

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

**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2019

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 000-21617

**ProPhase Labs, Inc.**

(Exact name of registrant as specified in its charter)

<u>Delaware</u> (State or other jurisdiction of incorporation or organization)	<u>23-2577138</u> (I.R.S. Employer Identification No.)
<u>621 N. Shady Retreat Road, Doylestown, Pennsylvania</u> (Address of principal executive offices)	<u>18901</u> (Zip Code)

Registrant's telephone number, including area code (215) 345-0919

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.0005 par value per share	NASDAQ Capital Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition 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       Non-accelerated filer       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 Act). Yes  No

The aggregate market value of the registrant's voting and non-voting Common Stock held by non-affiliates was \$18,874,940 as of June 30, 2019, based on the closing price of the Common Stock on The Nasdaq Capital Market.

As of March 26, 2020, there were 11,581,939 shares outstanding of the registrant's common stock, par value \$0.0005 per share.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive proxy statement relating to its 2020 annual meeting of stockholders (the "2020 Proxy Statement") are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated. The 2020 Proxy Statement will be filed with the U.S. Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates.

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## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (“Annual Report”) contains “forward looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements typically are identified by use of terms such as “anticipate”, “believe”, “plan”, “expect”, “intend”, “may”, “will”, “should”, “estimate”, “predict”, “potential”, “continue” and similar words although some forward-looking statements are expressed differently. These forward looking statements relate to future events or our future financial performance and are subject to known and unknown risks, uncertainties and other factors that may cause our or our industry’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements. Many of these factors are beyond our ability to predict. Given the risks and uncertainties surrounding forward-looking statements, you should not place undue reliance on these statements. You are cautioned that such forward looking statements are not guarantees of future performance and that all forward-looking statements address matters that involve risks and uncertainties, and that there are many important risks, uncertainties and other factors that could cause our actual results, levels of activity, performance, achievements and prospects, as well as those of the markets we serve, to differ materially from the forward-looking statements contained in this Annual Report.

Such risks and uncertainties include, but are not limited to:

- We have a history of losses;
- Our dependence on our largest manufacturing customers;
- Potential disruptions in our ability to manufacture our products and those of others or our access to raw materials;
- Seasonal fluctuations in demand for the products we manufacture at our manufacturing facility; and
- Our ability to successfully develop and commercialize our existing products and any new products;
- Our ability to secure additional capital, when needed, to support our product development and commercialization programs;
- Our ability to compete effectively, including our ability to maintain and increase our markets and/or market share in the markets in which we do business;
- Our ability to protect our proprietary rights;
- The general financial and economic uncertainty, fluctuations in consumer confidence and the strength of the United States economy, and their impacts on our business including demand for our products;
- Our continued ability to comply with regulations relating to our current products and those we manufacture for others, any new products we develop, including our ability to effectively respond to changes in laws and regulations or the interpretation thereof including changing market rules and evolving federal, state and regional laws and regulations;
- Our ability to attract, retain and motivate our key employees.

You should also consider carefully the statements under other sections of this Annual Report, including the Risk Factors included in Item 1A, which address additional risks that could cause our actual results to differ from those set forth in any forward-looking statements. Our forward-looking statements speak only as of the date of this Annual Report. We undertake no obligation to publicly update or review any forward-looking statements, whether as a result of new information, future developments or otherwise except as otherwise required by law.

## **PART I**

### **Item 1. Business**

#### **General**

ProPhase Labs, Inc. (“ProPhase” or the “Company”) was initially organized in Nevada in July 1989. Effective June 18, 2015, we changed our state of incorporation from the State of Nevada to the State of Delaware. Our principal executive offices are located at 621 N. Shady Retreat Road, Doylestown, Pennsylvania 18901 and our telephone number is 215-345-0919.

We are a manufacturing and marketing company with deep experience with OTC consumer healthcare products and dietary supplements. We are also engaged in the research, development, manufacture, distribution, marketing and sale of OTC consumer healthcare products and dietary supplements in the United States. This includes the development and marketing of dietary supplements under the TK Supplements® brand.

Our wholly-owned subsidiary, Pharmaloz Manufacturing, Inc. (“PMI”), is a full service contract manufacturer and private label developer of a broad range of non-GMO, organic and natural-based cough drops and lozenges and OTC drug and dietary supplement products.

Since the sale of our Cold-EEZE® business in 2017, we will continue to actively pursue acquisition opportunities for other businesses, technologies and products within and outside the consumer products industry.

We use a December 31 year-end for financial reporting purposes. References in this Annual Report to “Fiscal 2019” mean the fiscal year ended December 31, 2019 and references to other “Fiscal” years mean the year that ended on December 31 of the year indicated. The term “we”, “us” or the “Company” as used herein also refer, where appropriate, to the Company, together with its subsidiaries unless the context otherwise requires.

Revenues from continuing operations for Fiscal 2019 and 2018 were \$9.9 million and \$13.1 million, respectively. As of December 31, 2019, we had working capital of approximately \$9.0 million, including \$0.9 million of marketable securities available for sale. We believe our current working capital is an acceptable and adequate level of working capital to support our business for at least the next twelve months.

Net loss for Fiscal 2019 and 2018 were \$3.1 million and \$1.7 million, respectively.

#### **Contract Manufacturing Services**

PMI provides product development, pre-commercialization services, production, warehousing and distribution services for its customers. Our manufacturing facility, which is located in Lebanon, Pennsylvania, is registered with the U.S. Food and Drug Administration (the “FDA”) and is certified organic and kosher.

As part of the sale of our Cold-EEZE® business in March 2017 (see “Discontinued Operations” below), PMI entered into a manufacturing agreement with Mylan Consumer Healthcare Inc. (formerly known as Meda Consumer Healthcare Inc.) (“MCH”) and Mylan Inc. (together with MCH, “Mylan”) to supply various Cold-EEZE® lozenge products to Mylan following the sale for a period of five years with annual renewal options.

For each of Fiscal 2019 and 2018, our revenues from continuing operations have come principally from our contract manufacturing services. Three third-party contract manufacturing customers accounted for 36.5%, 30.5% and 11.1%, respectively, of our Fiscal 2019 revenues from continuing operations. The loss of sales to any one or more of these large third-party contract manufacturing customers could have a material adverse effect on our business operations and financial condition, unless we are able to increase revenue from other sources.

#### **TK Supplements® Product Line**

Our TK Supplements® product line is dedicated to promoting better health, energy and sexual vitality. Each of our herbal supplements is researched to determine the optimum blend of ingredients to ensure our customers receive premium quality products. To achieve this, we formulate with the highest quality ingredients derived from nature and ingredients enhanced by science. Our TK Supplements® product line includes Legendz XL®, a male sexual enhancement, Triple Edge XL®, an energy and stamina booster, and Super Prostaflow+™, a supplement to support prostate and urinary health.

In Fiscal 2019, we extended our distribution of Legendz XL<sup>®</sup> to include more customer accounts including national chain drug retailers, internet-based retailers and several regional retailers. We are currently awaiting for product acceptance from other national retailers, which we expect to receive in Fiscal 2020, and intend to leverage our existing infrastructure and retail distribution platform during Fiscal 2020. We have produced and refined a direct response television commercial and initiated television and digital media testing for Legendz XL<sup>®</sup> for marketing direct to consumers. We have also completed a broad series of clinical studies that support important product claims that we have incorporated into our product packaging and marketing communications for Legendz XL<sup>®</sup>.

We also introduced Triple Edge XL<sup>®</sup> to a limited number of retail customers in Fiscal 2019 and we are awaiting customer acceptance for this product.

As with any new product launch, we anticipate losses from our TK Supplements<sup>®</sup> product line as we optimize our market strategy and expand our channels of distribution. There can be no assurance that our strategic focus will result in any revenue growth.

### **Direct Marketing Services**

In August 2017, we formed ProPhase Digital Media (“PDM”), Inc., a Delaware corporation and wholly-owned subsidiary of ProPhase Labs, Inc. PDM was set up as an independent full-service direct marketing agency whose first initiative was to market the TK Supplements<sup>®</sup> product line. We closed the operations of PDM in fourth quarter of Fiscal 2019 due to underperformance of expected sales levels for our TK Supplements<sup>®</sup> product line.

### **Discontinued Operations**

Prior to March 29, 2017, our flagship OTC drug brand was Cold-EEZE<sup>®</sup> and our principal product was Cold-EEZE<sup>®</sup> cold remedy zinc gluconate lozenges. In addition to Cold-EEZE<sup>®</sup> cold remedy lozenges, we also marketed and distributed non-lozenge forms of our proprietary zinc gluconate formulation, (i) Cold-EEZE<sup>®</sup> cold remedy QuickMelts<sup>®</sup>, (ii) Cold-EEZE<sup>®</sup> Gummies and (iii) Cold-EEZE<sup>®</sup> cold remedy oral spray.

Effective March 29, 2017, we sold our intellectual property rights and other assets related to the Cold-EEZE<sup>®</sup> brand and product line, including all then current and pipeline over-the-counter allergy, cold, flu, multi-symptom relief and immune support treatments for adults and children to the extent each was, or was intended to be, branded “Cold-EEZE<sup>®</sup>”, including all formulations and derivatives thereof (collectively referred to as the “Cold-EEZE<sup>®</sup> business”) to Mylan. As a consequence of the sale of the Cold-EEZE<sup>®</sup> business, for the year ended December 31, 2017, we have classified as discontinued operations (i) all income and expenses attributable to the Cold-EEZE<sup>®</sup> Business, (ii) the gain from the sale of the Cold-EEZE<sup>®</sup> business, and (iii) the income tax expense attributed to the sale of the Cold-EEZE<sup>®</sup> business. Excluded from the sale of the Cold-EEZE<sup>®</sup> business were our accounts receivable and inventory. We have also retained all liabilities associated with our Cold-EEZE<sup>®</sup> business operations arising prior to March 29, 2017.

