2017		
Service revenue, net	\$ 1,464	\$ 508	\$ 956	188%
Clinical research grants	62	-	62	-
Other	3	-	3	-
Net Sales	<u>1,529</u>	<u>508</u>	<u>1,021</u>	<u>201%</u>

Net sales for the six months ended June 30, 2018 were \$1.5 million, an increase of \$1.0 million, or 201%, as compared to the same period in 2017. This increase was a result of increases in contract diagnostic service revenue, patient diagnostic service revenue and clinical research grants. Contract diagnostic service revenue increased as a result of the Merger and was \$0.9 million and zero for the six months ended June 30, 2018 and 2017, respectively. Patient diagnostic service revenue had an increase of \$0.1 million for the six months ended June 30, 2018 as compared to the same period in 2017 due to an increase in cases processed. We processed 523 cases during the six months ended June 30, 2018 as compared to 429 cases during the same period in 2017, or a 22% increase in cases. The increase in volume is the result of increased sales personnel in the second quarter of 2018 as compared to 2017. Grant revenue increased by approximately \$0.1 million. There was one grant program that had revenue recognition during the six months ended June 30, 2018 and none during the six months ended June 30, 2017.

Cost of Sales. Cost of sales includes material and supply costs for the patient tests performed and other direct costs (primarily personnel costs and rent) associated with the operations of our laboratory and the costs of projects related to clinical research grants (personnel costs and operating supplies). Cost of sales increased by \$0.9 million for the six months ended June 30, 2018 as compared to the same period in 2017. The increase is due to increased biomarker subcontracted processing fees, increased professional medical fees involved with the processing of patient tests, increased operating supplies in our diagnostic laboratory and increased costs related to clinical research grants. These increases were mainly a result of the increased revenues discussed above.

Gross Profit. Gross profit and gross margins were as follows:

	Dollars in Thousands			
	Six Months Ended		Margin %	
	June 30,			
	2018	2017	2018	2017
Gross Profit	\$ 199	\$ 42	13%	8%

Gross margin was 13% of total net sales, for the six months ended June 30, 2018, compared to 8% of total net sales for the same period in 2017. The gross profit increased by \$0.1 million during the six months ended June 30, 2018 as compared to the same period in 2017 and was due to the increased revenues during the current year.

Operating Expenses. Operating expenses primarily consist of personnel costs, professional fees, travel costs, facility costs and depreciation and amortization. Our operating expenses increased by \$3.4 million to \$4.8 million for the six months ended June 30, 2018 as compared to the same period in 2017. This increase is impacted by the Merger and other costs associated with operating as a public company which did not exist in the second quarter of 2017. The increase in operating expenses reflects increased personnel costs of \$0.8 million associated with increased headcount, increased expenses of \$0.9 million related to professional fees and other costs associated with operating as a public company, increased amortization of \$0.6 million related to acquired intangibles from the Merger, increased taxes and insurances of \$0.3 million, increased stock compensation costs of \$0.2 and increased other costs of \$0.3 million. During the six months ended June 30, 2018, we also recorded a \$0.3 million charge for goodwill impairment.

Other Income (Expense). Other expense for the six months ended June 30, 2018 and 2017 includes interest expense of \$0.1 million and \$0.4 million, respectively. Other expense for the six months ended June 30, 2018 and 2017, also included \$0.6 million of income and \$3,000 of expense, respectively, for the change in fair value of common stock warrant liabilities. During the six months ended June 30, 2018, we also had income from gains on settlements of certain vendor liabilities of \$0.1 million, a loss on settlement of equity instruments of \$0.4 million and an expense of \$0.9 million related to a loss on issuance of convertible notes.

Liquidity and Capital Resources

Our working capital positions were as follows:

	Dollars in Thousands		
	June 30, 2018	December 31, 2017	Change
Current assets (including cash of \$71 and \$421 respectively)	\$ 1,158	\$ 1,742	\$ (584)
Current liabilities	9,282	10,036	(754)
Working capital	<u>\$ (8,124)</u>	<u>\$ (8,294)</u>	<u>\$ 170</u>

During the first quarter of 2018 we received gross proceeds of \$400,000 when we entered into an agreement with the Connecticut Department of Economic and Community Development by which we received a grant of \$100,000 and a loan of \$300,000 with a payment term of ten years and we entered into an equity purchase agreement for the purchase of up to \$8,000,000 of shares of our common stock from time to time, at our option. The initial sale of 721,153 shares of our common stock resulted in net proceeds to us of approximately \$618,000.

