
**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 September 30, 2017

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)

91-1789357

(I.R.S. Employer
Identification No.)

4 Science Park, New Haven, CT

(Address of principal executive offices)

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

Accelerated filer

(Do not check if a smaller reporting

Non-accelerated filer

company)

Smaller reporting company

Emerging growth
company

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 November 9, 2017, the number of shares of common stock outstanding was 10,028,763.

PRECIPIO, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

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

| | September 30, 2017 (unaudited) | December 31, 2016 |
|--|--------------------------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 381 | \$ 51 |
| Accounts receivable, net | 505 | 388 |
| Inventories | 99 | 100 |
| Other current assets | 127 | 13 |
| Total current assets | <u>1,112</u> | <u>552</u> |
| PROPERTY AND EQUIPMENT, NET | 255 | 280 |
| OTHER ASSETS: | | |
| Goodwill | 12,817 | — |
| Intangibles, net | 20,779 | — |
| Other assets | 14 | 10 |
| | <u>\$ 34,977</u> | <u>\$ 842</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | | |
| CURRENT LIABILITIES: | | |
| Current maturities of long-term debt | \$ 42 | \$ 395 |
| Convertible bridge notes, less debt discounts and debt issuance costs | — | 695 |
| Accounts payable | 10,034 | 1,084 |
| Current maturities of capital leases | 49 | 46 |
| Accrued expenses | 1,872 | 700 |
| Deferred revenue | 210 | 92 |
| Other current liabilities | 1,528 | — |
| Total current liabilities | <u>13,735</u> | <u>3,012</u> |
| LONG TERM LIABILITIES: | | |
| Long-term debt, less current maturities and discounts | — | 4,127 |
| Common stock warrant liability | 618 | — |
| Capital leases, less current maturities | 126 | 163 |
| Other long-term liabilities | 92 | — |
| Total liabilities | <u>14,571</u> | <u>7,302</u> |
| STOCKHOLDERS' EQUITY (DEFICIT): | | |
| Preferred stock - \$0.01 par value, 15,000,000 and 1,294,434 shares authorized at September 30, 2017 and December 31, 2016, respectively, 3,641 and 780,105 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively | — | 8 |
| Common stock, \$0.01 par value, 150,000,000 and 1,806,850 shares authorized at September 30, 2017 and December 31, 2016, respectively, 9,446,878 and 449,175 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively | 94 | 4 |
| Additional paid-in capital | 41,879 | 4,376 |
| Accumulated deficit | <u>(21,567)</u> | <u>(10,848)</u> |

Total stockholders' equity (deficit)

20,406

(6,460)

\$ 34,977

\$ 842

See notes to unaudited condensed consolidated financial statements.

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

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-----------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| SALES | | | | |
| Patient service revenue, net | \$ 327 | \$ 445 | \$ 946 | \$ 1,716 |
| less provision for bad debts | (57) | (80) | (168) | (309) |
| Net sales | 270 | 365 | 778 | 1,407 |
| COST OF DIAGNOSTIC SERVICES | 347 | 231 | 813 | 710 |
| Gross profit (loss) | (77) | 134 | (35) | 697 |
| OPERATING EXPENSES: | | | | |
| Operating expenses | 2,541 | 497 | 3,981 | 1,573 |
| Impairment of goodwill | 1,015 | — | 1,015 | — |
| TOTAL OPERATING EXPENSES | 3,556 | 497 | 4,996 | 1,573 |
| OPERATING LOSS | (3,633) | (363) | (5,031) | (876) |
| OTHER INCOME (EXPENSE): | | | | |
| Interest expense, net | (1,883) | (136) | (2,265) | (378) |
| Warrant revaluation | — | — | (3) | — |
| Loss on extinguishment of debt and induced conversion of convertible bridge notes | (1,338) | — | (1,391) | — |
| Gain on settlement of liability | 647 | — | 647 | — |
| Merger advisory fees | (73) | — | (2,676) | — |
| Other, net | — | — | — | 3 |
| | (2,647) | (136) | (5,688) | (375) |
| LOSS BEFORE INCOME TAXES | (6,280) | (499) | (10,719) | (1,251) |
| INCOME TAX EXPENSE | — | — | — | — |
| NET LOSS | (6,280) | (499) | (10,719) | (1,251) |
| DEEMED DIVIDENDS ON ISSUANCE OR EXCHANGE OF PREFERRED UNITS | (3,764) | — | (9,012) | (1,422) |
| PREFERRED DIVIDENDS | (84) | — | (84) | (433) |
| TOTAL DIVIDENDS | (3,848) | — | (9,096) | (1,855) |
| NET LOSS AVAILABLE TO COMMON STOCKHOLDERS | \$ (10,128) | \$ (499) | \$ (19,815) | \$ (3,106) |
| BASIC AND DILUTED LOSS PER COMMON SHARE | \$ (1.36) | \$ (1.15) | \$ (6.96) | \$ (7.23) |
| BASIC AND DILUTED WEIGHTED-AVERAGE SHARES OF COMMON STOCK OUTSTANDING | 7,430,741 | 435,060 | 2,846,221 | 429,851 |

See notes to unaudited condensed consolidated financial statements.

| | | | | | | | |
|--|-------|------|-----------|-------|-----------|-------------|-----------|
| compensation and vesting of restricted units | | | 64,593 | 1 | 40 | — | 41 |
| Balance, September 30, 2017 | 3,641 | \$ — | 9,446,878 | \$ 94 | \$ 41,879 | \$ (21,567) | \$ 20,406 |

See notes to unaudited condensed consolidated financial statements.

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

| | Nine Months Ended September 30, | |
|---|------------------------------------|--------------|
| | 2017 | 2016 |
| CASH FLOWS USED IN OPERATING ACTIVITIES: | | |
| Net loss | \$ (10,719) | \$ (1,251) |
| Adjustments to reconcile net loss to net cash flows used in operating activities: | | |
| Depreciation and amortization | 395 | 99 |
| Amortization of deferred financing costs and debt discount | 1,898 | 31 |
| Loss on extinguishment of debt and induced conversion of convertible bridge notes | 1,391 | — |
| Gain on settlement of liability | (647) | — |
| Stock-based compensation and change in liability of stock appreciation rights | 33 | 9 |
| Merger advisory fees | 2,676 | — |
| Impairment of goodwill | 1,015 | — |
| Provision for losses on doubtful accounts | 168 | 309 |
| Capitalized PIK interest on convertible bridge notes | — | 85 |
| Warrant revaluation | 3 | — |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (129) | (314) |
| Inventories | 15 | (12) |
| Other assets | 30 | (27) |
| Accounts payable | 484 | 58 |
| Accrued expenses and other liabilities | (1,094) | 371 |
| Net cash used in operating activities | (4,481) | (642) |
| CASH FLOWS PROVIDED BY INVESTING ACTIVITIES: | | |
| Cash acquired in business combination | 101 | — |
| Net cash provided by investing activities | 101 | — |
| CASH FLOWS PROVIDED BY FINANCING ACTIVITIES: | | |
| Principal payments on capital lease obligations | (34) | (29) |
| Issuance of preferred stock | 5,380 | — |
| Payment of deferred financing costs | (25) | (10) |
| Proceeds from exercise of warrants | 25 | — |
| Proceeds from long-term debt | 315 | 175 |
| Proceeds from convertible bridge notes | 1,365 | 455 |
| Principal payments on convertible bridge notes | (1,500) | — |
| Principal payments on long-term debt | (816) | (116) |
| Net cash flows provided by financing activities | 4,710 | 475 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 330 | (167) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 51 | 235 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 381 | \$ 68 |
| SUPPLEMENTAL CASH FLOW INFORMATION | | |
| Cash paid during the period for interest | \$ 65 | \$ 48 |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH INFORMATION | | |

| | | |
|---|-------|-------|
| Purchases of equipment financed through capital lease | — | 49 |
| Preferred unit dividend financed through exchange agreement | — | 433 |
| Convertible bridge notes exchanged for long-term debt | — | 680 |
| Series A and B preferred exchanged for long-term debt | — | 1,715 |
| Conversion of bridges loans plus interest into common stock | 1,787 | — |
| Conversion of senior and junior notes plus interest into preferred stock and common stock | 4,771 | — |

| | | |
|---|-------|---|
| Deferred debt issuance cost | 64 | — |
| Beneficial conversion feature on issuance of bridge notes | 1,856 | — |
| Accrued merger cost | 10 | — |
| Issuance of warrants in conjunction with issuance of side agreement | 487 | — |
| Purchases of equipment financed through accounts payable | 20 | — |

See notes to unaudited condensed consolidated financial statements.

PRECIPIO, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Three and Nine Months Ended September 30, 2017 and 2016

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:

PRECIPIO, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—
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Three and Nine Months Ended September 30, 2017 and 2016

- 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 (See Note 3 - Reverse Merger). In connection with the Merger, the Company changed its name from Transgenomic, Inc. to Precipio, Inc., relisted its common stock under Precipio, Inc. on the National Association of Securities Dealers Automated Quotations ("NASDAQ"), and effected a 1-for-30 reverse stock split of its common stock. 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 (the "Exchange Ratio"). See Note 3 - Reverse Merger for additional discussion of the Merger.

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 September 30, 2017, the Company had a net loss of \$10.7 million and negative working capital of \$12.6 million. The Company's ability to continue as a going concern 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.

To meet its current and future obligations the Company has taken the following steps to capitalize the business and successfully achieve its business plan:

- On October 31, 2017, the Company entered into a Debt Settlement Agreement (the “Settlement Agreement”) with certain of its accounts payable vendors (the “Creditors”) pursuant to which the Creditors agreed to a reduction of approximately \$5.0 million in currently due vendor liabilities. The Company and the Creditors agreed to restructure

PRECIPIO, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—
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Three and Nine Months Ended September 30, 2017 and 2016

these liabilities into approximately \$2.5 million in secured, long-term vendor obligations with payments beginning in July 2018 and continuing over 48 months.

- On November 7, 2017, the Company completed its capital raise initiative issuing \$2.8 million in units consisting of Series C Preferred stock and warrants to purchase common stock.

Notwithstanding the aforementioned circumstances, there remains substantial doubt about the Company's ability to continue as a going concern. 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. 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.

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 September 30, 2017 for potential recognition or disclosure in the condensed consolidated financial statements and concluded that, other than what is disclosed in Note 13 - Subsequent Events, there were no other subsequent events that required recognition or disclosure.

The condensed consolidated balance sheet as of December 31, 2016 was derived from our audited balance sheet as of that date. There has been no change in the balance sheet from December 31, 2016. The accompanying condensed consolidated financial statements as of and for the three and nine months ended September 30, 2017 and 2016 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 of Precipio Diagnostics for the year ended December 31, 2016 contained in our current report on Form 8-K/A, filed with the Securities and Exchange Commission (the "SEC") on July 31, 2017. The results of operations for the interim periods presented are not necessarily indicative of the results for fiscal year 2017.

Reclassifications.

Certain reclassifications were made to the 2016 financial statements to conform to current year financial statement presentation. These reclassifications had no effect on previously reported net earnings.

Principles of Consolidation.

The condensed consolidated financial statements include the accounts of Precipio, Inc. and our wholly owned subsidiary. All inter-company balances and transactions have been eliminated in consolidation.

Use of Estimates.

The preparation of condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of net sales and expenses during the reporting period. In addition, estimates and assumptions associated with the determination of the fair value of certain assets and related impairments require considerable judgment by management. Actual results could differ from the estimates and assumptions used in preparing these condensed consolidated financial statements.

Risks and Uncertainties.

Certain risks and uncertainties are inherent in our day-to-day operations and in the process of preparing our financial statements. The more significant of those risks are presented below and throughout the notes to the unaudited condensed consolidated financial statements.

The Company operates in the healthcare industry which 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 requirements, reimbursement for patient services, and Medicare and Medicaid fraud

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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.

Fair Value.

Unless otherwise specified, book value approximates fair value. The common stock warrant liability is recorded at fair value. See Note 11 - Fair Value for additional information.

Cash and Cash Equivalents and Other Current Assets.

Cash and cash equivalents include cash and investments with original maturities at the date of acquisition of three months or less. Other current assets as of September 30, 2017 of \$0.1 million includes prepaid assets of less than \$0.1 million and other receivables of less than \$0.1 million and consisted of primarily prepaid assets as of December 31, 2016.

Concentrations of Risk.