For Fiscal 2019 and 2018, we incurred costs of \$40,000 and \$170,000, respectively, which were recorded as a loss on sale of discontinued operations, net of taxes.

### **Seasonality of the Business**

Our manufacturing revenues are subject to seasonal fluctuations. As the majority of products that we manufacture for our customers are OTC healthcare and cold remedy products, our revenues tend to be higher in the first, third and fourth quarters during the cold season. Generally, a cold season is defined as the period from September to March when the incidence of the common cold rises as a consequence of the change in weather and other factors. Revenues are generally at their lowest levels during the second quarter when contract manufacturing demand generally declines.

### **Patents, Trademarks and Royalty Agreements**

We do not currently own any patents. We maintain various trademarks for our TK Supplements<sup>®</sup> products including Legendz XL<sup>®</sup>, Triple Edge XL<sup>®</sup> and Super ProstaFlow+<sup>™</sup>.

### **Government Regulation**

Our business is subject to extensive governmental regulation by various federal, state, and local agencies.

## *U.S. Food and Drug Administration*

### Pharmaceutical Regulation

The manufacturing and distribution of pharmaceutical products are subject to extensive regulation by the federal government, primarily through the FDA and the Drug Enforcement Administration (“DEA”), and to a lesser extent by state and local government agencies. The Food, Drug, and Cosmetic Act (“FFDCA”) and other federal statutes and regulations govern or influence the manufacture, labeling, testing, storage, record keeping, approval, advertising and promotion of OTC pharmaceutical products.

Facilities used in the manufacture, packaging, labeling and repackaging of drug products, including OTC drug products, must be registered with the FDA and are subject to FDA inspection to ensure that drug products are manufactured in accordance with current Good Manufacturing Practice (“cGMPs”).

FDA approval is required before any “new drug” may be marketed, including new formulations, strengths, dosage forms and generic versions of previously approved drugs. Generally, to obtain FDA approval of a “new drug” a company must file a New Drug Application (“NDA”) or Abbreviated New Drug Application (“ANDA”).

Under the OTC monograph system, selected OTC drugs are generally recognized as safe and effective and do not require the submission and approval of a NDA or ANDA prior to marketing.

The FDA OTC monographs include well-known ingredients and specify requirements for permitted indications, required warnings and precautions, allowable combinations of ingredients and dosage levels. Drug products marketed under the OTC monograph system must conform to specific quality, formula and labeling requirements; however, these products can be developed and marketed without prior FDA approval unlike products requiring a submission and approval of an ANDA or NDA. In general, it is less costly to develop and bring to market a product regulated under the OTC monograph system. From time to time, adequate information may become available to the FDA regarding certain prescription drug products that will allow the reclassification of those products as no longer requiring the approval of an ANDA or NDA prior to marketing. For this reason, there may be increased competition and lower profitability related to a particular OTC-switch product should it be reclassified to the OTC monograph system.

The FDA and the United States Pharmacopeia Convention (the “USP”) have embarked on an initiative to modernize the monograph requirements of OTC drugs. We are monitoring the situation and will make appropriate adjustments to remain in compliance. In addition, regulations may change from time to time, requiring formulation, packaging or labeling changes for certain products. We cannot predict whether new legislation regulating our activities will be enacted or what effect any legislation would have on our business.

Noncompliance with applicable requirements can result in product recalls, seizure of products, injunctions, suspension of production and/or distribution, refusal of the government or third parties to enter into contracts with us, withdrawal or suspension of the applicable regulator’s review of our drug applications, civil penalties and criminal fines, and disgorgement of profits.

### Dietary Supplement Regulation

The FDA regulates dietary supplements under a different set of regulations than those covering “conventional” foods and drug products (prescription and OTC). Under the Dietary Supplement Health and Education Act (the “DSHEA”), which was passed in 1994, dietary supplements that were in commerce prior to 1994 are broadly presumed safe. For these supplements, manufacturers do not need to register their products with the FDA nor get FDA approval before producing or selling them. Manufacturers must make sure that product label information is truthful and not misleading. For these products, the FDA is responsible for taking action against any unsafe or misbranded dietary supplement product after it reaches the market. All new ingredients marketed within dietary supplements after 1994 that are not found in food must meet a stricter set of regulations and notification prior to release in the marketplace.

In June 2007, pursuant to the authority granted by the FFDCA as amended by DSHEA, the FDA published detailed cGMP regulations that govern the manufacturing, packaging, labeling, and holding operations of dietary supplement manufacturers. The cGMP regulations, among other things, impose significant recordkeeping requirements on manufacturers. The cGMP requirements are in effect for all manufacturers, and the FDA is conducting inspections of dietary supplement manufacturers pursuant to these requirements. The failure of a manufacturing facility to comply with the cGMP regulations renders products manufactured in such facility “adulterated” and subjects such products and the manufacturer to a variety of potential FDA enforcement actions.

In addition, under the Food Safety Modernization Act, (the “FSMA”), which was enacted on January 2, 2011, the manufacturing of dietary ingredients contained in dietary supplements are subject to similar or even more burdensome manufacturing requirements, which has the potential to increase the costs of dietary ingredients and subject suppliers of such ingredients to more rigorous inspections and enforcement. The FSMA requires importers of food, including dietary supplements and dietary ingredients, to conduct verification activities to ensure that the food they might import meets applicable domestic requirements. The FSMA also expands the reach and regulatory powers of the FDA with respect to the production and importation of food, including dietary supplements. The expanded reach and regulatory powers include the FDA’s ability to order mandatory recalls, administratively detain domestic products, require certification of compliance with domestic requirements for imported foods associated with safety issues and administratively revoke manufacturing facility registrations, effectively enjoining manufacturing of dietary ingredients and dietary supplements without judicial process. The regulation of dietary supplements may increase or become more restrictive in the future.

Under FFDCA, dietary supplements are subject to both adulteration and misbranding provisions. Adulterated products are those that contain unlisted ingredients or are not prepared or packaged under the FDA cGMPs for dietary supplements and misbranded products are those with false or misleading labels. Adulterated or misbranded products are subject to the full range of civil and criminal enforcement measures under the FFDCA and all violations of FFDCA are subject to criminal enforcement at the FDA’s discretion.

We are also subject to the Dietary Supplement and Nonprescription Drug Consumer Protection Act, which was passed in 2006 to amend the FFDCA with respect to serious adverse event reporting for dietary supplements and nonprescription drugs, among other things. The law requires that the manufacturer, packer or distributor of a dietary supplement or OTC drug notify the FDA of all serious adverse events it receives associated with their dietary supplement or OTC product within 15 business days. Serious adverse events are defined as those that result in death, a life-threatening experience, in-patient hospitalization, a persistent or significant disability or incapacity, congenital anomaly or birth defect, as well as situations where medical/surgical intervention is required to prevent the previously listed events.

### ***Consumer Product Safety Commission***

Under the Poison Prevention Packaging Act (“PPPA”), the CPSC has authority to require that certain dietary supplements and certain pharmaceuticals have child-resistant packaging to help reduce the incidence of accidental poisonings. The CPSC has published regulations requiring iron-containing dietary supplements and various pharmaceuticals to have child resistant packaging, and has established rules for testing the effectiveness of child-resistant packaging and for ensuring senior adult effectiveness.

The Consumer Product Safety Improvement Act of 2008 (“CPSIA”) amended the Consumer Product Safety Act (“CPSA”) to require that the manufacturer of any product that is subject to any CPSC rule, ban, standard or regulation certify that based on a reasonable testing program the product complies with CPSC requirements. This certification applies to pharmaceuticals and dietary supplements that require child-resistant packaging under the PPPA. The CPSC lifted the stay of enforcement of the certification requirement and the regulation has been in effect since February 9, 2010.

### ***Federal Trade Commission***

Advertising of our products in the United States is subject to regulation by the Federal Trade Commission (the “FTC”) under the Federal Trade Commission Act (the “FTC Act”). Under the FTC’s Substantiation Doctrine, an advertiser is required to have a “reasonable basis” for all objective product claims before the claims are made. Failure to adequately substantiate claims may be considered either deceptive or unfair practices. Pursuant to this FTC requirement, we are required to have adequate substantiation for all material advertising claims that we make for any products sold in the United States.

In recent years, the FTC has initiated numerous investigations of and actions against companies that sell dietary supplements. The FTC has issued guidance to assist companies in understanding and complying with its substantiation requirement. We believe that we have adequate substantiation for all material advertising claims that we make for our products in the United States, and we believe that we have organized the documentation to support our advertising and promotional practices in compliance with these guidelines. However, no assurance can be given that the FTC would reach the same conclusion if it were to review or question our substantiation for our advertising claims in the United States.

The FTC may enforce compliance with the law in a variety of ways, both administratively and judicially, using compulsory process, cease and desist orders, and injunctions. FTC enforcement can result in orders requiring, among other things, limits on advertising, corrective advertising, consumer redress, divestiture of assets, rescission of contracts, and such other relief as the agency deems necessary to protect the public. Violation of these orders could result in substantial financial or other penalties. Although we have not been the subject of any action by the FTC, no assurance can be given that the FTC will not question our advertising or other operations in the United States in the future. Any action in the future by the FTC could materially and adversely affect our ability to successfully market our products in the United States.