In April 2018, we received gross proceeds of approximately \$1.7 million through the issuance of convertible notes and during the six months ended June 30, 2018 we also received approximately \$1.1 million from the exercise of warrants.

Analysis of Cash Flows – Six Months Ended June 30, 2018 and 2017

Net Change in Cash. Cash decreased by \$0.4 million during the six months ended June 30, 2018, compared to an increase of \$0.9 million during the six months ended June 30, 2017.

Cash Flows Used in Operating Activities. The cash flows used in operating activities of approximately \$3.6 million during the six months ended June 30, 2018 included a net loss of \$5.3 million, an increase in accounts receivable of \$0.2 million and a decrease in accrued expenses and other liabilities of \$0.3 million. These were partially offset by a decrease in other assets of \$0.2 million and non-cash adjustments of \$2.0 million. The cash flows used in operating activities in the six months ended June 30, 2017 included the net loss of \$4.4 million and an increase in accounts receivable of \$0.1 million. These were partially offset by an increase in accounts payable, accrued expenses and other liabilities of \$0.8 million and non-cash adjustments of \$2.9 million.

Cash Flows Used In Investing Activities. Cash flows used in investing activities were \$0.1 million for the six months ended June 30, 2018, resulting from purchases of property and equipment. Cash flows provided by investing activities were \$0.1 million for the six months ended June 30, 2017 and was cash acquired as part of the merger transaction.

Cash Flows Provided by Financing Activities. Cash flows provided by financing activities totaled \$3.3 million for the six months ended June 30, 2018, which included proceeds of \$0.6 million from the issuance of common stock, \$0.3 million from the issuance of long-term debt, \$1.7 million from the issuance of convertible notes and \$1.1 million from the exercise of warrants. These proceeds were partially offset by payments on our long-term debt of \$0.2 million and payments for our capital lease obligations and deferred financing costs of \$0.2 million. Cash flows provided by financing activities during the six months ended June 30, 2017 included proceeds of \$1.7 million from the issuance of long-term debt and convertible notes, and \$0.4 million from the issuance of preferred stock. These were partially offset by \$0.4 million of payments on our debt and capital lease obligations.

Off-Balance Sheet Arrangements

At each of June 30, 2018 and December 31, 2017, we did not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Contractual Obligations and Commitments

No significant changes to contractual obligations and commitments occurred during the six months ended June 30, 2018, as compared to those disclosed in our Annual Report on form 10-K for the fiscal year ended December 31, 2017, filed with the Securities and Exchange Commission on April 13, 2018.

Critical Accounting Policies and Estimates

Accounting policies used in the preparation of our financial statements may involve the use of management judgments and estimates. Certain of our accounting policies are considered critical as they are both important to the portrayal of our financial statements and require significant or complex judgments on the part of management. Our judgments and estimates are based on experience and assumptions that we believe are reasonable under the circumstances. Further, we evaluate our judgments and estimates from time to time as circumstances change. Actual financial results based on judgments or estimates may vary under different assumptions or circumstances. Our critical accounting policies are discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the Securities and Exchange Commission on April 13, 2018.

Recently Issued Accounting Pronouncements

See the accompanying unaudited condensed consolidated financial statements and Note 2 - “Summary of Significant Accounting Policies” in the Notes to unaudited condensed financial statements for additional information regarding recently issued accounting pronouncements.

Impact of Inflation

We do not believe that price inflation or deflation had a material adverse effect on our financial condition or results of operations during the periods presented.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

We are a smaller reporting company, as defined by Rule 12b-2 of the Securities Exchange Act of 1934, as amended, and are not required to provide the information required under this item.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, management performed, with the participation of our Chief Executive Officer and Chief Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (the “SEC”), and that such information is accumulated and communicated to management including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and no evaluation of controls and procedures can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2018.

Changes in Internal Control over Financial Reporting

We have evaluated the changes in our internal control over financial reporting that occurred during the six months ended June 30, 2018 and concluded that there have not been any changes that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. On January 1, 2018, we adopted ASC 606 by using the modified-retrospective method. An adjustment was not required and a change to the prior revenue recognition process and policy to adopt the new standard was not necessary.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See the accompanying unaudited condensed consolidated financial statements and Note 6 - “Contingencies” in the Notes to unaudited condensed consolidated financial statements for additional information regarding legal proceedings.