From time to time, we may maintain a cash position with financial institutions in amounts that exceed Federal Deposit Insurance Corporation insured limits. We have not experienced any losses on such accounts as of September 30, 2017.

Service companies in the health care industry typically grant credit without collateral to patients. The majority of these patients are insured under third-party insurance agreements. The services provided by the Company are routinely billed utilizing the Current Procedural Terminology (CPT) code set designed to communicate uniform information about medical services and procedures among physicians, coders, patients, accreditation organizations, and payers for administrative, financial, and analytical purposes. CPT codes are currently identified by the Centers for Medicare and Medicaid Services and third-party payors. The Company utilizes CPT codes for Pathology and Laboratory Services contained within codes 80000-89398.

Property and Equipment.

Depreciation expense related to property and equipment was less than \$0.1 million for both the three and nine months ended September 30, 2017 and 2016. Depreciation expense during each period 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. See Note 3 - Reverse Merger for the amounts recorded.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets of the business acquired. See Note 3 - Reverse Merger for the amount recorded. 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. In assessing goodwill for impairment, the Company has the option to assess qualitative factors to determine whether events or circumstances indicate that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, for which the consolidated Company is considered one reporting unit. If this is the case, then performing the quantitative goodwill impairment test is unnecessary. An entity can choose not to perform a qualitative assessment for any or all of its reporting units, and proceed directly to the use of the quantitative impairment test. In assessing qualitative factors to determine whether it is more likely than not that the fair value of a

reporting unit is less than its carrying amount, the relevant events and circumstances that may impact the fair value and the carrying amount of a reporting unit are assessed. The identification of relevant events and circumstances and how these may impact a reporting unit's fair value or carrying amount involve significant judgments by management. These judgments include the consideration of macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, events which are specific to the company, and trends in the market price of our common

PRECIPIO, INC. AND SUBSIDIARY
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stock. Each factor is assessed to determine whether it impacts the impairment test positively or negatively, and the magnitude of any such impact. During the three months ended September 30, 2017, the Company experienced a decline in its share price and a significant reduction in its market capitalization, as such the Company determined that an assessment of goodwill should be performed using the qualitative approach described above. 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. While there were positive qualitative factors discovered during the qualitative analysis, the instability of the market price of the Company's common stock and the decline in revenues were significant adverse factors that directed a full assessment. In estimating fair value, the Company utilized the market capitalization to estimate the fair value. The impairment test performed by the Company indicated that the estimated fair value of the Company was less than its carrying amount. As a result of the analysis performed, the Company recorded a goodwill impairment charge of \$1.0 million during the three months ended September 30, 2017.

Intangibles

We review our amortizable long-lived assets for impairment annually or whenever events indicate that the carrying amount of the asset (group) may not be recoverable. An impairment loss may be needed if the sum of the future undiscounted cash flows is less than the carrying amount of the asset (group). The amount of the loss would be determined by comparing the fair value of the asset to the carrying amount of the asset (group). There were no impairment charges during the nine months ended September 30, 2017.

In-process research and development ("IPR&D") represents the fair value assigned to research and development assets that were not fully developed at the date of the Merger. Until the IPR&D projects are completed, the assets are accounted for as indefinite-lived intangible assets and subject to impairment testing. For the nine months ended September 30, 2017, there was no impairment of IPR&D.

Stock-Based Compensation.

All stock-based awards to date have exercise prices equal to the market price of our common stock on the date of grant and have ten-year contractual terms. Unvested awards as of September 30, 2017 had vesting periods of up to four years from the date of grant. None of the awards outstanding at September 30, 2017 are subject to performance or market-based vesting conditions.

Net Sales Recognition.

Revenue is realized and earned when all of the following criteria are met:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred or services have been rendered;
- The seller's price to the buyer is fixed or determinable; and
- Collectability is reasonably assured.

In our New Haven, Connecticut laboratory, we primarily recognize revenue for services rendered upon completion of the testing process. Net patient 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.

In our Omaha, Nebraska laboratory, we perform services on a project by project basis. When we receive payment in advance, we initially defer the revenue and recognize it when we deliver the service. These projects typically do not extend beyond one year.

At each of September 30, 2017 and December 31, 2016, deferred net sales included in the balance sheet in deferred revenue were \$0.2 million and \$0.1 million, 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.

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The Company accounts for its insurance claims and related insurance recoveries at their gross values as standards for health care entities do not allow the Company to net insurance recoveries against the related claim liabilities. There were no insurance claims or insurance recoveries recorded during the three and nine months ended September 30, 2017 and 2016.

Income Taxes.

Deferred tax assets and liabilities are determined based on the differences between the financial reporting and tax basis of assets and liabilities at each balance sheet date using tax rates expected to be in effect in the year the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to the extent that it is more likely than not that they will not be realized.

Beneficial Conversion Features.

The intrinsic value of a beneficial conversion feature (“BCF”) inherent to a convertible note payable, which is not bifurcated and accounted for separately from the convertible note payable and may not be settled in cash upon conversion, is treated as a discount to the convertible note payable. This discount is amortized over the period from the date of issuance to the first conversion date using the effective interest method. If the note payable is retired prior to the end of its contractual term, the unamortized discount is expensed in the period of retirement to interest expense. In general, the BCF is measured by comparing the effective conversion price, after considering the relative fair value of detachable instruments included in the financing transaction, if any, to the fair value of the common shares at the commitment date to be received upon conversion.

Deemed dividends are also recorded for the intrinsic value of conversion options embedded in preferred shares based upon the differences between the fair value of the underlying common stock at the commitment date of the transaction and the effective conversion price embedded in the preferred shares. When the preferred shares are non-redeemable the BCF is fully amortized into additional paid-in capital and preferred discount. If the preferred shares are redeemable, the discount is amortized from the commitment date to the first conversion date.

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 5,919,819 and 2,765,904 shares of our common stock have been excluded from the computation of diluted loss per share at September 30, 2017 and 2016, respectively, because the effect is anti-dilutive due to the net loss.

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 will be effective for our annual reporting period beginning on January 1, 2018, including interim periods within that year. 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 expect to apply the new standard using the modified retrospective method upon its adoption date on January 1, 2018. Under the modified retrospective method, we will recognize the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The comparative information will not be restated and will continue to be reported under the accounting standards in effect for those periods. Implementation steps we are taking include reviewing our current accounting policies and practices to identify potential differences that would result from the application of this standard, determining key factors to recognize revenue as prescribed by the new standard

that may be applicable to each of our business segments, analyzing our current portfolio of business contracts including our third-party payor contracts and evaluating our historical accounting policies and practices to identify potential differences in applying the new guidance. We anticipate that our evaluation will include the related qualitative disclosures regarding the potential impact of the effects of the accounting policies we expect to apply and a comparison to our current revenue recognition policies. We expect to complete this process prior to the filing of, and make disclosures in, our Annual Report on Form 10-K for the year ended December 31, 2017. Based on our evaluation so far, we believe there will be no significant changes required to our

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business processes, systems and controls to effectively report revenue recognition under the new standard. Adoption of the new standard is not expected to materially change the timing or amount of revenue recognized in our Consolidated Financial Statements.

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 March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The new standard simplifies several aspects related to the accounting for share-based payment transactions, including the accounting for income taxes, statutory tax withholding requirements, forfeitures and classification on the statement of cash flows. This guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2016. The Company adopted ASU No. 2016-09 as of January 1, 2017. The adoption of this guidance does not have a material effect on the Company's financial position and results of operations.

In August 2016, FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. ASU No. 2016-15 eliminates the diversity in practice related to the classification of certain cash receipts and payments in the statement of cash flows by adding or clarifying guidance on eight specific cash flow issues. ASU No. 2016-15 is effective for fiscal years beginning after December 15, 2017, and for interim periods within that fiscal year. We do not believe ASU No. 2016-15 will have a material effect on our financial position and results of operations.

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 Company does not believe ASU No. 2017-01 will have a material effect on its financial position and results of operations.

In January 2017, FASB issued ASU No. 2017-04, Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which removes Step 2 from the goodwill impairment test. It is effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment test performed with a measurement date after January 1, 2017. The Company has adopted this standard and, as discussed above, performed interim impairment testing of goodwill during the three months ended September 30, 2017 which resulted in the Company recording a goodwill impairment charge of \$1.0 million.

In July 2017, FASB issued ASU No. 2017-11, Earning Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480) and Derivatives and Hedging (Topic 815), which was issued in two parts, Part I, Accounting for Certain Financial Instruments with Down Round Features and Part II, Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception. Part I of ASC No. 2017-11 addresses the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. The amendments also clarify existing disclosure requirements for equity-classified instruments. As a result, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down round feature. For freestanding equity classified financial instruments, the amendments require entities that present earnings per share (EPS) in accordance with Topic 260 to recognize the effect of the down round feature when it is triggered. That effect is treated as a dividend

and as a reduction of income available to common shareholders in basic EPS. The amendments in Part II of ASU 2017-11 recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the codification, to a scope exception. Part II amendments do not have an accounting effect. The ASU 2017-11 is effective for annual and interim periods beginning after December 15, 2018, with early adoption permitted. The Company has early adopted this standard as of January 1, 2017 with the only impact being that the warrants with down round provisions are classified within equity. (See Note 6 - Convertible Bridge Notes and Note 10 - Stockholders' Equity).

3. REVERSE MERGER

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On June 29, 2017 (the “Closing Date”), the Company completed the Merger with Precipio Diagnostics, in accordance with the terms of the Merger Agreement. 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.

On the Closing Date, the outstanding common and preferred units of Precipio Diagnostics and certain debt of Precipio Diagnostics were converted into (i) 5,352,847 shares of Precipio common stock, together with cash in lieu of fractional units, and (ii) 802,920 shares of Precipio preferred stock with an aggregate face amount equal to \$3 million.

In connection with the Merger, on the Closing Date, Precipio also issued promissory notes and shares of Precipio preferred and common stock in a number of transactions, whereby:

- Holders of certain secured indebtedness of Transgenomic received in exchange for such indebtedness 802,925 shares of Precipio preferred stock in an amount equal to \$3.0 million stated value, and 352,630 shares of Precipio common stock;
- Holders of Transgenomic preferred stock converted it into 7,155 shares of Precipio common stock; and
- Precipio issued 107,056 shares of Precipio preferred stock to certain investors in exchange for \$400,000 in a private placement. Precipio also completed the sale of an aggregate of \$800,000 of promissory notes pursuant to a securities purchase agreement.

Purchase Consideration

The preliminary estimated purchase consideration based on the value of the equity of Transgenomic, the accounting acquiree, is as follows:

(dollars in thousands)

| | | |
|---|----|---------------|
| Legacy Transgenomic common stock | \$ | 6,088 |
| Fair value of preferred stock converted to common stock | | 49 |
| Fair value of debt converted to common stock | | 2,398 |
| Fair value of debt converted to preferred stock | | 9,796 |
| Fair value of existing bridge notes | | 1,275 |
| Fair value of warrants | | 1,996 |
| Purchase consideration | \$ | <u>21,602</u> |

In estimating the preliminary purchase consideration above, Transgenomic used its closing stock price of \$6.80 as of the Closing Date. Transgenomic had 895,334 common shares outstanding prior to the Merger. In connection with the Merger, Transgenomic preferred stock converted into 7,155 shares of Precipio common stock and certain of Transgenomic debt and accrued interest converted into 352,630 shares of Precipio common stock and 802,925 shares of Precipio preferred stock, face value \$3.0 million with an 8% annual dividend. At the Closing Date, the preferred stock had a fair value of \$12.20 per share.

Allocation of Purchase Consideration

The following table sets forth an allocation of the purchase consideration to the identifiable tangible and intangible assets of Transgenomic, the accounting acquiree, based on fair values as of the Closing Date with the excess recorded as goodwill:

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(dollars in thousands)

| | | |
|--|-----------|---------------|
| Current and other assets | \$ | 419 |
| Property and equipment | | 29 |
| Goodwill | | 13,832 |
| Other intangible assets ⁽¹⁾ | | 21,100 |
| Total assets | | 35,380 |
| Current liabilities | | 13,604 |
| Other liabilities | | 174 |
| Total liabilities | | 13,778 |
| Net assets acquired | \$ | 21,602 |

(1) Other intangible assets consist of:

(dollars in thousands)

| | | |
|-------------------------------------|-----------|---------------|
| Acquired technology | \$ | 18,990 |
| Customer relationships | | 250 |
| Non-compete agreements | | 30 |
| Trademark and trade name | | 40 |
| Backlog | | 200 |
| In-process research and development | | 1,590 |
| Total intangibles | \$ | 21,100 |

We determined the estimated fair value of the acquired technology but using the multi-period excess earnings method of the income approach. The estimated fair value of the remaining identifiable intangible assets acquired were determined primarily by using the income approach.