## **Other Regulatory Oversight**

We are also subject to regulation under various state, local, and international laws that include provisions governing, among other things, the formulation, manufacturing, packaging, labeling, advertising, and distribution of dietary supplements and OTC drugs. For example, Proposition 65 in the State of California is a list of substances deemed to pose a risk of carcinogenicity or birth defects at or above certain levels. If any such ingredient exceeds the permissible levels in a dietary supplement, cosmetic, or drug, the product may be lawfully sold in California only if accompanied by a prominent warning label alerting consumers that the product contains an ingredient linked to cancer or birth defect risk. Private attorney general actions as well as California attorney general actions may be brought against non-compliant parties and can result in substantial costs and fines.

## **Competition**

We compete with other contract manufacturers of OTC healthcare products. These suppliers range widely in size. Management believes that our manufacturing capacity and abilities offer a significant advantage over many of our competitors in the full service contract development and manufacturing industry. We have over 20 years of manufacturing experience and industry know how in large scale batch production of OTC lozenge products. The markets for OTC healthcare products and dietary supplements are highly competitive. Many of the participants in these industries have substantially greater capital resources, technical staffs, facilities, marketing resources, product development, and distribution experience than we do. We believe that our ability to compete in these industries will continue to depend on a number of factors, including product quality and price, availability, speed to market, consumer marketing, reliability, credit terms, brand name recognition, delivery time and post-sale service and support.

## **Employees**

At December 31, 2019, we employed 48 full-time employees and 2 part-time employees, the majority of whom were employed at our manufacturing facility in a production function. The remaining employees were involved in an executive, sales, marketing or administrative capacity. None of our employees are covered by a collective bargaining agreement or are members of a union.

## **Where You Can Find Other Information**

We file periodic and current reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). We make available on our website ([www.ProPhaseLabs.com](http://www.ProPhaseLabs.com)) free of charge our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to or exhibits included in those reports as soon as reasonably practical after we electronically file such materials with or furnish them to the SEC. Information appearing on our website is not part of this Annual Report. In addition, the SEC maintains an Internet site ([www.sec.gov](http://www.sec.gov)) that contains reports, proxy and information statements regarding issuers that file electronically with the SEC, including the Company.

## **Item 1A. Risk Factors**

*The following discussion addresses risks and uncertainties that could cause, or contribute to causing, actual results to differ from our expectations in material ways. In evaluating our business, investors should pay particular attention to the risks and uncertainties described below and in other sections of this Annual Report and in our subsequent filings with the SEC. These risks and uncertainties, or other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations, cash flows and financial condition. The trading price of our common stock could also decline due to any of these risks. The following information should be read in conjunction with Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the financial statements and related notes included in Part II, Item 8, "Financial Statements and Supplementary Data" of this Annual Report.*

### ***We have a history of losses.***

We have experienced net losses from continuing operations before income tax for our last two fiscal years. As of December 31, 2019, we had working capital of approximately \$9.0 million, which we believe is an acceptable and adequate level of working capital to support our business for at least the next twelve months ending March 2021. Following the sale of our Cold-EEZE® business in March 2017, we have been actively exploring new product technologies, applications, product line extensions and other new product opportunities and may consider and pursue other alternatives and strategies, including, but not limited to, investments and acquisitions in other sectors and industries. There can be no assurance that our strategic focus will result in any revenue growth or that we will be successful in initiating or acquiring any new lines of business, or that any such new lines of business will achieve profitability.



***The loss of sales to any one or more of our large third-party contract manufacturing customers could have a material adverse effect on our business operations and financial condition.***

For each of Fiscal 2019 and 2018, our revenues from continuing operations came principally from our contract manufacturing services. Three third-party contract manufacturing customers, accounted for 36.5%, 30.5% and 11.1%, respectively, of Fiscal 2019 revenues from continuing operations. The loss of sales to any one or more of these third-party contract manufacturing customers could have a material adverse effect on our business operations and financial condition, unless we are able to increase revenue from other sources.

***Our financial condition and results of operations could be adversely affected by the recent coronavirus outbreak.***

Our financial condition and results of operations could be adversely affected by the recent coronavirus outbreak. On March 19, 2020, the Governor of Pennsylvania ordered all non-life-sustaining businesses in Pennsylvania to close their physical locations in order to slow the spread of COVID-19. As a pharmaceutical manufacturer, we are currently permitted to continue our operations. However, as the impact of the global outbreak of the coronavirus continues to rapidly evolve, the extent to which the coronavirus may ultimately impact our business will depend on future developments, which are highly uncertain and cannot be predicted with confidence at this time.

At this time, the coronavirus has not caused major disruptions to our operations, nor has it affected our employees. However, if the coronavirus outbreak continues to spread, it may affect our employees, our customers and our suppliers in ways which could materially adversely affect our business, financial condition and results of operations. The coronavirus outbreak could disrupt our operations due to absenteeism by infected or ill employees and/or members of management, or absenteeism by employees and/or members of management who elect not to come to work due to the virus affecting others in our office or manufacturing facility, or due to quarantines.

If the scope and severity of the coronavirus outbreak continues to worsen, our operations could potentially experience disruptions, such as temporary closure of our headquarters or manufacturing facility, and/or delays or suspensions in our manufacturing services, which may materially and adversely affect our business, financial condition and results of operations. We may also experience challenges in obtaining sufficient components or raw materials at a cost-effective price to fulfill our customers' orders or to manufacture our own TK Supplements® products. If our manufacturing customers' businesses are similarly affected, they may delay or reduce purchases of products from us, which could materially and adversely affect our business, financial condition and results of operations. Moreover, the coronavirus outbreak has begun to have indeterminable adverse effects on general commercial activity and the world economy, and our business and results of operations could be adversely affected to the extent the coronavirus harms the global economy generally.

***The customers for whom we contract manufacture may significantly influence our business, financial condition and results of operations.***

Our contract manufacturing business is dependent on demand for the products we manufacture for our customers and we have no control or influence over the market demand for those products. Demand for our customers' products may be adversely affected by, among other things, regulatory issues, the loss of patent or other intellectual property rights protection, the emergence of competing products, competition from other contract manufacturers, negative public or consumer perception of those products or our industry and changes in the marketing strategies for such products. If production volumes of products that we manufacture for third-parties and related revenues are not maintained or if there is any change in the terms or termination of our manufacturing agreement with Mylan or any of our other significant customers, it may have a material adverse impact on our business, financial condition and results of operations.

***Our business is subject to significant competitive pressures.***

We compete with other contract manufacturers of OTC drug and dietary supplement products. These suppliers range widely in size. We compete primarily on the basis of price, quality and service. Management believes that our manufacturing capacity and abilities offer a significant advantage over many of our competitors in the full service contract development and manufacturing industry. We have over 20 years of manufacturing experience and industry know how in large scale batch production of OTC lozenge products. To the extent that any of our competitors are able to offer better prices, quality and/or services, however, we could lose customers and our sales and margins may decline.

The OTC healthcare products and dietary supplements industries are highly competitive. Many of the participants in these industries have substantially greater capital resources, technical staffs, facilities, marketing resources, product development, and distribution experience than we do. We believe that our ability to continue to compete in these industries will depend on a number of factors, including product quality and price, availability, speed to market, consumer marketing, reliability, credit terms, brand name recognition, delivery time and post-sale service and support. However, our failure to appropriately and timely respond to consumer preferences and demand for new products could significantly harm our business, financial condition and results of operations. Furthermore, unfavorable publicity or consumer perception of products we develop and commercialize could have a material adverse effect on our business and operations.

There can be no assurance that we will be able to compete successfully in the future. If we are unable to compete effectively, our earnings may be significantly negatively impacted.

***Increases in the price or shortages of supply of key raw materials could materially and adversely affect our business, financial condition and results of operations.***

Our TK Supplements® products and the products we manufacture for third parties are composed of certain key raw materials. If the prices of these raw materials were to increase significantly, it could result in a significant increase to us in the prices charged to us for our own branded products and third-party products. Raw material prices may increase in the future and we may not be able to pass on those increases to customers who purchase our products or to the customers whose products we manufacture. A significant increase in the price of raw materials that cannot be passed on to customers could have a material adverse impact on our business, financial condition and results of operations.

We are reliant upon the supply of raw materials that meet our specifications and the specifications of third parties for whom we manufacture. If any raw material is adulterated and does not meet our specifications or third parties' specifications, it could significantly impact our ability to manufacture products and could materially and adversely impact our business, financial condition and results of operations.

In addition, if we are no longer able to obtain the resources, raw materials or components we need from one or more of our suppliers on terms reasonable to us or at all, including as a result of the increased demand that may be placed on our suppliers as a result of public health epidemics such as the coronavirus, our ability to perform under contracts with third parties for whom we manufacture products and our customer relationships could be materially and adversely affected.

***Disruptions at our PMI manufacturing facilities or any loss of manufacturing certifications could materially and adversely affect our business, financial condition, results of operations and customer relationships.***

Any significant disruption at our manufacturing facility for any reason, including regulatory requirements, an FDA determination that the facility is not in compliance with the applicable cGMP regulations, the loss of certifications, power interruptions, destruction or damage to the facility could disrupt our ability to manufacture products for our contract manufacturing customers and any of our own branded products. Any such disruption could have a material adverse effect on our business, financial condition and results of operations.

***Our PMI manufacturing business is subject to seasonal fluctuations and may fluctuate from cold season to cold season.***

Because the majority of sales from our PMI manufacturing facility are from cold remedy products, our sales are subject to seasonal fluctuations and influenced by the timing, length and severity of each cold season. Our revenues tend to be higher in the first, third and fourth quarters during the cold season. Generally, a cold season is defined as the period of September to March, when the incidence of the common cold rises as a consequence of the change in weather and other factors.