Item 1A. Risk Factors

As disclosed in “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017, there are a number of risks and uncertainties that may have a material effect on the operating results of our business and our financial condition. The following information updates, and should be read in conjunction with, the factors discussed in Part I, Item 1A, “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017, which could materially affect our business, financial condition or future results. The risks described in this Quarterly Report and our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or operating results.

We have incurred losses since our inception and expect to incur losses for the foreseeable future. We cannot be certain that we will achieve or sustain profitability.

We have incurred losses since our inception and expect to incur losses in the future. As of June 30, 2018, we had a net loss of \$5.3 million, negative working capital of \$8.1 million and net cash used in operating activities of

\$3.6 million. To date, we have experienced negative cash flow from development of our diagnostic technology, as well as from the costs associated with establishing a laboratory and building a sales force to market our products and services. We expect to incur substantial net losses for the foreseeable future to further develop and commercialize our diagnostic technology. We also expect that our selling, general and administrative expenses will continue to increase due to the additional costs associated with market development activities and expanding our staff to sell and support our products. Our ability to achieve or, if achieved, sustain profitability is based on numerous factors, many of which are beyond our control, including the market acceptance of our products, competitive product development and our market penetration and margins. We may never be able to generate sufficient revenue to achieve or, if achieved, sustain profitability.

Because of the numerous risks and uncertainties associated with further development and commercialization of our diagnostic technology and any future tests, we are unable to predict the extent of any future losses or when we will become profitable, if ever. We may never become profitable and you may never receive a return on an investment in our securities. An investor in our securities must carefully consider the substantial challenges, risks and uncertainties inherent in the development and commercialization of tests in the medical diagnostic industry. We may never successfully commercialize our diagnostic technology or any future tests, and our business may fail.

We will need to raise substantial additional capital to commercialize our diagnostic technology, and our failure to obtain funding when needed may force us to delay, reduce or eliminate our product development programs or collaboration efforts or force us to restrict or cease operations.

As of June 30, 2018, our cash balance was \$0.1 million and our working capital was approximately negative \$8.1 million. Due to our recurring losses from operations and the expectation that we will continue to incur losses in the future, we will be required to raise additional capital to complete the development and commercialization of our current product candidates and to pay off our obligations. To date, to fund our operations and develop and commercialize our products, we have relied primarily on equity and debt financings. When we seek additional capital, we may seek to sell additional equity and/or debt securities or to obtain a credit facility, which we may not be able to do on favorable terms, or at all. Our ability to obtain additional financing will be subject to a number of factors, including market conditions, our operating performance and investor sentiment. If we are unable to raise additional capital when required or on acceptable terms, we may have to significantly delay, scale back or discontinue the development and/or commercialization of one or more of our product candidates, restrict or cease our operations or obtain funds by entering into agreements on unattractive terms.

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

None.

Item 6. Exhibits

(a) Exhibits

- [10.1 Form of 8% Senior Secured Convertible Promissory Note, dated April 20, 2018 \(incorporated by reference to Exhibit 10.1 of the Company's Form 8-K filed on April 23, 2018\).](#)
- [10.2 Form of Warrant to Purchase Common Stock dated April 20, 2018 \(incorporated by reference to Exhibit 10.2 of the Company's Form 8-K filed on April 23, 2018\).](#)
- [10.3 Form of Security Agreement by and among the Company and the investors named therein, dated April 20, 2018 \(incorporated by reference to Exhibit 10.3 of the Company's Form 8-K filed on April 23, 2018\).](#)
- [10.4 Form of Securities Purchase Agreement by and among the Company and the Purchasers named therein, dated April 20, 2018 \(incorporated by reference to Exhibit 10.4 of the Company's Form 8-K filed on April 23, 2018\).](#)
- [10.5 Form of Letter Agreement by and among the Company and Alliance Global Partners, dated April 20, 2018 \(incorporated by reference to Exhibit 10.5 of the Company's Form 8-K filed on April 23, 2018\).](#)
- [31.1* Certification of Principal Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended.](#)
- [31.2** Certification of Principal Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended.](#)
- [32.1** Certification of Principal Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended.](#)
- [32.2** Certification of Principal Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended.](#)

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

* Filed herewith
** Furnished herewith

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.

PRECIPIO, INC.

Date: August 16, 2018

By: /S/ ILAN DANIELI
 Ilan Danieli
 *Chief Executive Officer (Principal Executive
 Officer)*

Date: August 16, 2018

By: /S/ CARL IBERGER
 Carl Iberger
 *Chief Financial Officer (Principal Financial
 Officer)*