Unaudited pro forma information

The operating results of Transgenomic for the period after the Closing Date to September 30, 2017 have been included in the Company's condensed consolidated financial statements as of and for the three and nine months ended September 30, 2017.

The following unaudited pro forma information presents the Company's financial results as if the acquisition of Transgenomic had occurred on January 1, 2016:

Dollars in thousands, except per share amounts

| | Nine months ended September 30, | |
|---|---------------------------------|-----------|
| | 2017 | 2016 |
| Net sales | \$ 1,742 | \$ 2,605 |
| Net loss available to common stockholders | (22,980) | (15,838) |
| Loss per common share | \$ (3.40) | \$ (2.48) |

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4. INTANGIBLES

We had no intangible assets as of December 31, 2016. In conjunction with the Merger, we recorded intangible assets of \$21.1 million. As of September 30, 2017 our intangible assets consisted of the following:

| | Dollars in Thousands | | |
|--------------------------|----------------------|-----------------------------|-------------------|
| | September 30, 2017 | | |
| | Cost | Accumulated Amortization | Net Book Value |
| Technology | \$ 18,990 | \$ 237 | \$ 18,753 |
| Customer relationships | 250 | 21 | 229 |
| Backlog | 200 | 50 | 150 |
| Covenants not to compete | 30 | 8 | 22 |
| Trademark | 40 | 5 | 35 |
| IPR&D | 1,590 | — | 1,590 |
| | <u>\$ 21,100</u> | <u>\$ 321</u> | <u>\$ 20,779</u> |

| | Estimated Useful Life |
|--------------------------|-----------------------|
| Technology | 20 years |
| Customer relationships | 3 years |
| Backlog | 1 year |
| Covenants not to compete | 1 year |
| Trademark | 2 years |

Until our in-process research and development projects are completed, the assets are accounted for as indefinite-lived intangible assets and subject to impairment testing. For the nine months ended September 30, 2017, there was no impairment of IPR&D.

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

5. LONG-TERM DEBT

Long-term debt consists of the following:

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| | Dollars in Thousands | |
|---|----------------------|-------------------|
| | September 30, 2017 | December 31, 2016 |
| Senior Notes | \$ — | \$ 3,270 |
| Senior Note debt issuance costs | — | (9) |
| Junior Notes | — | 584 |
| Connecticut Innovations - line of credit | — | 162 |
| Department of Economic and Community Development (DECD) | — | 243 |
| DECD debt issuance costs | — | (30) |
| Webster Bank | — | 328 |
| Webster Bank debt discounts and issuance costs | — | (26) |
| Convertible promissory notes | 42 | — |
| Total long-term debt | 42 | 4,522 |
| Current portion of long-term debt | (42) | (395) |
| Long-term debt, net of current maturities | \$ — | \$ 4,127 |

Senior and Junior Notes

During 2016, the Company raised \$525,000 from members through the issuance of senior notes which accrue interest at a rate of 12% and are payable at the sooner of the closing of a qualified public offering, as outlined in the note agreement, or five years from date of issuance.

Also during 2016, the Company restructured equity through a redemption and exchange agreement by exchanging Member Equity comprised of Series A and Series B Convertible Preferred Units in the amount of \$2,147,716 (members' initial investment of \$1,715,000, plus declared dividends on these preferred units of \$432,716), and Convertible Bridge Notes of \$1,120,000, plus accrued interest of \$61,073 for new senior notes of \$2,744,968 ("Senior Notes") and new junior notes of \$583,821 ("Junior Notes"). The Senior and Junior Notes accrue interest at a rate of 12% and 15%, respectively, and have maturity dates ranging from March 2021 to September 2021, or earlier based on certain qualifying events as outlined in the note agreements.

During the nine months ended September 30, 2017, prior to the Merger, the Company raised \$315,000 from members through the issuance of Senior Notes at a rate of 12% interest that are payable at the sooner of the closing of a qualified public offering, as outlined in the note agreement, or five years from date of issuance.

On the Closing Date of the Merger, the outstanding balance of \$3,584,968 in Senior Notes and \$583,821 in Junior Notes, plus accrued interest of \$602,373, were converted into 802,920 shares of Precipio preferred stock and 1,414,700 shares of Precipio common stock. There were no Senior or Junior Notes outstanding as September 30, 2017.

As of December 31, 2016, the outstanding balance of Senior and Junior Notes was \$3,269,968 and \$583,821, respectively, with accrued interest included within the accrued expenses on the accompanying condensed consolidated balance sheet of \$279,740 and \$71,258, respectively.

Connecticut Innovations, Incorporated

The Company entered into a line of credit on April 1, 2012 with Connecticut Innovations, Incorporated (Connecticut Innovations), an entity affiliated with a director of the Company, for up to \$500,000 with interest paid monthly at 8%, due on September 1, 2018. Principal and interest payments began February 1, 2013 and ranged from \$7,436 to \$12,206 until September 2016, when the Company entered into a forbearance agreement to 1) defer monthly principal payments until October 2017 and 2) make interest-only

payments totaling \$1,041 per month through October 2017. Pursuant to the forbearance agreement, the Company was also restricted from any additional borrowings under the line of credit. The line was secured by substantially all of the Company's assets.

In connection with the Merger, the Company paid in full its loan obligations with Connecticut Innovations. The outstanding balance was zero and \$162,066 as of September 30, 2017 and December 31, 2016, respectively.

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Department of Economic and Community Development.

The Company entered into a 10-year term loan with the Department of Economic and Community Development (“DECD”) on May 1, 2013 for \$300,000, with interest paid monthly at 3%, due on April 23, 2023. The loan was secured by substantially all of the Company’s assets but was subordinate to the term loan with Webster Bank and the Connecticut Innovations line of credit. In connection with the Merger, the Company paid in full its loan obligations with DECD. The outstanding balance was zero and \$243,287 as of September 30, 2017 and December 31, 2016, respectively. The outstanding principal and accrued interest balance paid in full in July 2017 was \$225,714.

Webster Bank.

The Company entered into a 3.5-year term loan with Webster Bank on December 1, 2014 for \$500,000, with interest paid monthly at the one month LIBOR rate (1.16% at June 30, 2017) plus 500 basis points, due on May 31, 2018. The line was secured by substantially all of the Company’s assets and had first priority over all other outstanding debt.

The term loan with Webster Bank was subject to financial covenants relating to maintaining adequate cash runway, as defined in the term loan agreement. As of December 31, 2016 the Company was not in compliance with these covenants and, as such, the Webster Bank debt has all been presented as current in the accompanying condensed consolidated financial statements.

On June 29, 2017, the closing date of the Merger, the Company paid in full its loan obligations (including principal and interest) with Webster Bank. The outstanding balance was zero and \$328,000 as of September 30, 2017 and December 31, 2016, respectively.

During the nine months ended September 30, 2017, the Company incurred a loss on extinguishment of debt in the approximate amount of \$53,000, related to the extinguishment of the Connecticut Innovations, DECD and Webster Bank loans.

Convertible Promissory Notes.

The Company, as part of the merger, assumed an Unsecured Convertible Promissory Note (the “Note”) with an accredited investor (the “Investor”) in the aggregate principal amount of \$125,000 and interest accrues at a rate of 6% per year. The Note provided that two-thirds of the outstanding principal amount of the Note was due upon the earlier to occur of the close of the Merger or June 17, 2017 (such applicable date, the “Maturity Date”). The remaining one-third of the principal amount outstanding on the Note was to be paid on the six month anniversary of the Maturity Date.

On the Maturity Date, the then outstanding aggregate amount owed on the Note of \$143,041 (\$125,000 in principal amount and \$18,041 of accrued interest) became due. Pursuant to the terms of the Note, the Company’s failure to pay any principal or interest within 10 days of the date such payment is due will constitute an event of default (the “Prospective Event of Default”). On June 21, 2017, the Investor agreed to waive the Prospective Event of Default and agreed to further extend the Maturity Date of the Note pursuant to a side letter to the Note (the “Side Letter”). The Side Letter provides that two-thirds of the outstanding principal amount of the Note must be paid upon the earlier to occur of (1) the closing of a public offering by the Company of either common stock, convertible preferred stock or convertible preferred notes or (2) August 16, 2017 (such applicable date, the “Deferred Maturity Date”). On August 31, 2017, the Company made payment of \$83,333, two-thirds of the then outstanding principal amount. The remaining one-third of the principal amount outstanding on the Note must be paid on the six month anniversary of the Deferred Maturity Date (the “Extended Maturity Date”). All accrued and unpaid interest on the outstanding principal amount of the Note will be due and immediately payable on the Extended Maturity Date, unless the Note is converted in which case such interest will be payable in shares of the Company’s common stock as part of the conversion. As of September 30, 2017, the outstanding principal amount due was \$41,666 and accrued interest was approximately \$20,000 and is included within accrued expenses on the accompanying condensed consolidated balance sheet.

6. CONVERTIBLE BRIDGE NOTES.

Convertible Bridge Notes.

During the year ended December 31, 2016, the Company had outstanding \$695,000 of unsecured convertible bridge notes. The notes accrued interest at a rate of 14% and were payable on the extended maturity date of December 31, 2016. During January 2017, the holders of the convertible bridge notes agreed to waive the maturity date of December 31, 2016 and change it to payable on demand and accrue interest until paid.

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The convertible bridge notes had conversion terms of (i) convertible into Series C Preferred Units of the Company (at a 30% discount) upon a Qualified Series C Financing (as defined in the note agreement), (ii) at the option of the holders of a majority of the then-outstanding principal amount of the notes, convertible into Series C Preferred Units of the Company (at a 30% discount) upon any other Series C Financing, or (iii) if no such Qualified Series C Financing occurs, or no such optional conversion takes place by the maturity date (as hereinafter defined), the convertible notes will be fully repaid by Company or the notes and accrued and unpaid interest shall convert into Preferred Series B Units (at a 30% discount) of the Preferred Series B conversion Price as defined in the operating agreement provided that notice is given to the Company at least one day prior to maturity. In the event a Deemed Liquidity Event (merger, sale, IPO, or transaction with exchange of 50% or more of voting power) the holders of the notes at their sole discretion can (a) require the Company to pay an amount equal to two times the principal and accrued and unpaid interest or (b) convert all unpaid principal and interest at a rate of 70% of the applicable security. These notes were subordinated to Connecticut Innovations, DECD and Webster Bank.

In connection with the Merger, on the Closing Date, convertible bridge notes of \$695,000, plus \$192,000 of accrued interest, were converted into 155,639 shares of Precipio common stock.

2017 New Bridge Notes I.

Prior to the Merger, the Company (then Transgenomic) completed the sale of an aggregate of \$1.2 million of non-convertible promissory notes (the “2017 Bridge Notes”) in a bridge financing pursuant to a securities purchase agreement (the “Purchase Agreement”), for which \$561,500 was then given to Precipio Diagnostics through the issuance of a promissory note and is eliminated in consolidation. The financing was intended to help facilitate the completion of the Merger. The 2017 Bridge Notes had an annual interest rate of 4% and a 90-day maturity. The 2017 Bridge Notes may be repaid by the Company at any time in cash upon payment of a 20% premium. In connection with the issuance of the 2017 Bridge Notes, the Company issued warrants (the “2017 Bridge Warrants”) to acquire 40,000 shares of the Company's common stock at an exercise price of \$15.00 per share, subject to anti-dilution protection. The Purchase Agreement provides certain piggyback registration rights for the holders of the 2017 Bridge Warrants for a period of six months after the closing of the bridge financing. Aegis Capital Corp. (“Aegis”) acted as placement agent for the bridge financing and received a placement agent fee of \$84,000 and warrants (the “Aegis Warrants”) to acquire 5,600 shares of the Company's common stock at an exercise price of \$15.00 per share. The Aegis Warrants are identical to the 2017 Bridge Warrants except that the Aegis Warrants do not have anti-dilution protection.