***Our product development and commercialization efforts may be unsuccessful.***

There are numerous risks associated with OTC product development and commercialization. We may be subject to delays and/or be unable to successfully implement our business plan and strategy to develop and commercialize one or more OTC products and/or dietary supplements. The successful commercialization and market acceptance of any products we develop will be subject to, among other things, consumer purchasing trends, health and wellness trends, regulatory factors, retail acceptance and overall economic and market conditions. As a consequence, we may suspend or abandon some or all of our proposed new products before they ever become commercially viable. Even if we successfully develop and obtain approval of a new product, if we cannot successfully commercialize it in a timely manner, our business and financial condition may be materially adversely affected.

***We may require additional capital to support our product development and commercialization programs.***

We may require additional capital to support our product development and commercialization programs. The amount of capital that may be needed to support our product development initiatives will depend on many factors which may include, but are not limited to (i) the cost involved in applying for and obtaining FDA, international regulatory or other technical approvals, if required (ii) whether we elect to establish partnering or other strategic arrangements for the development, sales, manufacturing and marketing of such products, and (iii) the revenue we generate from our manufacturing services and the expenses incurred in marketing our manufacturing capabilities.

Income from our PMI manufacturing business and our TK Supplements® products line may not generate all the funds we need to support future product development and commercialization. To the extent that we do not generate sufficient cash from operations, we may, in the short and long-term, seek to raise capital through the issuance of equity securities or through other financing sources. To the extent that we seek to raise additional funds by issuing equity securities, our stockholders may experience significant dilution. Any debt financing, if available, may include financial and other covenants that could restrict our use of the proceeds from such financing or impose other business and financial restrictions on us. In addition, we may consider alternative approaches such as licensing, joint venture, or partnership arrangements to provide long term capital. Additional funding may not be available to us on acceptable terms, or at all.

***Failure to protect our trademarks and other intellectual property could impact our business.***

We will rely on trademark laws to protect our proprietary rights in any products we develop and commercialize. Monitoring the unauthorized use of our intellectual property will be difficult. Litigation may be necessary to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Litigation of this type could result in substantial costs and diversion of resources, may result in counterclaims or other claims against us and could significantly harm our results of operations. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States. From time to time, we may apply to have certain trademarks registered. There is no guarantee that such trademark registrations will be granted. The unauthorized reproduction of our trademarks could diminish the value of our brand and its market acceptance, competitive advantages or goodwill, which could adversely affect our business.

***We have contingent liabilities up to the amount paid by Mylan for our Cold-EEZE® Business, which could adversely affect our ability to pursue our business goals and objectives.***

We made customary representations and warranties to Mylan in the asset purchase agreement to purchase the Cold-EEZE® business. Pursuant to the terms of the asset purchase agreement, we agreed to indemnify Mylan for any losses caused by breaches of most of our representations, warranties or covenants that occur, in most cases, within 24 months after the closing date of the sale to Mylan, which was March 29, 2017. An escrow account was established to cover any such losses.

On August 2, 2018, we received notice of an indemnification claim from Mylan in relation to certain product advertising claims brought against Mylan relating to certain Cold-EEZE® products. Pursuant to the terms of the asset purchase agreement with Mylan, we have elected to assume the defense of these claims on behalf of Mylan.

While we believe these claims are without merit, we are currently negotiating a settlement of these claims. We expect to collect the remaining escrow balance within the next three months, net of an immaterial settlement amount. In the event we are unable to reach a reasonable settlement agreement, however, and the remaining escrow funds are insufficient to cover the losses asserted under these claims or the legal fees associated with defending these claims, we may be required to pay amounts in excess of what is remaining in the escrow account, which could have an adverse impact on our operations.

***Adverse credit market conditions may significantly affect our access to capital, cost of capital and ability to meet liquidity needs.***

Disruptions, uncertainty or volatility in the credit markets could adversely impact the availability and cost of credit to us in the future. Accordingly, we may be forced to delay raising capital or pay unattractive interest rates, which could increase our interest expense, decrease our profitability and significantly reduce our financial flexibility. Longer-term disruptions in the capital and credit markets as a result of uncertainty, changing or increased regulation, reduced alternatives or failures of significant financial institutions could adversely affect our access to liquidity needed for our business. Any disruption could require us to take measures to conserve cash until the markets stabilize or until alternative credit arrangements or other funding for our business needs can be arranged. Such measures could include deferring capital expenditures or other discretionary uses of cash. Overall, our results of operations, financial condition and cash flows could be materially adversely affected by disruptions in the credit markets.

***General economic and other conditions that impact consumer spending could adversely affect the Company.***

Adverse economic conditions, declines in the stock market and the instability of the credit markets, could cause a reduction in consumer spending. While there has been a trend toward lower unemployment in recent periods, which has contributed to a better economic climate, there is uncertainty about the continued strength of the economy. If the economy weakens, consumers may reduce consumer spending.

***Our business is subject to extensive governmental regulation.***

We are subject to laws and regulations that cover:

- the formulation, manufacturing, packaging, labeling, distribution, importation, sale and storage of our products;
- the health and safety of our products;
- trade practice and direct selling laws; and
- product claims and advertising.

Compliance with these laws and regulations is time consuming and expensive. Moreover, new regulations could be adopted that would severely restrict the products we sell or manufacture or our ability to continue our business. We are unable to predict the nature of any future laws, regulations, interpretations or applications, nor can we predict what effect additional governmental regulations or administrative orders, when and if promulgated, would have on our business in the future. These future changes could, however, require the reformulation or elimination of certain products; imposition of additional record keeping and documentation requirements; imposition of new federal reporting and application requirements; modified methods of importing, manufacturing, storing or distributing certain products; and expanded or different labeling and substantiation requirements for certain products and ingredients. Any or all of these requirements could harm our business.

In July 2011, the FDA issued draft guidance governing the notification of new dietary ingredients (“NDIs”) and in August 2016, the FDA issued revised draft guidance. Although FDA guidance is not mandatory, it is a strong indication of the FDA’s current views, including its position on enforcement. We believe that the draft guidance, if implemented as proposed, could have a material impact on our operations. FDA enforcement of the NDI guidance as written could require us to incur additional expenses, which could be significant, and negatively affect our business in several ways, including, but not limited to, the detention and refusal of admission of imported products, the injunction of manufacturing of any dietary ingredients or dietary supplements until the FDA determines that those ingredients or products are in compliance, and the potential imposition of penalties for non-compliance.

***Our failure to comply with FTC regulations could result in substantial monetary penalties and could adversely affect our operating results.***

The FTC exercises jurisdiction over the advertising of dietary supplements and has instituted numerous enforcement actions against OTC drug companies for failure to have adequate substantiation for claims made in advertising or for the use of false or misleading advertising claims. Failure by us to comply with applicable regulations could result in substantial monetary penalties, which could have a material adverse effect on our financial condition or results of operations.

***Laws and regulations regarding direct selling may prohibit or restrict our ability to sell our products in some markets or require us to make changes to our business model in some markets.***

Direct selling companies are subject to laws and regulations by various government agencies. These laws and regulations are generally intended to prevent fraudulent or deceptive practices and to protect consumers. The FTC periodically investigates and brings enforcement actions against direct selling companies based on alleged pyramid selling activity and/or false and misleading claims made by the direct selling company or its independent distributors. Direct selling companies that have been the subject of an FTC enforcement action have generally been required to make significant changes to their business model and pay significant monetary fines. Being the target of an investigation or enforcement action by the FTC could have a material adverse effect on our results of operations and financial condition.

***The storage, processing, and use of data, some of which contain personal information, are subject to complex and evolving privacy and data protection laws and regulations that could adversely affect our business and financial condition.***

Some data we store, process, and use, contains personal information, which subjects us to a variety of privacy, rights of publicity, data protection, content, protection of minors, and consumer protection laws and regulations in the United States. These laws and regulations are constantly evolving, can be particularly restrictive and may impose significant fines or penalties. The application and interpretation of these laws and regulations are often uncertain and could result in investigations, claims, changes to our business practices, and/or increased cost of operations, any of which could have a material adverse effect on our results of operations and financial condition.

While several proposals and discussions are before the United States federal government, a number of states have enacted laws or are considering the enactment of laws governing the protection of credit card or other personal information received from consumers. For example, on January 1, 2020, the California Consumer Privacy Act (the “CCPA”) went into effect, which, among other things, requires covered companies to provide new disclosures to California consumers, and afford such consumers new abilities to opt-out of certain sales of personal information. The California Attorney General has proposed implementing regulations to the CCPA that are not yet finalized and are subject to change.

***System failures could adversely affect our results of operations and financial condition.***

Like many companies, our business is highly dependent upon our information technology infrastructure (websites, accounting and manufacturing applications, and product and customer information databases) to manage effectively and efficiently our operations, including order entry, customer billing, accurate tracking of purchases and volume incentives and managing accounting, finance and manufacturing operations. The occurrence of a natural disaster, security breach or other unanticipated problem could result in interruptions in our day-to-day operations that could adversely affect our business. A long-term failure or impairment of any of our information systems could have a material adverse effect on our results of operations and financial condition.

***If our products do not have the effects intended or cause undesirable side effects, our business may suffer.***

Although many of the ingredients in our current dietary supplement products are vitamins, minerals, and other substances for which there is a long history of human consumption, they also contain innovative ingredients or combinations of ingredients. While we believe that all of these products and the combinations of ingredients in them are safe when taken as directed, the products could have certain undesirable side effects if not taken as directed or if taken by a consumer who has certain medical conditions. In addition, these products may not have the effect intended if they are not taken in accordance with certain instructions, which include certain dietary restrictions. Furthermore, there can be no assurance that any of the products, even when used as directed, will have the effects intended or will not have harmful side effects in an unforeseen way or on an unforeseen cohort. If any of our products or products we develop or commercialize in the future are shown to be harmful or generate negative publicity from perceived harmful effects, our business, financial condition, results of operations, and prospects could be harmed significantly.

***We may be subject to product liability claims.***

As a direct marketer and manufacturer of products designed for human consumption, we are subject to product liability claims if the use of our products or the products that we manufacture for third parties are alleged to have resulted in injury or to include inadequate instructions for use or inadequate warnings concerning possible side effects and interactions with other substances. Our current products and the products that we currently manufacture for third parties are not subject to pre-market regulatory approval in the United States and could contain contaminated substances.

While we currently maintain product liability insurance, a successful claim brought against us related to our branded products or products that we manufacture for third parties in excess of, or outside of, our existing insurance coverage, could result in increased costs and could adversely affect our reputation with customers, which could in turn materially adversely affect our business, financial condition and results of operations.

***Our success is dependent on key personnel.***

Our success depends, in part, upon the continued service of key personnel, such as Mr. Ted Karkus, Chairman and Chief Executive Officer and certain managers and strategists within the Company. The loss of the services of any one of them could have a material adverse effect on us.

In order to be successful, we must retain and motivate executives and other key employees, including those in managerial, technical, marketing and health product positions. In particular, our product generation efforts depend on hiring and retaining qualified health and science professionals. Competition for skilled employees who can perform the services that we require is intense and hiring, training, motivating, retaining and managing employees with the skills required is time-consuming and expensive. If we are not able to hire sufficient professional staff to support our operations, or to train, motivate, retain and manage the employees we do hire, it could have a material adverse effect on our business operations or financial results.

***Our ability to use our net operating loss carryforwards to offset future taxable income may be subject to certain limitations.***

In general, under Section 382 of the Internal Revenue Code of 1986, as amended (the “Section 382”), a corporation that undergoes an “ownership change” is subject to limitations on its ability to use its pre-change net operating loss carryforwards (the “NOLs”), to offset future taxable income. Future changes in our stock ownership, some of which are outside of our control, could result in an ownership change under Section 382. Furthermore, our ability to use NOLs of companies that we may acquire in the future may be subject to limitations.

Based on our Section 382 analysis, we do not believe our current net operating loss carryforwards are subject to these limitations as of December 31, 2019. Should we identify any limitations upon the completion of our final 2019 income tax return, the impact could be material to our consolidated financial statements.

***Future sales of shares of our Common Stock in the public market could adversely affect the trading price of shares of our Common Stock and our ability to raise funds in new stock offerings.***

Future sales of substantial amounts of shares of our Common Stock in the public market, or the perception that such sales are likely to occur, could affect prevailing trading prices of our Common Stock.

If a significant number of our outstanding stock options are exercised, and the holders of these options attempt to sell a substantial amount of their holdings all at once, the market price of our Common Stock would likely decline. Moreover, the perceived risk of this potential dilution could cause stockholders to attempt to sell their shares and investors to “short” our stock, a practice in which an investor sells shares that he or she does not own at prevailing market prices, hoping to purchase shares later at a lower price to cover the sale. As each of these events would cause the number of shares of Common Stock being offered for sale to increase, our Common Stock’s market price would likely further decline. All of these events could combine to make it very difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate.

***If securities or industry analysts do not publish research or reports about our business or if they issue an adverse or misleading opinion regarding our stock, our stock price and trading volume could decline.***

The trading market for our Common Stock will be influenced by the research and reports that industry or securities analysts publish about us or our business. If any of the analysts who cover us issue an adverse or misleading opinion regarding us, our business model, products or stock performance, our stock price would likely decline. If one or more of these analysts cease coverage of us or fail to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline. Moreover, the unpredictability of our financial results likely reduces the certainty, and therefore reliability, of the forecasts by securities or industry analysts of our future financial results, adding to the potential volatility of our stock price.

***Our Chief Executive Officer owns a substantial amount of our Common Stock.***

As of March 26, 2020, our Chief Executive Officer beneficially owned approximately 33.6% of our Common Stock. As such, our Chief Executive Officer may exert significant influence over the outcome of all matters submitted to stockholders for approval, including the election of directors. Consequently, he exercises substantial influence over major decisions including major corporate actions such as mergers and other business combinations transactions which could result in or prevent a change of control of the Company. Circumstances may occur in which the interests of our Chief Executive Officer could be in conflict with the interests of other stockholders. Accordingly, a stockholder’s ability to influence us through voting their shares may be limited.

***A number of companies are seeking to make acquisitions in our industry, which may make our acquisition strategy more difficult or expensive to pursue.***

The emergence and growth of OTC consumer healthcare products, dietary supplements and related products has brought increased media attention, and a number of companies and investors have begun making acquisitions of businesses or announced their intention to do so. We compete with many of these companies, and certain of them have greater financial resources than we do for pursuing and consummating acquisitions and developing and integrating acquired businesses. Any acquisitions we undertake may result in unanticipated costs, delays or other operational or financial problems related to integrating the acquired company and business with our Company, which may result in the diversion of our capital and our management’s attention from other business issues and opportunities. We may not be able to successfully integrate operations that we acquire, including their personnel, technology, financial systems, distribution and general business operations and procedures. We cannot provide assurance that any acquisition we make will be successful and our operating results may be adversely impacted by the integration of a new business and its financial results.

***We may be unsuccessful in identifying suitable acquisition candidates which may negatively impact our competitive position and our growth strategy.***

We may be unable to identify suitable targets for future acquisition or acquire businesses at favorable prices, which would negatively impact our growth strategy. In addition, in the course of negotiating potential acquisitions, we may enter into term sheets, letters of intent, purchase options or other similar agreements that provide the counterparties with advances and termination or break-up fees in the event that we do not ultimately consummate any such acquisition. In the aggregate, the payment of any such termination or break-up fees may negatively impact our financial condition. We may not be able to execute our growth strategy through organic expansion, and if we are unable to identify and successfully acquire new businesses or products complementary to ours, we may not be able to expand or achieve profitability.

***Our Certificate of Incorporation and By-laws contain certain provisions that may be barriers to a takeover.***

Our Certificate of Incorporation and By-laws contain certain provisions which may deter, discourage, or make it difficult for another person or entity to gain control of the Company through a tender offer, merger, proxy contest or similar transaction or series of transactions. These provisions may deter a future tender offer or other takeover attempt which could include a premium over the market price of our Common Stock at the time. Such provisions could depress the trading price of our Common Stock.

***We have agreed to indemnify our officers and directors from liability.***

Our Certificate of Incorporation and our By-laws provide that we will indemnify, to the fullest extent permitted by the Delaware General Corporation Law, any person who is or was made a party to, or is or was threatened to be made a party to, any pending, completed, or threatened action, suit or proceeding because he or she is or was a director, officer, employee or agent of the Company or is or was serving at the Company's request as a director, officer, employee or agent of any corporation, partnership, joint venture, trust or other enterprise. These provisions permit us to advance expenses to an indemnified party in connection with defending any such proceeding, upon receipt of an undertaking by the indemnified party to repay those amounts if it is later determined that the party is not entitled to indemnification. We entered into indemnity agreements with each member of our board of directors. These agreements provide, among other things, that we will indemnify each officer and director in the event they become a party or otherwise a participant in any action or proceeding on account of their service as a director or officer of the Company (or service for another corporation or entity in any capacity at the request of the Company) to the fullest extent permitted by applicable law. The indemnification provisions may reduce the likelihood of derivative litigation against directors and officers and discourage or deter stockholders from suing directors or officers for breaches of their duties to the Company, even though such an action, if successful, might otherwise benefit the Company or its stockholders. In addition, to the extent that we expend funds to indemnify directors and officers, funds will be unavailable for operational purposes.

**Item 1B. Unresolved Staff Comments**

Not applicable.

**Item 2. Properties**

Our corporate headquarters are located in Doylestown, Pennsylvania. We purchased this property in 1998. Our headquarters are approximately 13,000 square feet and is comprised of office space and a storage area. Our principal manufacturing facility is located in Lebanon, Pennsylvania. The facility was purchased in October 2004. The facility has a total area of approximately 57,500 square feet and is comprised of manufacturing, warehousing and office space. We believe that our existing facilities are adequate at this time and do not anticipate the need for additional facilities in the foreseeable future.

**Item 3. Legal Proceedings**

From time to time, we have been and may again become involved in legal proceedings arising in the ordinary course of business, including the lawsuit discussed below. We are not presently a party to any material litigation. It is our policy to vigorously defend litigation and/or enter into settlements of claims where management deems appropriate.

On November 12, 2019, Craig Cunningham filed an action in the United States District Court for the Eastern District of Texas against TK Supplements, Inc., one of our wholly-owned subsidiaries ("TK Sub"), asserting two class claims and alleging that, by sending plaintiff text messages to his cellular telephone number without his prior express consent and notwithstanding its listing on the Do No Call Registry, TK Sub violated the Telephone Consumer Protection Act, 47 U.S.C. § 227(b)(3)(B) and 47 U.S.C. § 227(c)(5). Plaintiff seeks to represent a class of (i) all residents within the United States to whom TK Sub or its agents sent text messages to the person's cellular telephone number in the past four years and (ii) all residents within the United States to whom TK Sub or its agents placed two or more telemarketing phone calls to the person's residential telephone number that was listed on the Do Not Call Registry in the past four years. On January 8, 2020, TK Supplements filed its Answer and Defenses to the Complaint. We intend to defend this matter vigorously.

**Item 4. Mine Safety Disclosures**

Not applicable.

## **PART II**

### **Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

#### **Market Information**

Our Common Stock is currently traded on The Nasdaq Capital Market under the trading symbol “PRPH.”