At the time of the Merger, the 2017 Bridge Notes were extinguished and replaced with convertible promissory notes (the “2017 New Bridge Notes I”) with an original principal amount of \$1.2 million in the aggregate pursuant to an Exchange Agreement (the “Exchange Agreement”) entered into on the Closing Date. The 2017 New Bridge Notes I have an annual interest rate of 8.0% and are due and payable upon the earlier to occur of (i) October 1, 2017 or (ii) the closing of a Qualified Offering (as defined in the 2017 New Bridge Notes I). The 2017 New Bridge Notes I are convertible into shares of our common stock at an initial conversion price of \$3.736329 per share, subject to adjustment, and may be convertible into shares of our preferred stock at the holder’s option if the Company does not complete a Qualified Offering (as defined in the 2017 New Bridge Notes I) by October 1, 2017. The Company may redeem the 2017 New Bridge Notes I at any time in cash upon payment of a 20% premium, or \$240,000. As the convertible promissory notes were convertible into the Company's common stock at a conversion rate lower than the fair market value of the common stock at the time of issuance, the Company recorded \$989,000 as a beneficial conversion feature, which was recorded as a debt discount in the balance sheet. The discount will be amortized using the effective interest method through the first conversion date of the 2017 New Bridge Notes I. On August 28, 2017, these 2017 New Bridge Notes I were partially converted and the remaining were paid off, refer below for further discussion.

Pursuant to the Exchange Agreement, the 2017 Bridge Warrants were canceled and replaced with new warrants to acquire 45,600 shares of our common stock (the “2017 New Bridge Warrants”). The initial exercise price of the 2017 New Bridge Warrants is \$7.50 (subject to adjustments). If the Company completes a Qualified Offering (as defined in the 2017 New Bridge warrants), the exercise price of the 2017 New Bridge Warrants will become the lower of (i) \$7.50, or (ii) 110% of the per share offering price in the Qualified Offering, but in no event lower than \$1.50 per share, which has been considered a down round

provision. At issuance, the 2017 New Bridge Warrants had a fair value of \$211,000 and were recorded as a debt discount to the related 2017 New Bridge Notes I, with the corresponding entry to additional paid in capital as the warrants were considered classified as equity in accordance with GAAP. As discussed in Note 2 of the accompanying unaudited condensed consolidated financial statements, the Company early adopted ASU 2017-11, which allowed the Company to treat the warrants as equity classified, despite the down round provision.

2017 New Bridge Note II.

In connection with the Merger, on the Closing Date and pursuant to a Securities Purchase Agreement (the “Bridge Purchase Agreement”), the Company completed the sale of an aggregate of \$800,000 of a convertible promissory note (the “2017 New

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Bridge Note II”). The Company received net proceeds of \$721,000 from the sale of the 2017 New Bridge Note II, which will be used for working capital purposes. The 2017 New Bridge Note II has an annual interest rate of 8.0% and is due and payable upon the earlier to occur of (i) October 1, 2017 or (ii) the closing of a Qualified Offering (as defined in the 2017 New Bridge Note II). The 2017 New Bridge Note II is convertible into shares of our common stock at an initial conversion price of \$3.736329 per share, subject to adjustment, and may be convertible into shares of our preferred stock at the holder’s option if the Company does not complete a Qualified Offering (as defined in the 2017 New Bridge Note II) by October 1, 2017. The Company may redeem the 2017 New Bridge Note II at any time in cash upon payment of a 20% premium, or \$160,000.

As the 2017 New Bridge Note II was convertible into the Company's common stock at a conversion rate lower than the fair market value of the common stock at the time of issuance, the Company recorded \$656,000 as a beneficial conversion feature, which was recorded as a debt discount in the balance sheet. The discount will be amortized using the effective interest method through the first conversion date of the 2017 New Bridge Note II. On August 28, 2017, this 2017 New Bridge Note II was partially converted and the remaining was paid off, refer below for further discussion.

In connection with the bridge financing and the assumption of certain obligations by an entity controlled by Mark Rimer (a director of the Company), the Company issued to that entity warrants (the “Side Warrants”) to purchase an aggregate of 91,429 shares of the Company's common stock at an exercise price of \$7.00 per share (subject to adjustment), with a fair value of \$487,000 at the date of issuance. The Side Warrants have a term of 5 years and are exercisable as to 22,857 shares of the Company's common stock upon grant and as to 68,572 shares of the Company's common stock upon the entity’s performance of the assumed obligations. All performance obligations have been met and the Company has recorded a merger advisory expense of \$73,000 and \$487,000 related to the Side Warrants during the three and nine months ended September 30, 2017, respectively.

In addition, upon the Company consummating one or more rounds of equity financing following July 1, 2017, with aggregate gross proceeds of at least \$7 million, the Company will use a portion of the proceeds from such financing to repay the principal amount of the 2017 New Bridge Notes, together with any premium and interest.

Conversion and Payment of the 2017 New Bridge Notes I and New Bridge Note II (collectively, the “New Bridge Notes”).

On August 28, 2017, the Company completed an underwritten public offering (the “August 2017 Offering”) of 6,000 units consisting of one share of the Company’s Series B Preferred Stock and one warrant to purchase up to 400 shares of the Company's common stock at a combined public offering price of \$1,000 per unit for gross proceeds of \$6.0 million (see Note 10 - Stockholders' Equity).

At the time of the closing of the August 2017 Offering, the aggregate amount due to the holders of the New Bridge Notes was \$2,436,551 (\$2,000,000 in principal, \$400,000 for a 20% redemption premium and \$36,551 in accrued interest). Upon the closing of the August 2017 Offering, the Company made a cash payment of \$1,536,551 to extinguish certain notes and the remaining \$900,000 of the Company’s New Bridge Notes were converted into an aggregate of 359,999 shares of the Company's common stock (the “Note Conversion Shares”) at a conversion price of \$2.50 per share and 359,999 warrants to purchase the Company's common stock (the “Note Conversion Warrants”). The Company issued the Note Conversion Warrants to the holders of the New Bridge Notes as consideration for their election to convert their New Bridge Notes into shares of the Company's common stock. The Company treated the \$900,000 debt conversion as an induced conversion and determined that the fair value of the consideration given in the conversion exceeded the fair value of the debt pursuant to its original conversion terms by approximately \$1.0 million. This amount was recorded as an expense included in loss on extinguishment of debt and induced conversion of convertible bridge notes in our unaudited condensed consolidated statements of operations. The Company also recorded a loss on extinguishment of debt of approximately \$0.4 million related to the extinguishment of the \$1,536,551 portion paid in cash, which was also recorded as an expense within the loss on extinguishment of debt and induced conversion of convertible bridge notes line in our unaudited condensed consolidated statements of operations. See Note 10 Stockholders Equity (Deficit) for discussion of the Note Conversion Warrants.

Upon conversion and payment of the New Bridge Notes, all remaining debt discounts and debt issuance costs associated with the conversions were fully amortized to interest expense and debt discounts and debt issuance costs associated with the portion paid in cash were amortized to interest expense up through the payment date. During the three and nine months ended September 30, 2017, debt discounts and debt issuance costs amortized to interest expense were \$1.8 million and \$1.9 million, respectively. As of September 30, 2017, the outstanding convertible bridge notes balance was zero.

7. ACCRUED EXPENSES.

Accrued expenses consist of the following:

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| | September 30, 2017 | December 31, 2016 |
|----------------------|--------------------|-------------------|
| Accrued expenses | \$ 1,323 | \$ 50 |
| Accrued compensation | 529 | 155 |
| Accrued interest | 20 | 495 |
| | <u>\$ 1,872</u> | <u>\$ 700</u> |

8. 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.

Claims assumed in the Merger

The Company assumed a number of claims as a result of the Merger. In addition to the claims described below, we are delinquent on the payment of outstanding accounts payable for certain of our vendors and suppliers who have taken or have threatened to take legal action to collect such outstanding amounts.

On February 25, 2016, the Board of Regents of the University of Nebraska ("UNMC") filed a lawsuit against us in the District Court of Douglas County, Nebraska, for breach of contract and seeking recovery of \$0.7 million owed by us to UNMC. A \$0.4 million liability was recorded and is reflected in accrued expenses at December 31, 2016. We and UNMC entered into a settlement agreement dated February 6, 2017, which included, among other things, a mutual general release of claims, and our agreement to pay \$0.4 million to UNMC in installments over a period of time. On September 8, 2017, we and UNMC entered into a First Amendment to the Settlement Agreement with quarterly payments in the amount of \$25,000 due commencing on December 15, 2017 and ending on June 15, 2020 and a final payment of \$100,000 due on or before September 15, 2020. A \$0.4 million liability has been recorded and is reflected in accrued expenses at September 30, 2017.

On April 13, 2016, Fox Chase Cancer Center ("Fox Chase") filed a lawsuit against Transgenomic in the Court of Common Pleas of Philadelphia County, First Judicial District of Pennsylvania Civil Trial Division (the "Court of Common Pleas"), alleging, among other things, breach of contract, tortious

interference with present and prospective contractual relations, unjust enrichment, fraudulent conversion and conspiracy and seeking punitive damages in addition to damages and other relief. This lawsuit relates to a license agreement Transgenomic entered into with Fox Chase in August 2000, as amended (the “License Agreement”), as well as the assignment of certain of Transgenomic's rights under the License Agreement to Integrated DNA Technologies, Inc. (“IDT”) pursuant to the Surveyor Kit Patent, Technology and Inventory Purchase Agreement Transgenomic entered into with IDT effective as of July 1, 2014 (the “IDT Agreement”). Pursuant to the terms of the IDT Agreement, Transgenomic agreed to indemnify IDT with respect to certain of the claims asserted in the Fox Chase proceeding. On July 8, 2016, the Court of Common Pleas sustained Transgenomic's preliminary objections to several of Fox Chase’s claims and dismissed the claims for tortious interference,

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fraudulent conversion, conspiracy, punitive damages and attorney's fees. Accordingly, the case has been narrowed so that only certain contract claims and an unjust enrichment claim remained pending against Transgenomic.

During June 2017, prior to the Merger, Transgenomic entered into a settlement agreement with Fox Chase (the "Agreement") to pay \$175,000 in three installments, which will resolve all outstanding claims in the litigation brought in April 2016 by Fox Chase against Transgenomic in the Court of Common Pleas of Philadelphia County (the "Action"). The case will remain pending with the Court until all settlement payments have been made to Fox Chase. On October 3, 2017, the final payment of \$55,000 was paid to Fox Chase totaling \$175,000. Once received Fox Chase was obligated to cause the Action to be formally dismissed with prejudice. The dismissal is still pending as of November 15, 2017. Also, on July 13, 2017 the Company entered into an agreement with its co-Defendant, IDT, regarding the Company's indemnity obligations to IDT for legal fees and expenses incurred in the Action pursuant to the terms of the IDT Agreement. The IDT Agreement provides for monthly payments of \$27,800 from the Company to IDT, in the total amount of \$139,000, commencing on August 15, 2017 and concluding on December 15, 2017. A \$0.2 million liability has been recorded and is reflected in accrued expenses at September 30, 2017.

On June 23, 2016, the Icahn School of Medicine at Mount Sinai ("Mount Sinai") filed a lawsuit against us 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 meruit, 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. A \$0.7 million liability has been recorded and is reflected in accrued expenses at September 30, 2017. 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 \$0.4 million accruing interest at 10% with monthly principal and interest payments of \$12,700 beginning in July 2018 and continuing over 48 months and to issue warrants in the amount of 24,900 shares, that are exercisable for 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. The Company does 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.

On December 19, 2016, Todd Smith ("Smith") filed a lawsuit against us in the District Court of Douglas County Nebraska, alleging breach of contract and seeking recovery of \$2.2 million owed by us to Smith for costs and damages arising from a breach of our obligations pursuant to a lease agreement between the parties. On April 7, 2017, we entered into a settlement agreement with Smith related to the early termination of our lease for our Omaha, Nebraska facility. The agreement included, among other things, a mutual general release of claims, and our agreement to pay approximately \$0.6 million to Smith in installments over a period of time. During the three and nine months ended September 30, 2017, the Company made payments totaling \$0.4 million and a \$0.2 million liability has been recorded and is reflected in accrued expenses at September 30, 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 us. On May 5, 2017, XIFIN filed an application for entry of default judgment against us. During the three and nine months ended September 30, 2017, the Company made payments totaling \$0.1 million and a \$0.2 million liability has been recorded and is reflected in accrued expenses at September 30, 2017.