As of March 24, 2020, there were approximately 193 holders of record of our Common Stock, including brokerage firms, clearing houses, and/or depository firms holding the Company’s securities for their respective clients. The exact number of beneficial owners of our securities is not known but exceeds 400.

#### **Securities Authorized Under Equity Compensation Plans**

See Part III, Item 12. “Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters” for information relating to our equity compensation plans.

#### **Recent Sales of Unregistered Securities**

None.

#### **Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

None.

### **Item 6. Selected Financial Data**

Not applicable because we are a smaller reporting company.

### **Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis should be read together with our financial statements and the related notes appearing elsewhere in this Annual Report. This discussion contains forward-looking statements reflecting our current expectations that involve risks and uncertainties. See “Special Note Regarding Forward-Looking Statements” for a discussion of the uncertainties, risks and assumptions associated with these statements. Actual results and the timing of events could differ materially from those discussed in our forward-looking statements as a result of many factors, including those set forth under “Risk Factors” and elsewhere in this Annual Report.*

#### **General**

We are a manufacturing and marketing company with deep experience with OTC consumer healthcare products and dietary supplements. We are engaged in the research, development, manufacture, distribution, marketing and sale of OTC consumer healthcare products and dietary supplements in the United States. This includes the development and marketing of dietary supplements under the TK Supplements® brand.

Our wholly-owned subsidiary, Pharmaloz Manufacturing, Inc. (“PMI”), is a full service contract manufacturer and private label developer of a broad range of non-GMO, organic and natural-based cough drops and lozenges and OTC drug and dietary supplement products.

In addition, we continue to actively pursue acquisition opportunities for other companies, technologies and products within and outside the consumer products industry.

#### **Income Taxes**

We recognize tax assets and liabilities for the future tax consequences related to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and for net operating loss carryforwards. Management has evaluated the deferred tax assets for recoverability using a consistent approach that considers the relative impact of negative and positive evidence, including historical profitability and projections of future reversals of temporary differences and future taxable income. We are required to establish a valuation allowance for deferred tax assets if management determines, based on available evidence at the time the determination is made, that it is not more likely than not that some portion or all of the deferred tax assets will be realized.



A valuation allowance for all of our net deferred tax assets has been provided as we are unable to determine, at this time, that the generation of future taxable income against which the net operating losses (“NOL”) carryforwards could be used is more likely than not. As a result of ongoing losses from continuing operations the Company has concluded that it is more likely than not that it will not realize all of its deferred tax assets relating to federal and state filing jurisdictions. As of December 31, 2019, there is a valuation allowance of \$4.7 million. As of December 31, 2019, the Company has state NOL carryforwards of \$1.1 million, which begin to expire in 2024 and federal NOL carryforwards of \$3.6 million. The amount of the federal NOL generated prior to the 2017 legislation commonly referred to as the Tax Cuts and Jobs Act (“TCJA”) of \$2.6 million may be carried forward for 20 years and begins to expire in 2032. The remaining amount of \$0.9 million federal NOL generated in years 2018 and 2019 may be carried forward indefinitely and its utilization is limited to 80% of taxable income. This limitation applies to losses arising in taxable years beginning after December 31, 2017.

We file a consolidated federal income tax returns and separate company state returns as well as combined state returns where applicable. There are currently no pending income tax examinations.

## **Results of Operations from Continuing Operations**

### **Fiscal 2019 compared with Fiscal 2018**

Net sales for Fiscal 2019 decreased \$3.2 million to \$9.9 million as compared to \$13.1 million for Fiscal 2018. The decrease in net sales from Fiscal 2019 to Fiscal 2018 is principally due to a decrease in contract manufacturing net sales as a result of the demand of third party customer orders.

Cost of sales for Fiscal 2019 were \$7.3 million as compared to \$8.3 million for Fiscal 2018. For Fiscal 2019 and 2018, we realized a gross margin of 26.5% and 36.4%, respectively. The decrease in gross profit to \$2.6 million for Fiscal 2019 as compared to \$4.8 million for Fiscal 2018 is principally due to (i) a decrease in the absorption of fixed production costs and (ii) fluctuations in our product mix shipped and pricing fluctuations from period to period. Gross margins are generally influenced by fluctuations in quarter-to-quarter production volume, fixed production costs and related overhead absorption, raw ingredient costs, inventory mark to market write-downs and timing of shipments to customers.

Sales and marketing expense for Fiscal 2019 was \$1.0 million as compared to \$1.1 million for Fiscal 2018. The decrease of \$65,000 was principally related to a reduction in marketing expenses associated with our digital media business, which has since been terminated.

Administrative expense decreased \$0.4 million for Fiscal 2019 to \$4.5 million as compared to \$4.9 million in Fiscal 2018. The decrease in administrative expense for Fiscal 2019 as compared to Fiscal 2018 was principally due to a decrease in professional and legal fees.

Research and development costs for Fiscal 2019 and 2018 were \$332,000 and \$398,000, respectively. The decrease of \$66,000 in research and development costs for Fiscal 2019 as compared to Fiscal 2018 was principally due to a decrease in the amount and the timing of product research expenses in the current period.

Net interest income for Fiscal 2019 was \$133,000 as compared to \$167,000 for Fiscal 2018. The decrease in interest income in Fiscal 2019 as compared to Fiscal 2018 is principally due to a lower balance in our investment account.

As a result of the effects of the above, the loss from continuing operations for Fiscal 2019 was \$3.1 million, or (\$0.27) per share, as compared to a loss from continuing operations of \$1.6 million, or (\$0.14) per share, for Fiscal 2018. Loss from discontinued operations for Fiscal 2019 was \$40,000, or (\$0.00) per share, as compared to \$170,000, or (\$0.01) per share, for Fiscal 2018. Net loss for Fiscal 2019 was \$3.1 million, or (\$0.27) per share, as compared to \$1.7 million, or (\$0.15) per share for Fiscal 2018.

## **Liquidity and Capital Resources**

Our aggregate cash and cash equivalents and marketable securities as of December 31, 2019 were \$1.4 million as compared to \$8.2 million at December 31, 2018. Our working capital was \$9.0 million and \$14.0 million as of December 31, 2019 and 2018, respectively. The decrease of \$6.8 million in our cash and cash equivalents and marketable securities balance for the 12 months ended December 31, 2019 was principally due to the \$2.9 million payment of a \$0.25 special cash dividend per share in January 2019 and the \$2.9 million payment of a \$0.25 special cash dividend per share in December 2019 and cash used in operations of \$841,000.

As a consequence of the seasonality of our business, we realize variations in operating results and demand for working capital from quarter to quarter.

### ***Amended and Restated Employment Agreement with Ted Karkus***

On February 16, 2018, our board of directors approved the Amended and Restated 2015 Executive Employment Agreement with Ted Karkus, our Chief Executive Officer (the “Amended Employment Agreement”), which became effective February 23, 2018, and was approved by stockholders at a special meeting of stockholders held April 12, 2018. Pursuant to the terms of the Amended Employment Agreement, Mr. Karkus voluntarily agreed to reduce his base salary from the rate set forth in his prior agreement (*i.e.*, not less than \$675,000 per annum) to a base salary of \$125,000 per annum (the “Term Base Salary”) through February 22, 2021. Unless otherwise determined by the mutual agreement of the Company and Mr. Karkus, on February 22, 2021 and thereafter, Mr. Karkus’s salary will increase from the Term Base Salary to not less than \$675,000 per annum.

In consideration of Mr. Karkus’s voluntary reduction in salary, our board of directors awarded Mr. Karkus a stock option to purchase 2,300,000 shares of our Common Stock at an exercise price of \$3.00 per share on February 23, 2018 (the “CEO Option”). The CEO Option will vest and be exercisable in 35 equal monthly installments of 63,888 shares and one monthly installment of 63,290 shares, subject to his continued employment, and subject to accelerated vesting in the event Mr. Karkus’s employment is terminated for any reason other than by us for Cause or by Mr. Karkus without Good Reason (as such terms are defined in the Amended Employment Agreement). The CEO Option is exercisable for a five year term commencing on the date of grant. The CEO Option was granted pursuant to the 2018 Stock Plan, which was also adopted and approved by our board of directors on February 16, 2018. The 2018 Plan, like the Amended Employment Agreement, received stockholder approval at a special meeting of stockholders held on April 12, 2018 at which time the options were considered granted for accounting purposes. The 2018 Plan authorizes the issuance of up to 2,300,000 shares pursuant to stock options granted under the 2018 Plan, all of which were issued to Mr. Karkus as part of the CEO Option.

The 2018 Plan requires certain proportionate adjustments to be made to the stock options granted under the 2018 Plan upon the occurrence of certain events, including special distributions (whether in the form of cash, shares, other securities, or other property) in order to maintain parity. Accordingly, the Compensation Committee of the board of directors adjusted the exercise price of the CEO Option on May 7, 2018, such that the exercise price of the CEO Option was reduced from \$3.00 per share to \$2.00 per share, effective as of June 5, 2018, the date a special \$1.00 cash dividend was paid to our stockholders, from \$2.00 to \$1.75 per share, effective as of January 24, 2019, the date a special \$0.25 cash dividend was paid to our stockholders, and from \$1.75 to \$1.50 per share, effective as of December 12, 2019, the date another special \$0.25 cash dividend was paid to our stockholders.

### ***Asset Purchase Agreement with Mylan***

We have indemnification obligations to Mylan under the asset purchase agreement with Mylan (the “asset purchase agreement”) that may require us to make future payments to Mylan and/or other related persons for any damages incurred by Mylan or such related persons as a result of any breaches of our representations, warranties, covenants or agreements contained in the asset purchase agreement, or arising from the Retained Liabilities (as such term is defined in the asset purchase agreement) or certain third-party claims specified in the asset purchase agreement. Generally, our representations and warranties survive for a period of 24 months from the closing date, which was March 29, 2017, other than certain fundamental representations which survive until the expiration of the applicable statute of limitations. There is a limited indemnification cap with respect to a majority of the Company’s indemnification obligations under the asset purchase agreement with the exception of claims for actual fraud, the breach of any fundamental representations and certain other items, which have a larger indemnification cap (e.g., the purchase price).

Pursuant to the terms of the asset purchase agreement, we, Mylan, and an escrow agent entered into an Escrow Agreement at closing, pursuant to which Mylan deposited \$5 million of the aggregate purchase price for the Cold-EEZE® Business into an escrow account established with the Escrow Agent in order to satisfy, in whole or in part, certain of our indemnity obligations under the asset purchase agreement. The terms of the Escrow Agreement provide that if, as of September 29, 2018 (the 18 month anniversary of the closing date), there were funds remaining in the escrow account, then the escrow account would be reduced by the difference, if a positive number, of (i) \$2.5 million minus (ii) the aggregate amount of all escrow claims asserted by Mylan prior to this date that had either been paid out of the escrow account or were pending as of such date, and, within two business days of such date, the Escrow Agent would disburse such difference, if a positive number, to us. In addition, within two business days of March 29, 2019 (the second anniversary of the closing date), the Escrow Agent would release any funds remaining in the escrow account to us minus any amounts being reserved for escrow claims asserted by Mylan prior to such date. Upon the resolution of any pending escrow claims, the Escrow Agent would then, within two business days of receipt of joint instructions or a final order from a court (as described in the Escrow Agreement), disburse such reserved amount to the parties entitled to such funds. As described below, in August 2018, Mylan asserted an indemnification claim against us, for a yet to be determined amount. Accordingly, the distributions were not released to us on September 29, 2018 or March 29, 2019.

On May 31, 2018, we received notice of an indemnification claim for \$800,000 in losses. We have resolved this claim pursuant to a settlement agreement with Mylan, which became effective October 16, 2018, pursuant to which \$160,000 of the funds held in escrow were released to Mylan. This expense is reflected in discontinued operations for the year ended December 31, 2018.

On August 2, 2018, we received notice of an indemnification claim from Mylan in relation to certain product advertising claims brought against Mylan relating to certain Cold-EEZE<sup>®</sup> products. Pursuant to the terms of the asset purchase agreement, we have elected to assume the defense of these claims on behalf of Mylan. We dispute these product advertising claims and intend to vigorously contest such claims. While we believe these claims are without merit, we are currently negotiating a settlement of these claims. We expect to collect the remaining escrow balance within the next three months, net of an immaterial settlement amount. In the event we are unable to reach a reasonable settlement agreement, however, and the remaining escrow funds are insufficient to cover the losses asserted under these claims or the legal fees associated with defending these claims, we may be required to pay amounts in excess of what is remaining in the escrow account, which could have an adverse impact on our operations.

## **General**

Management is not aware of any other trends, events or uncertainties that have or are reasonably likely to have a material negative impact upon our (i) short-term or long-term liquidity, or (ii) net sales or income from continuing operations. Any challenge to our trademark rights could have a material adverse effect on our future; however, we are not aware of any condition that would make such an event probable. Our business is subject to seasonal variations thereby impacting our liquidity and working capital during the course of our fiscal year.

To the extent that we do not generate sufficient cash from operations, our cash balances will decline. We may also use our cash to explore and/or acquire new product technologies, applications, product line extensions, new contract manufacturing applications and other new business opportunities. In the event that our available cash is insufficient to support such initiatives, we may need to incur indebtedness or issue Common Stock to finance plans for growth. Volatility in the credit markets and the liquidity of major financial institutions may have an adverse effect on our ability to fund our business strategy through borrowings, under either existing or newly created instruments in the public or private markets on terms that we believe to be reasonable, if at all.

## **Off-Balance Sheet Arrangements**

It is not our usual business practice to enter into off-balance sheet arrangements such as guarantees on loans and financial commitments and retained interests in assets transferred to an unconsolidated entity for securitization purposes. We have no off-balance sheet arrangements that have, or are reasonably likely to have, a material current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

## **Impact of Inflation**

We are subject to normal inflationary trends and anticipate that any increased costs would be passed on to our customers. Inflation has not had a material effect on our business.

## **Critical Accounting Policies and Estimates**

Our significant accounting policies are described in Note 2 of the Notes to Consolidated Financial Statements included under Item 8 of this Part II. However, certain accounting policies are deemed “critical”, as they require management’s highest degree of judgment, estimates and assumptions. These accounting policies, estimates and disclosures have been discussed with the Audit Committee of our Board of Directors. A discussion of our critical accounting policies and estimates, the judgments and uncertainties affecting their application and the likelihood that materially different amounts would be reported under different conditions or using different assumptions are as follows:

### ***Use of Estimates***

The preparation of financial statements and the accompanying notes thereto, in conformity with generally accepted accounting principles in the United States of America (“GAAP”), requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the respective reporting periods. Examples include the provision for bad debt, sales returns and allowances, inventory obsolescence, useful lives of property and equipment, impairment of property and equipment, income tax valuations and assumptions related to accrued advertising. When providing for the appropriate sales returns, allowances, cash discounts and cooperative incentive promotion costs, we apply a uniform and consistent method for making certain assumptions for estimating these provisions. These estimates and assumptions are based on historical experience, current trends and other factors that management believes to be relevant at the time the financial statements are prepared. Management reviews the accounting policies, assumptions, estimates and judgments on a quarterly basis. Actual results could differ from those estimates.

## **Revenue Recognition**

We generate sales principally through two types of customers, contract manufacturing customers and retail customers. Sales from product shipments to contract manufacturing and retailer customers are recognized at the time ownership is transferred to the customer. In 2019, approximately \$9.0 million of our approximately \$9.9 million of sales were from contract manufacturing customers.

## **Revenue Recognition – Sales Allowances**

When providing for the appropriate sales returns, allowances, cash discounts and cooperative incentive promotion costs (“sales allowances”), we apply a uniform and consistent method for making certain assumptions for estimating these provisions. These estimates and assumptions are based on historical experience, current trends and other factors that management believes to be relevant at the time the financial statements are prepared. Management reviews the accounting policies, assumptions, estimates and judgments on a quarterly basis. Actual results could differ from those estimates.

Our return policy accommodates returns for (i) discontinued products, (ii) store closings and (iii) products that have reached or exceeded designated expiration date. The following is a summary of the change in the return provision for the years ended December 31, 2019 (in thousands):

	<u>Amount</u>
Return provision at December 31, 2018.....	\$ 196
Net change in the return provision Fiscal 2019.....	(27)
Return provision at December 31, 2019.....	<u>\$ 169</u>

For Fiscal 2019, the return provision decreased by \$27,000. The decrease in the return provision was principally due to net returns associated with Fiscal 2019.

A one percent deviation for these sales allowance provisions for Fiscal 2019 and 2018 would affect net sales by approximately \$101,000 and \$60,000, respectively.

## **Income Taxes**

Accounting for income taxes requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities. These deferred taxes are measured by applying the provisions of tax laws in effect at the balance sheet date, including the impact of the TCJA enacted on December 22, 2017. The TCJA made broad and significant changes to the U.S. tax code that affects the year ended December 31, 2017, including, but not limited to, a change in the federal rate from 35% to 21% effective January 1, 2018.

The Company recognizes in income the effect of a change in tax rates on deferred tax assets and liabilities in the period that includes the TCJA enactment date. We utilize the asset and liability approach which requires the recognition of deferred tax assets and liabilities for the future tax consequences of events that have been recognized in our financial statements or tax returns. In estimating future tax consequences, we generally consider all expected future events other than enactments of changes in the tax law or rates. Until sufficient taxable income to offset the temporary timing differences attributable to operations and the tax deductions attributable to option, warrant and stock activities are assured, a valuation allowance equaling the total net current and non-current deferred tax asset is being provided.

## **Recently Adopted Accounting Standards**

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02, Leases (Topic 842) in order to increase transparency and comparability among organizations by, among other provisions, recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. For public companies, ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. In transition, entities may also elect a package of practical expedients that must be applied in its entirety to all leases commencing before the adoption date, unless the lease is modified, and permits entities to not reassess (a) the existence of a lease, (b) lease classification or (c) determination of initial direct costs, as of the adoption date, which effectively allows entities to carryforward accounting conclusions under previous GAAP. In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements, which provides entities an optional transition method to apply the guidance under Topic 842 as of the adoption date, rather than as of the earliest period presented. We adopted Topic 842 on January 1, 2019, using the optional transition method to apply the new guidance as of January 1, 2019, rather than as of the earliest period presented, and elected the package of practical expedients described above. The adoption of this standard did not have a material impact on our consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07 “Improvements to Nonemployee Share-Based Payment Accounting”, which simplifies the accounting for share-based payments granted to nonemployees for goods and services. Under the ASU, most of the guidance on such payments to nonemployees would be aligned with the requirements for share-based payments granted to employees. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, but not earlier than an entity’s adoption date of Topic 606. We adopted this standard on January 1, 2019. The adoption of this standard did not have a material impact on our consolidated financial statements.

#### ***Recently Issued Accounting Standards, Not Yet Adopted***

In September 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326). The ASU sets forth a “current expected credit loss” (CECL) model which requires the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. In February 2020, the FASB issued ASU 2020-02, Financial Instruments - Credit Losses (Topic 326), which amends the effective date of the original pronouncement for smaller reporting companies. ASU 2016-13 and its amendments will be effective for the Company for interim and annual periods in fiscal years beginning after December 15, 2022. The Company is currently assessing the impact of the adoption of this ASU on its financial statements.