We and Science Park Development Corporation ("SPDC") entered into that certain Lease dated as of December 31, 2011, as modified by the First Amendment to Lease dated as of June 18, 2013, as further modified by a letter agreement dated as of February 2, 2015, as modified by the Second Amendment to Lease dated as of June 26, 2015 (the "SPDC Lease"). In November 2016, SPDC alleged that we defaulted on our obligations under the SPDC Lease. Specifically, SPDC alleges that we failed to pay approximately \$0.4 million in rental payments due under the SPDC Lease and that we vacated a portion of the leased premises in violation of the terms of the SPDC Lease. We and SPDC entered into a settlement agreement dated March 6, 2017, which included, among other things, a mutual general release of claims, and our

agreement to pay approximately \$0.4 million to SPDC in installments over a period of time. This liability has been recorded and is reflected in accrued expenses at September 30, 2017. We and Science Park are currently in negotiations to restructure the settlement agreement.

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. During the three and nine months ended September 30, 2017, the Company made payments of less than \$0.1 million and a liability of approximately \$0.2 million has been recorded and is reflected in accrued expenses at September 30, 2017.

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On March 9, 2016, counsel for Edge BioSystems, Inc. (“EdgeBio”) sent a demand letter on behalf of EdgeBio to us in connection with the terms of that certain Asset Purchase Agreement dated September 8, 2015 (the “EdgeBio Agreement”). EdgeBio alleges, among other things, that certain customers of EdgeBio erroneously remitted payments to us, that such payments should have been paid to EdgeBio and that we failed to remit these funds to EdgeBio in violation of the terms of the EdgeBio Agreement. On September 13, 2016, we received a demand for payment letter from EdgeBio’s counsel alleging that the balance due to EdgeBio is approximately \$0.1 million. On September 19, 2017 a summary of action from the Judicial District of New Haven, CT for a judgement of \$113,000 was issued. A liability of approximately \$0.1 million has been recorded and is reflected in accrued expenses at September 30, 2017 and we and EdgeBio are currently in discussions regarding settlement.

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 have 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, he alleges that we have violated Sections 14(a) and 20(a) of the Exchange Act and Rule 14a-9 promulgated thereafter. Although we intend to defend the lawsuit, there can be no assurance regarding the ultimate outcome of this case. Given the uncertainty of litigation, the legal standards that must be met for, among other things, class certification and success on the merits, we are unable to estimate the amount of loss, or range of possible loss, at this time that may result from this action. In the event that a settlement is reached related to these matters, the amount of such settlement may be material to our results of operations and financial condition and may have a material adverse impact on our liquidity.

9. INCOME TAXES

The Company's transaction with Precipio Diagnostics, LLC constitutes a reverse acquisition under Treas. Reg. § 1.1502-75(d)(3). Consequently, the Company's portion of the year, prior to the transaction will not be included in the current year’s US federal consolidated income tax return, but instead filed in a separate short period tax return.

Income tax expense for both the three months and nine months ended September 30, 2017 was zero as a result of recording a full valuation allowance against the deferred tax asset generated predominantly by net operating losses.

We had no material interest or penalties during fiscal 2017 or fiscal 2016, 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.

As a result of the merger, there was a change in ownership as defined in IRS § 382. Because of this change, use of a portion of the accumulated net operating losses and tax credit carryforwards will be eliminated and the remainder will be limited in future periods. Since the net deferred tax assets have a full valuation allowance recorded, any limitation generated from this calculation would not effect the current financial statements.

10. STOCKHOLDERS’ EQUITY (DEFICIT)

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.

In connection with the Merger, the Company effected a 1-for-30 reverse stock split of its common stock. This reverse stock split became effective on June 13, 2017 and, unless otherwise indicated, all share amounts, per share data, share prices, exercise prices and conversion rates set forth in these notes and the accompanying unaudited condensed consolidated financial statements have, where applicable, been adjusted retroactively to reflect this reverse stock split. Additionally, as a result of the Merger, the

Company has recapitalized its stock. All 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 the Company's common stock.

During 2017, restricted stock of zero and 59,563 shares were granted during the three and nine months ended September 30, 2017, none of which vested prior to the merger. Upon closing of the merger, all shares fully vested. During 2017, 64,593

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shares were released to common stock. We recorded stock compensation expense of approximately \$28,000 related to the restricted stock that vested during the nine months ended September 30, 2017.

On the Closing Date, Precipio Diagnostics received 7,356,170 shares of Precipio common stock from the conversion of preferred stock, senior and junior debt, bridge notes and warrants. Also, certain advisors of Precipio Diagnostics received 321,821 shares of Precipio common stock related to services performed in connection with the Merger. The fair value of these advisory shares was \$2.2 million at the date of the Merger and is included as a merger advisory fee expense in the accompanying financial statements.

As part of the Merger, Precipio Diagnostics also received 200,081 shares of Precipio common stock that have not been issued yet. 135,000 of these shares are being held for future issuance to advisors pending completion of certain performance obligations. If these performance obligations are not met, the shares will remain with Precipio Diagnostics as part of the unissued pool. For any shares that remain unissued, it is the intent of the Company to allocate these to Precipio Diagnostics shareholders on a pro rata basis.

Also, upon completion of the Merger, Transgenomic legacy stockholders had 1,255,119 shares of Precipio common stock outstanding.

Upon the closing of the August 2017 Offering, the Company issued 359,999 shares of its common stock upon conversion of \$900,000 of its New Bridge Notes (See Note 6 - Convertible Bridge Notes) and 1,735,419 shares of its common stock upon conversion of its Series A Senior stock (see below - Series A Senior Preferred Stock).

Also, during the three months ended September 30, 2017, the Company issued 943,600 shares of its common stock in connection with conversions of its Series B Preferred Stock (see below - Series B Preferred Stock).

Series A and Series B Preferred Stock.

Prior to the Merger and under Precipio Diagnostics, the Company had outstanding preferred units of 367,299 for Series A and 412,806 for Series B as of December 31, 2016. These units have been recapitalized and are included in preferred stock. On the Closing Date, the outstanding preferred units for Series A and Series B, along with the related accumulated dividends, were converted into common shares of the Company.

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. The authority of the Board of Directors includes, but is not limited to, the determination or fixing of the following with respect to shares of such class or any series thereof: (i) the number of shares; (ii) the dividend rate, whether dividends shall be cumulative and, if so, from which date; (iii) whether shares are to be redeemable and, if so, the terms and amount of any sinking fund providing for the purchase or redemption of such shares; (iv) whether shares shall be convertible and, if so, the terms and provisions thereof; (v) what restrictions are to apply, if any, on the issue or reissue of any additional preferred stock; and (vi) whether shares have voting rights. The preferred stock may be issued with a preference over the common stock as to the payment of dividends. We have no current plans to issue any additional preferred stock. Classes of stock such as the preferred stock may be used, in certain circumstances, to create voting impediments on extraordinary corporate transactions or to frustrate persons seeking to effect a merger or otherwise to gain control of the Company. For the foregoing reasons, any additional preferred stock issued by the Company could have an adverse effect on the rights of the holders of the common stock.

Series A Senior Preferred Stock.

In connection with the Merger, the Company filed a Certificate of Designation with the Secretary of State of the State of Delaware on June 29, 2017, designating 4,100,000 shares of the Company's Preferred Stock, par value \$0.01 per share, as Series A Senior Convertible Preferred Stock ("Series A Senior") and

establishing the rights, preferences and privileges of the new preferred stock. Generally, the holders of the Series A Senior stock are entitled to vote as a single voting group with the holders of the Company's common stock, and the holders of the Series A Senior stock are generally entitled to that number of votes as is equal to the number of whole shares of the Company's common stock into which the Series A Senior stock may be converted as of the record date of such vote or consent.

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So long as the shares of Series A Senior stock are outstanding certain actions will require the separate approval of at least two-thirds of the Series A Senior stock, including: changes to the terms (requires three-fourths approval) of the Series A Senior stock, changes to the number of authorized shares of Series A Senior stock, issuing a series of preferred stock that is senior to the Series A Senior stock, changing the size of the board of directors, certain changes to the capital stock of the Company, bankruptcy proceedings and granting security interests in the Company's assets.

The Series A Senior stock will be convertible into the Company's common stock at any time at the then applicable conversion price. The initial conversion price for the Series A Senior stock issued in connection with the Merger and the other transactions described herein is \$3.736329, but will be subject to anti-dilution protections including adjustments for stock splits, stock dividends, other distributions, recapitalizations and the like. Additionally, each holder of the Series A Senior stock will have a right to convert such holder's Series A Senior stock into securities issued in any future private offering of the Company's securities at a 15% discount to the proposed price in such private offering.

The Series A Senior stock will be entitled to an annual 8% cumulative payment in lieu of interest or dividends, payable in-kind for the first two years and in cash or in-kind thereafter, at the option of the Company. The Series A Senior stock also will be entitled to share in any dividends paid on the Company's common stock.

As discussed in Note 3 - Reverse Merger, in connection with the Merger, the Company issued 1) to holders of certain Transgenomic secured indebtedness, 802,925 shares of Series A Senior stock in an amount equal to \$3 million, 2) to holders of certain Precipio Diagnostic indebtedness, 802,920 shares of Series A Senior stock in an amount equal to \$3 million and 3) to certain investors, 107,056 shares of Series A Senior stock in exchange for \$400,000 in a private placement.

We determined that there was a beneficial conversion feature in connection with the issuances of the Series A Senior stock since the conversion price of \$3.736329 was at a discount to the fair market value of the Company's common stock at issuance date. The Series A Senior stock is non-redeemable and as a result, the Company recognized the full beneficial conversion feature in the amount of \$5.2 million as a deemed dividend at the time of issuance.

Upon the closing of the August 2017 Offering, all of the Company's outstanding Series A Senior stock converted into an aggregate of 1,712,901 shares of the Company's common stock, at the existing conversion rate of one share of Common Stock for one share of Series A Senior stock (the "Conversion"). The Company also issued an aggregate of 22,518 shares of Series A Senior stock to these holders, which shares represented the Series A Preferred Payment (as defined in the Company's Certificate of Designation of Series A Senior Convertible Preferred Stock) accrued through the date of Conversion and immediately converted into an aggregate of 22,518 shares of the Company's common stock in connection with the Conversion. The Company issued warrants (the "Series A Conversion Warrants") to purchase an aggregate of 856,446 shares of Common Stock to these former holders of Series A Senior stock as consideration for the conversion of their shares of Series A Senior stock into shares of Common Stock. The Company treated this as an induced conversion of the Series A Senior stock.

At the date of the Conversion, the fair value of the Series A Conversion Warrants was approximately \$1.4 million. The Company determined that the \$1.4 million represented the excess fair value of all consideration transferred to the Series A Senior holders as compared to the fair value of the Series A Senior stock pursuant to its original conversion terms. The \$1.4 million was recorded as a deemed dividend at the time of the Conversion.

The Series A Preferred Payment of 22,518 shares of Series A Senior stock had a fair value of approximately \$84,000 at the time of issuance and was recorded as a deemed dividend on preferred shares.

At September 30, 2017, the Company had zero shares of Series A Senior outstanding.

Series B Preferred 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, par value \$0.01 per share ("Series B Preferred Stock"), which is 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. The Offering was completed pursuant to the terms of an underwriting agreement dated as of August 22, 2017 (the "Underwriting Agreement") between the Company and Aegis. The net proceeds

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received by the Company from the sale of the units was approximately \$5.0 million, after deducting underwriting discounts and estimated offering expenses, which have been recorded as stock issuance costs within additional paid in capital.

For purposes of recording this transaction, the gross proceeds of \$6.0 million from the August 2017 Offering were allocated to the Series B Preferred Stock and the August 2017 Offering Warrants based on their relative fair values at the date of issuance. The portion allocated to the Series B Preferred stock was \$3.1 million with the remaining \$2.9 million allocated to the August 2017 Offering Warrants. As a result of the allocation of the proceeds, we determined that there was a beneficial conversion feature in connection with the issuance of the Series B Preferred Stock since the calculated effective conversion price was at a discount to the fair market value of the Company's common stock at issuance date. The Company recognized the full beneficial conversion feature in the amount of \$2.3 million as a deemed dividend at time of issuance.

The conversion price of the Series B Preferred Stock contains a down round feature. As discussed in Note 2 of the accompanying unaudited condensed consolidated financial statements, the Company early adopted ASU 2017-11, which allowed the Company to treat the preferred stock as equity classified, despite the down round provision. The Company will recognize the effect of the down round feature when it is triggered. At that time, the effect would be treated as a deemed dividend and as a reduction of income available to common shareholders in our basic earnings per share calculation.

During the three and nine months ended September 30, 2017, 2,359 shares of Series B Preferred Stock were converted into 943,600 shares of our common stock.

At September 30, 2017, the Company had 3,641 shares of Series B Preferred Stock outstanding.

Common Stock Warrants.

Prior to the Merger, in connection with the line of credit with Connecticut Innovations, the Company issued warrants to purchase 8,542 Series A Preferred shares of the Company, which were classified as an equity warrant, at an exercise price of \$2.93 per unit, subject to adjustments as defined in the warrant agreement. The warrants were valued at \$6,000 at the date of the grant utilizing the Black-Scholes model (volatility 40%, expected life 7 years, and risk free rate .36%). The value of the warrants was treated as a debt discount. At the Merger date, the warrants were exercised and then converted into shares of Precipio common stock.

In connection with the Webster Bank agreement, the Company issued 7 years warrants to purchase 20,000 Series B Preferred shares of the Company. At the Merger date, Webster Bank declined to exercise their warrants and, per the terms of the warrant agreement, the warrants were retired.

In March 2016, the Company entered into a redemption and exchange agreement with certain member's relating to their 275,237 Preferred A Units and 208,087 Preferred B Units. Under the terms of the agreement, the unit holders would exchange their units in the Company for the issuance of debt. The aggregate purchase price per the agreement was the member's initial investment of \$750,000 for Preferred A Units and \$965,000 for Preferred B Units, along with a preferred return of 8%, recorded as a dividend in the amount of \$432,716. In addition to the debt issued as consideration for the members' preferred units, the Company also issued common warrant units, which allows the holders to collectively purchase common units of the Company, representing approximately 60% of the Company at the time of exercise. At the time of issuance, this represented approximately 1,958,204 common units. The common warrant units had a \$0.00 exercise price with a ten year expiration date. The common warrant units were classified as equity awards and the fair value upon issuance was calculated utilizing a discounted cash flow analysis to value the Company's equity and an option pricing method to allocate the value of the equity. The fair value of the warrants was determined directly utilizing the option pricing method as the exercise price was \$0.00. The aggregate value of the common warrant units was \$1,421,738, which was considered a deemed dividend. At the time of the Merger, these warrants were converted into 1,958,204 shares of Precipio common stock.

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 below.

2017 New Bridge Warrants

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During the nine months ended September 30, 2017, prior to the Merger, Transgenomic completed the sale of the 2017 Bridge Notes in the amount of \$1.2 million and the issuance of the 2017 Bridge Warrants to acquire 40,000 shares of the Company's common stock at an exercise price of \$15.00 per share, subject to anti-dilution protection. Aegis acted as placement agent for the bridge financing and received Aegis Warrants to acquire 5,600 shares of Transgenomic common stock at an exercise price of \$15.00 per share. The Aegis Warrants are identical to the 2017 Bridge Warrants except that the Aegis Warrants do not have anti-dilution protection. (See Note 5 - Convertible Bridge Notes).

In connection with the Merger, the holders of the 2017 Bridge Notes, the 2017 Bridge Warrants and the Aegis Warrants agreed to exchange the 2017 Bridge Notes, the 2017 Bridge Warrants and the Aegis Warrants for 2017 New Bridge Notes and the 2017 New Bridge Warrants to acquire 45,600 shares of our common stock. (See Note 6 - Convertible Bridge Notes). The initial exercise price of the 2017 New Bridge Warrants was \$7.50 (subject to adjustments). These warrants had a provision that if the Company completed a Qualified Offering (as defined in the 2017 New Bridge Warrants), the exercise price of the 2017 New Bridge Warrants would become the lower of (i) \$7.50 or (ii) 110% of the per share offering price in the Qualified Offering, but in no event lower than \$1.50 per share. As a result of the Series B Preferred Stock issued in the August 2017 Offering, the exercise price of the 2017 New Bridge Warrants was adjusted to \$2.75 per share.

At issuance, the 2017 New Bridge Warrants had a fair value of \$211,000 and were recorded as a debt discount to the related 2017 New Bridge Notes I, with the corresponding entry to additional paid in capital as the warrants were considered classified as equity in accordance with GAAP. At the time the exercise price was adjusted, due to the down round provision, the Company calculated the fair value of the down round provision on the warrants to be approximately \$12,000 and recorded this as deemed dividend.

Side Warrants

In connection with the bridge financing and the assumption of certain obligations by an entity controlled by Mark Rimer (a director of the Company), the Company issued to that entity Side Warrants to purchase an aggregate of 91,429 shares of the Company's common stock at an exercise price of \$7.00 per share (subject to adjustment), with a fair value of \$487,000 at the date of issuance. The Side Warrants have a term of 5 years and are exercisable as to 22,857 shares of the Company's common stock upon grant and as to 68,572 shares of the Company's common stock upon the entity's performance of the assumed obligations. All performance obligations have been met and the Company has recorded merger advisory expense of \$73,000 and \$487,000 related to the Side Warrants during the three and nine months ended September 30, 2017, respectively.

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 contains a down round provision. The August 2017 Offering Warrants were exercisable immediately and expire 5 years from date of issuance. The terms of the August 2017 Offering Warrants prohibit a holder from exercising its August 2017 Offering Warrants if doing so would result in such holder (together with its affiliates) beneficially owning more than 4.99% of the Company's outstanding shares of common stock after giving effect to such exercise, provided that, at the election of a holder and notice to the Company, such beneficial ownership limitation may be increased to 9.99% of the Company's outstanding shares of common stock after giving effect to such exercise.

Representative Warrants

In accordance with the underwriting agreement for the August 2017 Offering, the underwriter purchased 60,000 warrants, with an exercise price of \$3.125, for an aggregate price of \$100. The Representative Warrants are exercisable beginning one year after the date of the prospectus for the August 2017 Offering and expiring on a date which is no more than five years from the date of the prospectus for the August 2017 Offering. The fair value of the warrants at date of issuance of approximately \$113,000 was treated as a stock issuance cost and recorded as a reduction to additional paid in capital.

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. At the time of issuance, the Series A Conversion Warrants had a fair value of \$1.4 million and, as discussed in the Series A Senior Preferred Stock section above, these were issued and recorded as deemed dividends.

Note Conversion Warrants

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Three and Nine Months Ended September 30, 2017 and 2016

Upon the closing of the August 2017 Offering, \$900,000 of the Company's New Bridge Notes were converted into an aggregate of 359,999 shares of the Company's common stock and 359,999 Note Conversion Warrants. The Note Conversion Warrants have an exercise price of \$3.00 per share and a five year term. The exercise price contains a down round provision. The conversion of the Company's New Bridge Notes was treated as an induced conversion and at the date of the conversion the Company recorded an expense of approximately \$1.0 million which is included in loss on extinguishment of debt and induced conversion of convertible bridge notes in our unaudited condensed consolidated statements of operations (See Note 6 - Convertible Bridge Notes).

The following represents a summary of the warrants outstanding as of September 30, 2017:

| | Issue Year | Expiration | Underlying Shares | Exercise Price |
|--|------------|---------------|-------------------|----------------|
| <i><u>Warrants Assumed in Merger</u></i> | | | | |
| (1) | 2013 | January 2018 | 23,055 | \$270.00 |
| (2) | 2014 | April 2020 | 12,487 | \$120.00 |
| (3) | 2015 | February 2020 | 23,826 | \$67.20 |
| (4) | 2015 | December 2020 | 4,081 | \$49.80 |
| (5) | 2015 | January 2021 | 38,733 | \$36.30 |
| (6) | 2016 | January 2021 | 29,168 | \$36.30 |
| <i><u>Warrants</u></i> | | | | |
| (7) | 2017 | June 2022 | 45,600 | \$2.75 |
| (8) | 2017 | June 2022 | 91,429 | \$7.00 |
| (9) | 2017 | August 2022 | 2,680,000 | \$3.00 |
| (10) | 2017 | August 2022 | 60,000 | \$3.125 |
| (11) | 2017 | August 2022 | 856,446 | \$10.00 |
| (12) | 2017 | August 2022 | 359,999 | \$3.00 |
| | | | 4,224,824 | |

- (1) These warrants were issued in connection with an offering which was completed in January 2013.
- (2) These warrants were issued in connection with a private placement which was completed in October 2014.
- (3) These warrants were issued in connection with an offering which was completed in February 2015.
- (4) These warrants were issued in connection with an offering which was completed in July 2015.
- (5) These warrants were originally issued in connection with an offering in July 2015, and were amended in connection with an offering which was completed in January 2016.
- (6) These warrants were issued in connection with an offering which was completed in January 2016.
- (7) These warrants were issued in connection with the Merger and are the 2017 New Bridge Warrants discussed above.
- (8) These warrants were issued in connection with the Merger and are the Side Warrants discussed above.
- (9) These warrants were issued in connection with the August 2017 Offering and are the August 2017 Offering Warrants discussed above.
- (10) These warrants were issued in connection with the August 2017 Offering and are the Representative Warrants discussed above.
- (11) 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 above.

- (12) 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 above.

PRECIPIO, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—
(Continued)
Three and Nine Months Ended September 30, 2017 and 2016

11. 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.

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, 25,584 warrants remain outstanding as of September 30, 2017. 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.

The 2016 Warrant Liability is considered a Level 3 financial instrument and is valued using a binomial lattice simulation model. This method is well suited to valuing options with non-standard features. Assumptions and inputs used in the valuation of the common stock warrants include: our equity value, which was estimated using our stock price of \$2.16 as of September 30, 2017; volatility of 137%; and a risk-free interest rate of 1.20%.

During the three and nine months ended September 30, 2017, the changes in the fair value of the liability measured using significant unobservable inputs (Level 3) were comprised of the following:

Dollars in Thousands

| | <u>For the Three Months Ended</u> | |
|---|-----------------------------------|------------|
| | <u>September 30, 2017</u> | |
| Beginning balance at July 1 | \$ | 618 |
| Additions - liability assumed in the Merger | | — |
| Total (gains) or losses: | | |
| Recognized in earnings | | — |
| Balance at September 30 | <u>\$</u> | <u>618</u> |

PRECIPIO, INC. AND SUBSIDIARY
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Three and Nine Months Ended September 30, 2017 and 2016

Dollars in Thousands

| | <u>For the Nine Months Ended</u> <u>September 30, 2017</u> |
|---|---|
| Beginning balance at January 1 | \$ — |
| Additions - liability assumed in the Merger | 615 |
| Total (gains) or losses: | |
| Recognized in earnings | 3 |
| Balance at September 30 | <u>\$ 618</u> |

12. STOCK OPTIONS

Stock Options.

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 will expire on June 5, 2027. The following table summarizes stock option activity under our plans during the nine months ended September 30, 2017:

| | <u>Number of</u> <u>Options</u> | <u>Weighted-</u> <u>Average</u> <u>Exercise Price</u> |
|-----------------------------------|------------------------------------|---|
| Outstanding at January 1, 2017 | 24,600 | \$ 107.83 |
| Granted | 225,332 | 1.87 |
| Forfeited | (13,044) | 103.13 |
| Outstanding at September 30, 2017 | <u>236,888</u> | <u>\$ 7.30</u> |
| Exercisable at September 30, 2017 | <u>10,284</u> | <u>\$ 121.97</u> |

As of September 30, 2017, there were 236,590 options that were vested or expected to vest with an aggregate intrinsic value of approximately one hundred thousand with a remaining weighted average contractual life of 9.9 years. The weighted-average grant date fair values, based on the Black-Scholes option model, of options granted during the nine months ended September 30, 2017 was \$1.63.

During the three and nine months ended both September 30, 2017 and 2016, we recorded compensation expense for all stock awards of less than \$0.1 million within operating expense. As of September 30, 2017, the unrecognized compensation expense related to unvested stock awards was \$0.4 million, which is expected to be recognized over a weighted-average period of 3.8 years.

Stock Appreciation Rights ("SARs")

As of September 30, 2017, zero SARs shares were outstanding. During the nine months ended September 30, 2017, the SARs liability decreased approximately \$1,000 and at September 30, 2017, no liability was recorded in accrued expenses since there were no shares outstanding.

13. SUBSEQUENT EVENTS

Debt Settlement Agreements

On October 31, 2017, the Company entered into a Debt Settlement Agreement (the "Settlement Agreement") with certain of its accounts payable vendors (the "Creditors") pursuant to which the Creditors agreed to a reduction of approximately \$5.0 million in currently due vendor liabilities. The Company and the Creditors agreed to restructure these liabilities into approximately \$2.5 million in secured, long-term vendor

obligations with payments beginning in July 2018 and continuing over 48 months. In connection with the settlement, the Company agreed to issue to certain of the Creditors warrants (the “Creditor Warrants”) to purchase approximately 86,000 shares of the Company’s common stock at an exercise price of \$7.50 per share.

PRECIPIO, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—
(Continued)
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The Company also entered into a Security Agreement (the “Security Agreement”), dated October 31, 2017, with a collateral agent for the Creditors, pursuant to which the Company granted to the collateral agent, for the benefit of the Creditors, a security interest in certain property of the Company to secure its obligations under the Settlement Agreement.

The Creditor Warrants have a per share exercise price of \$7.50, are exercisable on the date of issuance and will expire five years from the date of issuance.

Issuance of preferred stock and warrants

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 Convertible Preferred Stock, par value \$0.01 per share (the “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 “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 gross proceeds to the Company from the sale of the Series C Preferred Stock and Warrants, before deducting the placement agent fee and other estimated offering expenses payable by the Company and assuming no exercise of the Warrants, were \$2,748,000. The Company expects to use the net proceeds of the offering for general corporate purposes, including, but not limited to, growth of the Company’s sales force and business development team, progression of the Company’s product development and working capital. The offering closed on November 9, 2017.

The Series C Preferred Offering required the Company to adjust downward the exercise and conversion prices of various warrants and Series B Preferred Stock that were outstanding at the time of the closing of the Series C Preferred Offering due to the down round provisions contained in certain of the Company's warrants and Series B Preferred Stock.

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.

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 audited financial statements and notes thereto of Precipio Diagnostics for the year ended December 31, 2016 contained in our current report on Form 8-K/A, filed with the Securities and Exchange Commission (the

“SEC”) on July 31, 2017. Results for the three and nine months ended September 30, 2017 are not necessarily indicative of results that may be attained in the future.

Merger

On June 29, 2017, or the Closing Date, the Company (then known as Transgenomic, Inc., or Transgenomic), completed a reverse merger, or the Merger, with Precipio Diagnostics, LLC, a privately held Delaware limited liability company, or Precipio Diagnostics, in accordance with the terms of the Agreement and Plan of Merger, or 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., or 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 merged company. In connection with the Merger, the Company changed its name from Transgenomic, Inc. to Precipio, Inc. and effected a 1-for-30 reverse stock split of its common stock. 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.

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. 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.

The following discussion should be read together with our financial statements and related notes contained in this Quarterly Report. Results for the three and nine months ended September 30, 2017 are not necessarily indicative of results that may be attained in the future.

Third Quarter 2017 Overview and Recent Highlights

During the third quarter of 2017, laboratory operations for Clinical Laboratory Improvement Amendments regulated commercial diagnostic testing were relocated and consolidated from the Omaha, Nebraska facility to New Haven, Connecticut. The initiative has enabled the Company to leverage its laboratory assets to accelerate commercialization of research and development products. The Company continued to work to integrate the finance organizations providing financial, billing, AP and accounting functions.

From a corporate governance perspective, we enhanced our board of directors by electing three experienced industry individuals. In addition, we also formulated our scientific advisory board, to create a strong scientific backbone to support the management team, and ensure that we continue product development. We continue to build on our long standing relationships with Yale Medicine, Harvard, and Dana Farber. Collaboration with academia and biopharma remains an integral component of our strategy to access advanced genetic technology and diagnostic testing in the cancer marketplace for future growth.

During the three months ending September 30, 2017, we focused on expanding our product offering and market awareness for ICP-PCR. These efforts will continue through 2017 and beyond. In addition, significant resource was directed on communicating the broad technical synergies and product development capabilities created through the Merger. We signed our first multi-national distribution agreement with Clearbridge Health, a Singaporean-based healthcare company that will be providing Precipio's services in numerous countries throughout Asia.

We have continued efforts to restructure our pre-merger debt obligations to manage expenses and cash

flow obligations. On October 31, 2017, we entered into a Debt Settlement Agreement, or the Settlement Agreement, with certain of our accounts payable vendors, or the Creditors, pursuant to which the Creditors agreed to a reduction of approximately \$5.0 million in currently due

vendor liabilities. We and the Creditors agreed to restructure these liabilities into approximately \$2.5 million in secured, long-term vendor obligations with payments beginning in July 2018 and continuing over 48 months. In connection with the settlement, we agreed to issue to certain of the Creditors warrants to purchase approximately 86,000 shares of our common stock at an exercise price of \$7.50 per share.

We also entered into a Security Agreement, dated October 31, 2017, with a collateral agent for the Creditors, pursuant to which we granted to the collateral agent, for the benefit of the Creditors, a security interest in certain of our property to secure our obligations under the Settlement Agreement.

Uncertainties

We have historically operated at a loss and have not consistently generated sufficient cash from operating activities to cover our operating and other cash expenses. We have been able to historically finance our operating losses through borrowings or from the issuance of additional equity. At September 30, 2017, we had cash and cash equivalents of approximately \$0.4 million. Our ability to continue as a going concern is dependent upon a combination of generating additional revenue and raising necessary financing to meet our obligations and pay our liabilities arising from normal business operations when they come due. The outcome of these matters cannot be predicted with any certainty at this time and raises substantial doubt that we will be able to continue as a going concern.

Results of Operations for the Three Months Ended September 30, 2017 and 2016

Net Sales. Net sales were as follows:

| | Dollars in Thousands | | | |
|-----------------|----------------------|--------|---------|-------|
| | Three Months Ended | | | |
| | September 30, | | | |
| | 2017 | 2016 | \$ | % |
| Total Net Sales | \$ 270 | \$ 365 | \$ (95) | (26)% |

Net sales decreased by \$0.1 million, or 26%, during the three months ended September 30, 2017 as compared to the same period in 2016. The decrease is entirely due to the decrease in cases processed during the three months ended September 30, 2017 as compared to the same period in 2016. We processed 207 cases during the three months ended September 30, 2017 as compared to 269 cases during the same period in 2016, or a 23% decrease in cases. The decrease in volume is the result of turnover of key sales personnel.

Cost of Diagnostic Services. Cost of diagnostic services 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. Cost of diagnostic services increased by \$0.1 million, or 46%, for the three months ended September 30, 2017 as compared to the same period in 2016. The increase is due to increased professional fees involved with the processing of patient tests in the three months ended September 30, 2017.

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

| | Dollars in Thousands | | | |
|---------------------|----------------------|--------|-------|------|
| | Three Months Ended | | | |
| | September 30, | | | |
| | 2017 | 2016 | 2017 | 2016 |
| Gross (Loss) Profit | \$ (77) | \$ 134 | (29)% | 35% |

Gross loss was a negative (29)% of total net sales, during the third quarter of 2017, compared to 35% of total net sales during the same quarter in 2016. The gross profit decreased by \$0.2 million during the three months ended September 30, 2017 as compared to the same period in 2016 due to the decreased revenues discussed above and associated fixed costs to operate our laboratories.

Operating Expenses. Operating expenses primarily consist of personnel costs, professional fees, travel costs, facility costs and depreciation. Our operating expenses increased by \$3.1 million to \$3.6 million during the three months ended September 30, 2017 as compared to the same period in 2016. The increase in operating expenses reflects the increase in professional fees attributed to legal expenses related to the Merger and increased compensation and other costs associated with restructuring the organization resulting from the Merger. Additional increases in our general and administrative expenses resulted from increased

related to acquired intangibles from the Merger and expenses related to operating as a public company. The increase during the three months ended September 30, 2017 also included a \$1.0 million impairment of goodwill charge resulting from interim impairment testing of goodwill during the current quarter. The interim impairment testing was triggered by the significant reduction in our market capitalization during the three months ended September 30, 2017.

Other Income (Expense). Other expense for the three months ended September 30, 2017 and 2016 includes interest expense of approximately \$1.9 million and \$0.2 million, respectively. The increase in interest expense is due to \$1.8 million of debt discounts and debt issuance costs that were amortized to interest expense during the third quarter of 2017 as a result of the payment and conversion of all of our convertible bridge notes during the quarter.

Also included in other expense for the three months ended September 30, 2017 was \$0.1 million of advisory fees related to the Merger.

Lastly, other expense included \$1.3 million in losses on extinguishment of debt and induced conversion of convertible bridge notes related to the conversion and payment of our convertible bridge notes during the current quarter.

During the three months ended September 30, 2017, other income included \$0.6 million in gains on settlements of certain vendor liabilities.

Results of Operations for the Nine Months Ended September 30, 2017 and 2016

Net Sales. Net sales were as follows:

| | Dollars in Thousands | | | |
|-----------------|----------------------|----------|----------|-------|
| | Nine Months Ended | | | |
| | September 30, | | | |
| | 2017 | 2016 | \$ | % |
| Total Net Sales | \$ 778 | \$ 1,407 | \$ (629) | (45)% |

Net sales decreased by \$0.6 million, or 45%, for the nine months ended September 30, 2017 as compared to the same period in 2016. The decrease is entirely due to the decrease in cases processed during the nine months ended September 30, 2017 as compared to the same period in 2016. We processed 636 cases during the nine months ended September 30, 2017 as compared to 996 cases during the same period in 2016, or a 36% decrease in cases. The decrease in volume is the result of turnover of key sales personnel.

Cost of Diagnostic Services. Cost of diagnostic services 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. Cost of diagnostic services increased by \$0.1 million for the nine months ended September 30, 2017 as compared to the same period in 2016. The increase is due to increased expenses to restructure and relocate the laboratory operations as a result of the Merger in 2017 and increased professional fees involved with the processing of patient tests during the nine months ended September 30, 2017.

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

| | Dollars in Thousands | | | |
|---------------------|----------------------|--------|------|------|
| | Nine Months Ended | | | |
| | September 30, | | | |
| | 2017 | 2016 | 2017 | 2016 |
| Gross (Loss) Profit | \$ (35) | \$ 697 | (5)% | 49% |

Gross profit was a negative (5)% of total net sales, for the nine months ended September 30, 2017, compared to 49% of total net sales for the same period in 2016. The gross profit decreased by \$0.7 million during the nine months ended September 30, 2017 as compared to the same period in 2016 and was due to the decreased revenues discussed above.

Operating Expenses. Operating expenses primarily consist of personnel costs, professional fees, travel costs, facility costs and depreciation. Our operating expenses increased by \$3.4 million to \$5.0 million for the nine months ended September 30, 2017 as compared to the same period in 2016. The increase in

operating expenses reflects the increase in professional fees attributed to legal expenses related to the Merger and increased compensation and other costs associated with the increased headcount and additional facility resulting from the Merger. Additional increases in our general and administrative expenses resulted from increased amortization related to acquired intangibles from the Merger and expenses related to operating as a public company. The increase during the nine months ended September 30, 2017 also included a \$1.0 million impairment of goodwill charge

resulting from interim impairment testing of goodwill during the third quarter. The interim impairment testing was triggered by the significant reduction in our market capitalization during the three months ended September 30, 2017.

Other Income (Expense). Other expense for the nine months ended September 30, 2017 and 2016 includes interest expense of approximately \$2.3 million and \$0.4 million, respectively. The increase in interest expense in the current year is due to \$1.9 million of debt discounts and debt issuance costs that were amortized to interest expense during 2017 related to our convertible bridge notes which were paid or converted to common stock during the third quarter.

Also included in other expense for the nine months ended September 30, 2017 was \$2.7 million of advisory fees related to the Merger.

Lastly, other expense included \$1.4 million in losses on extinguishment of debt and induced conversion of convertible bridge notes primarily related to the conversion and payment of our convertible bridge notes during the current quarter.

During the nine months ended September 30, 2017, other income included \$0.6 million in gains on settlements of certain vendor liabilities.

Liquidity and Capital Resources

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 we will realize our assets and discharge our liabilities in the ordinary course of business. We have incurred substantial operating losses and have used cash in our operating activities for the past several years. As of September 30, 2017, we had a net loss of \$10.7 million and negative working capital of \$12.6 million. Our ability to continue as a going concern is dependent upon a combination of achieving our business plan, including generating additional revenue, and raising additional financing to meet our debt obligations and paying liabilities arising from normal business operations when they come due.

To meet our current and future obligations we have taken the following steps to capitalize the business and successfully achieve our business plan:

- On October 31, 2017, we entered into a Debt Settlement Agreement, or the Settlement Agreement, with certain of our accounts payable vendors, or the Creditors, pursuant to which the Creditors agreed to a reduction of approximately \$5.0 million in currently due vendor liabilities. We and the Creditors agreed to restructure these liabilities into approximately \$2.5 million in secured, long-term vendor obligations with payments beginning in July 2018 and continuing over 48 months.
- On November 7, 2017, we completed our capital raise initiative issuing \$2.8 million in units consisting of Series C Preferred shares and warrants to purchase shares of our common stock.

Our working capital positions at September 30, 2017 and December 31, 2016 were as follows:

| | Dollars in Thousands | | |
|--|-----------------------|----------------------|-------------|
| | September 30, 2017 | December 31, 2016 | Change |
| Current assets (including cash and cash equivalents of \$381 and \$51, respectively) | \$ 1,112 | \$ 552 | \$ 560 |
| Current liabilities | 13,735 | 3,012 | 10,723 |
| Working capital | \$ (12,623) | \$ (2,460) | \$ (10,163) |

We completed the Merger on June 29, 2017 and in connection with the Merger we raised approximately \$1.2 million in gross proceeds and during the third quarter we completed an underwritten public offering with net proceeds of approximately \$5.0 million. These proceeds were used to fund our operating expenses and for payments on our debt and other liabilities. At September 30, 2017, we had cash on hand of \$0.4 million. To execute our strategic plan, on November 9, 2017 we raised additional funds from the sale of our Series C Preferred Stock and warrants to purchase our common stock. Net proceeds from this offering were approximately \$2.4 million. Also, on October 31, 2017, we entered into the Settlement Agreement with the Creditors pursuant to which the Creditors agreed to a reduction of approximately

\$5.0 million in currently due vendor liabilities. We and the Creditors agreed to restructure these liabilities into approximately \$2.5 million in secured, long-term vendor obligations with payments beginning in July 2018 and continuing over 48 months.

Notwithstanding the aforementioned circumstances, there remains substantial doubt about our ability to continue as a going concern. There can be no assurance that we will be able to successfully achieve our initiatives summarized above in order to continue as a going concern. The accompanying financial statements have been prepared assuming we will continue as a going concern and do not include any adjustments that might result should we be unable to continue as a going concern as a result of the outcome of this uncertainty.

Analysis of Cash Flows - Nine Months Ended September 30, 2017 and 2016

Net Change in Cash and Cash Equivalents. Cash and cash equivalents increased by \$0.3 million during the nine months ended September 30, 2017, compared to a decrease of \$0.2 million during the nine months ended September 30, 2016.

Cash Flows Used in Operating Activities. The cash flows used in operating activities of \$4.5 million during the nine months ended September 30, 2017 included a net loss of \$10.7 million, a decrease in accrued expenses and other liabilities of \$1.1 million and an increase in accounts receivable of \$0.1 million. These were partially offset by an increase in accounts payable of \$0.5 million and non-cash adjustments of \$5.9 million. The cash flows used in operating activities in the first nine months of 2016 included the net loss of \$1.3 million and an increase in accounts receivable of \$0.3 million. These were partially offset by an increase in accounts payable, accrued expenses and other liabilities of \$0.5 million and non-cash adjustments of \$0.5 million.

Cash Flows Provided by Investing Activities. Cash flows provided by investing activities were \$0.1 million and zero for the nine months ended September 30, 2017 and 2016, respectively. The \$0.1 million for the nine months ended September 30, 2017 was cash acquired as part of the merger transaction.

Cash Flows Provided by Financing Activities. Cash flows provided by financing activities totaled \$4.7 million for the nine months ended September 30, 2017, which included proceeds of \$0.3 million from the issuance of senior notes, \$1.4 million from the issuance of convertible notes and \$5.4 million from the issuance of preferred stock. These proceeds were partially offset by payments on our long-term debt of \$0.8 million, payments on our convertible bridge notes of \$1.5 million, and payments of capital lease obligations and deferred financing costs of \$0.1 million. Cash flows provided by financing activities during the nine months ended September 30, 2016 included proceeds of \$0.6 million from the issuance of convertible notes and other debt partially offset by \$0.1 million of payments on our debt, capital lease obligations and for deferred financing costs.

Off-Balance Sheet Arrangements

At each of September 30, 2017 and December 31, 2016, 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

We have entered into certain operating leases and purchase commitments as part of our normal course of business. See the accompanying unaudited condensed consolidated financial statements and Note 8 - "Contingencies" in the Notes to unaudited condensed consolidated financial statements for additional information regarding our contractual obligations and commitments

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. For additional information regarding our critical accounting policies and estimates, see the accompanying unaudited condensed consolidated financial statements and Note 2 - "Summary of Significant Accounting Policies" in the Notes to unaudited condensed consolidated Financial Statements and Note 1 of the audited financial statements and notes thereto of Precipio Diagnostics for the

year ended December 31, 2016 contained in our current report on Form 8-K/A, filed with the Securities and Exchange Commission (the “SEC”) on July 31, 2017.

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 Disclosures 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

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2017. Our management recognizes that neither our disclosure controls and procedures nor our internal controls over financial reporting will prevent all fraud and material error. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving our objectives. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Based on the evaluation of our disclosure controls and procedures as of September 30, 2017, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are not effective at a reasonable assurance level.

A material weakness is a significant deficiency, or combination of deficiencies, in internal control over financial reporting that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Based on the evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of September 30, 2017, the following deficiencies, that were noted in our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2017, continue to be material weaknesses:

- The Company's inability to account for the complex technical accounting treatment of complex debt and equity instruments.
- The Company's controls as related to revenue recognition resulting from the fact the Company does not have contracts with certain payors and does not have proper controls over the estimates for doubtful accounts and contractual allowances.

Accounting for technical accounting and valuation of complex debt and equity instruments:

A material weakness exists pertaining to a lack of expertise in the technical accounting and valuation of complex debt and equity instruments that are required to be reported in accordance with accounting principles generally accepted in the United States of America and the valuation of fair values. To address the material weaknesses the Company continues to seek assistance with various third parties with expertise in such instruments and matters of fair value, in order to ensure that the Company's financial statements were prepared in accordance with U.S. GAAP on a timely basis.

Controls related to revenue recognition:

A material weakness exists due to the fact the Company does not have contracts with certain payors and does not have proper controls over the estimates for doubtful accounts and contractual allowances. The Company's net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered. Revenue estimates are also subject to retroactive

adjustments under reimbursement agreements. Healthcare reimbursement laws and regulations governing Medicare and Medicaid programs that represent a portion of the Company's net patient service revenues

are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near future. To address the material weakness the Company has added an additional review and reconciliation step to the revenue recognition process to ensure that all reported revenue recognizes appropriate third party contractual allowances and allowance for doubtful accounts. In addition, the additional review process will include current collection trends of payments and their impact on realizable revenues.

While implementation of the remediation actions are in process, it will take time for such actions to be fully integrated and confirmed to be effective and sustainable. Until such time, the material weaknesses described above will continue to exist.

Changes in Internal Control over Financial Reporting

We have evaluated the changes in our internal control over financial reporting that occurred during the three months ended September 30, 2017 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.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See the accompanying unaudited condensed consolidated financial statements and Note 8 - "Contingencies" in the Notes to unaudited condensed consolidated financial statements for additional information regarding legal proceedings.

Item 1A. Risk Factors

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, 2016, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K, as updated in our Quarterly Report for the quarter ended June 30, 2017 and this Quarterly Report, 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 September 30, 2017 and December 31, 2016, we have an accumulated total deficit of approximately \$21.5 million and \$10.8 million, respectively. For the nine months ended September 30, 2017 and the fiscal year ended December 31, 2016, we had a net loss and comprehensive loss attributable to common stockholders of approximately \$19.8 million and \$4.1 million, respectively. 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 September 30, 2017, our cash balance was \$0.4 million and our working capital was approximately negative \$12.6 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.

We will need to obtain stockholder approval of the shares issued and issuable in our November 2017

registered direct offering before we can raise additional capital.

Our Series C Certificate of Designation prohibits us from issuing any shares of common stock or securities convertible or exercisable into common stock at a price per share below the then effective conversion price of our Series C Preferred Stock, subject to certain

exceptions, or entering into any agreement or making any public announcement with respect to such a dilutive issuance, until we have filed a proxy statement under Section 14(a) of the Exchange Act or information statement pursuant to Section 14(c) of the Exchange Act with the SEC and obtained approval of our November 2017 registered direct offering from our stockholders, or the Stockholder Approval, including approval of issuances in excess of the maximum number of shares issuable under the rules and regulations of the Nasdaq Capital Market. In addition, pursuant to the placement agency agreement for our November 2017 registered direct offering, or the November Offering, we have agreed, until the later of (i) 90 days after the closing date of the November Offering, and (ii) the date on which Stockholder Approval has been obtained, not to issue, enter into any agreement to issue or announce the issuance or proposed issuance of any shares of common stock or securities convertible or exercisable into common stock, subject to certain exceptions; provided that the foregoing restriction under the placement agency agreement will lapse at such time as each holder of Series C Preferred Stock owns less than 20% of the number of shares of Series C Preferred Stock originally purchased in the November Offering and less than 20% of the warrants (based on the number of shares underlying the warrants) originally purchased in the November Offering. If we are not able to obtain Stockholder Approval or a waiver of the foregoing restriction under the placement agency agreement, we will not be able to raise additional capital and we may have to significantly delay, scale back or discontinue the development and/or commercialization of one or more of our product candidates or restrict or cease our operations.

We have identified material weaknesses in our internal control over financial reporting that could, if not remediated, result in material misstatements in our financial statements.

We have identified material weaknesses in our internal control over financial reporting that could, if not remediated, result in material misstatements in our financial statements.

Based on our evaluation of internal control over financial reporting, we have identified the following deficiencies that we believe to be material weaknesses: (i) our lack of expertise necessary to validate the proper accounting and valuation for the complex technical accounting treatment of complex debt and equity instruments and (ii) our controls as related to revenue recognition resulting from the fact we do not have contracts with certain payors and do not have proper controls over the estimates for doubtful accounts and contractual allowances.

We have initiated remedial measures, but if our remedial measures are insufficient to address the material weaknesses, or if the material weaknesses are not remediated within the time period we currently anticipate, or if additional material weaknesses or significant deficiencies in our internal control over financial reporting are discovered or occur in the future, our consolidated financial statements may contain material misstatements, and we could be required to restate our financial results. In addition, if we are unable to successfully remediate these material weaknesses and if we are unable to produce accurate and timely financial statements, our stock price may be materially adversely affected and we may be unable to maintain compliance with applicable stock exchange listing requirements. Effective internal controls are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information, and the trading price of our common stock could drop significantly.

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

None other than the sales previously disclosed in our Current reports on Form 8-K filed on April 17, 2017, June 27, 2017 and June 20, 2017.

Item 6.

Exhibits

(a) Exhibits

- 1.1 [Underwriting Agreement, dated August 22, 2017, by and among the Company and the underwriters party thereto \(incorporated by reference to Exhibit 1.1 of the Company's Form 8-K filed on August 23, 2017\).](#)
- 3.1 [Certificate of Designation for Series B Preferred Stock \(incorporated by reference to Exhibit 3.1 of the Company's Form 8-K filed on August 31, 2017\).](#)
- 4.1 [Form of Offering Warrant \(incorporated by reference to Exhibit 4.1 of the Company's Form 8-K filed on August 23, 2017\).](#)
- 4.2 [Form of Underwriter Warrant \(incorporated by reference to Exhibit 4.2 of the Company's Form 8-K filed on August 23, 2017\).](#)
- 4.3 [Form of Conversion Warrant \(incorporated by reference to Exhibit 4.3 of the Company's Form 8-K filed on August 23, 2017\).](#)
- 31.1 [Certification of Ilan Danieli, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended.](#)
- 31.2 [Certification of Carl Iberger, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended.](#)
- 32.1 [Certification of Ilan Danieli, Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended.](#)
- 32.2 [Certification of Carl Iberger, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended.](#)
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