In December 2019, the FASB issued ASU No. 2019-12, “Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes (“ASU 2019-12”), which is intended to simplify various aspects related to accounting for income taxes. ASU 2019-12 removes certain exceptions to the general principles in Topic 740 and also clarifies and amends existing guidance to improve consistent application. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020, with early adoption permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements and related disclosures.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Like virtually all commercial enterprises, we can be exposed to the risk (“market risk”) that the cash flows to be received or paid relating to certain financial instruments could change as a result of changes in interest rate, exchange rates, commodity prices, equity prices and other market changes.

Our operations are not subject to risks of material foreign currency fluctuations, nor do we use derivative financial instruments in our investment practices. We place our marketable investments in instruments that meet high credit quality standards. We do not expect material losses with respect to our investment portfolio or excessive exposure to market risks associated with interest rates. The impact on our results of one percentage point change in short-term interest rates would not have a material impact on our future earnings, fair value, or cash flows related to investments in cash equivalents or interest-earning marketable securities.

Current economic conditions may cause a decline in business and consumer spending which could adversely affect our business and financial performance including the collection of accounts receivables, realization of inventory and recoverability of assets. In addition, our business and financial performance may be adversely affected by current and future economic conditions, including a reduction in the availability of credit, financial market volatility and recession.

**Item 8. Financial Statements and Supplementary Data**

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
ProPhase Labs, Inc.

### *Opinion on the Financial Statements*

We have audited the accompanying consolidated balance sheets of ProPhase Labs, Inc. and Subsidiaries (the “Company”) as of December 31, 2019 and 2018, and the related consolidated statements of operations and other comprehensive income (loss), stockholders’ equity, and cash flows for each of the years then ended and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2019 and 2018, and the consolidated results of their operations and their cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States of America.

### *Basis for Opinion*

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

*/s/ EisnerAmper LLP*

We have served as the Company’s auditor since 2010.

EISNERAMPER LLP

Iselin, New Jersey

March 26, 2020

**PROPHASE LABS, INC AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share amounts)

	<u>December 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents .....	\$ 434	\$ 1,554
Marketable debt securities, available for sale .....	926	6,687
Escrow receivable .....	4,812	4,830
Accounts receivable, net .....	2,010	2,968
Inventory .....	1,459	1,903
Prepaid expenses and other current assets .....	304	296
Total current assets .....	<u>9,945</u>	<u>18,238</u>
Property, plant and equipment, net of accumulated depreciation of \$6,252 and \$5,854, respectively .....	<u>2,329</u>	<u>2,499</u>
<b>TOTAL ASSETS .....</b>	<b><u>\$ 12,274</u></b>	<b><u>\$ 20,737</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable .....	\$ 432	\$ 437
Accrued advertising and other allowances .....	92	101
Dividend payable .....	-	2,929
Other current liabilities .....	409	766
Total current liabilities .....	<u>933</u>	<u>4,233</u>
Non-current liabilities:		
Deferred revenue, net of current portion .....	<u>110</u>	<u>-</u>
Total non-current liabilities .....	<u>110</u>	<u>-</u>
Total liabilities .....	<u>1,043</u>	<u>4,233</u>
<b>COMMITMENTS AND CONTINGENCIES</b>		
-		
Stockholders' equity		
Preferred stock authorized 1,000,000, \$.0005 par value, no shares issued	-	-
Common stock authorized 50,000,000, \$.0005 par value, issued 28,225,615 and 28,201,541 shares, respectively .....	14	14
Additional paid-in capital .....	60,215	59,471
Retained earnings (accumulated deficit) .....	(1,506)	4,533
Treasury stock, at cost, 16,652,022 and 16,652,022 shares .....	(47,490)	(47,490)
Accumulated comprehensive loss .....	(2)	(24)
Total stockholders' equity .....	<u>11,231</u>	<u>16,504</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY .....</b>	<b><u>\$ 12,274</u></b>	<b><u>\$ 20,737</u></b>

See accompanying notes to consolidated financial statements



**PROPHASE LABS, INC & SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND**  
**OTHER COMPREHENSIVE INCOME (LOSS)**  
(in thousands, except per share amounts)

	<b>For the Years Ended</b>	
	<b>December 31, 2019</b>	<b>December 31, 2018</b>
Net sales.....	\$ 9,876	\$ 13,126
Cost of sales.....	7,261	8,345
Gross profit.....	2,615	4,781
Operating expenses:		
Sales and marketing.....	1,042	1,107
Administration.....	4,480	4,910
Research and development.....	332	398
Total operating expenses.....	5,854	6,415
Loss from operations.....	(3,239)	(1,634)
Interest income, net.....	133	167
Loss from continuing operations before income taxes.....	(3,106)	(1,467)
Income tax liability from continuing operations.....	-	(103)
Loss from continuing operations.....	(3,106)	(1,570)
Discontinued operations:		
Loss on discontinued operations, net of taxes.....	(40)	(170)
Loss from discontinued operations.....	(40)	(170)
<b>Net loss</b> .....	<b>\$ (3,146)</b>	<b>\$ (1,740)</b>
Other comprehensive income (loss):		
Unrealized gain on marketable debt securities.....	22	54
Total comprehensive loss.....	\$ (3,124)	\$ (1,686)
Basic and diluted loss per share:		
Loss from continuing operations.....	\$ (0.27)	\$ (0.14)
Loss from discontinued operations.....	-	(0.01)
Net loss.....	\$ (0.27)	\$ (0.15)
Weighted average common shares outstanding:		
Basic and diluted.....	11,564	11,396

See accompanying notes to consolidated financial statements

**PROPHASE LABS, INC & SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(in thousands, except share data)

	Common Stock Shares Outstanding, Net of Shares of Treasury Stock	Par Value	Additional Paid in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Comprehensive Loss	Treasury Stock	Total
<b>Balance as of December 31, 2017</b> .....	<b>11,129,892</b>	<b>\$ 14</b>	<b>\$ 58,034</b>	<b>\$ 20,902</b>	<b>\$ (78)</b>	<b>\$ (47,025)</b>	<b>\$ 31,847</b>
Proceeds for options exercised .....	240,000	-	338	-	-	-	338
Cashless options exercise .....	164,679	-	465	-	-	(465)	-
Cash dividends.....	-	-	-	(14,629)	-	-	(14,629)
Unrealized gain on marketable debt securities, net of realized losses of \$130, net of taxes.....	-	-	-	-	54	-	54
Stock-based compensation.....	14,948	-	634	-	-	-	634
Net loss .....	-	-	-	(1,740)	-	-	(1,740)
<b>Balance as of December 31, 2018</b> .....	<b>11,549,519</b>	<b>14</b>	<b>59,471</b>	<b>4,533</b>	<b>(24)</b>	<b>(47,490)</b>	<b>16,504</b>
Cash dividends.....	-	-	-	(2,893)	-	-	(2,893)
Unrealized gain on marketable debt securities, net of realized losses of \$12, net of taxes.....	-	-	-	-	22	-	22
Stock-based compensation.....	24,074	-	744	-	-	-	744
Net loss .....	-	-	-	(3,146)	-	-	(3,146)
<b>Balance as of December 31, 2019</b> .....	<b>11,573,593</b>	<b>\$ 14</b>	<b>\$ 60,215</b>	<b>\$ (1,506)</b>	<b>\$ (2)</b>	<b>\$ (47,490)</b>	<b>\$ 11,231</b>

See accompanying notes to consolidated financial statements

**PROPHASE LABS, INC & SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	<b>For the Years Ended</b>	
	<b>December 31, 2019</b>	<b>December 31, 2018</b>
<b>Cash flows from operating activities</b>		
Net loss .....	\$ (3,146)	\$ (1,740)
Adjustments to reconcile net loss to net cash used in operating activities:		
Realized loss on marketable debt securities.....	12	130
Loss on discontinued operations, net of taxes.....	40	170
Depreciation and amortization.....	398	383
Stock-based compensation expense.....	744	634
Changes in operating assets and liabilities:		
Accounts receivable.....	936	(1,023)
Inventory.....	444	(372)
Prepaid and other assets.....	(8)	185
Accounts payable and accrued expenses.....	(14)	(125)
Accrued advertising and other allowances.....		(99)
Due to Mylan, Inc. and affiliates.....	-	(59)
Other liabilities.....	(247)	(225)
Assets held for sale.....	-	22
Net cash used in operating activities.....	(841)	(2,119)
<b>Cash flows from investing activities</b>		
Purchase of marketable securities.....	(3,137)	(13,350)
Proceeds from maturities of marketable debt securities.....	-	14,280
Proceeds from sale of marketable debt securities.....	8,908	11,071
Capital expenditures.....	(228)	(140)
Net cash provided by investing activities.....	5,543	11,862
<b>Cash flows from financing activities</b>		
Payment of dividends.....	(5,822)	(11,700)
Proceeds from exercise of stock options.....	-	337
Net cash used in financing activities.....	(5,822)	(11,362)
Decrease in cash and cash equivalents.....	(1,120)	(1,619)
Cash and cash equivalents, at the beginning of the year.....	1,554	3,173
<b>Cash and cash equivalents, at the end of the year.....</b>	<b>\$ 434</b>	<b>\$ 1,554</b>
<b>Supplemental disclosures:</b>		
Cash paid for income taxes.....	\$ 103	\$ -
<b>Supplemental disclosure of non-cash investing and financing activities:</b>		
Net unrealized gain, investments in marketable debt securities.....	\$ 22	\$ 54

See accompanying notes to consolidated financial statements

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 – Organization and Business**

ProPhase Labs, Inc. (“we”, “us” or the “Company”) was initially organized as a corporation in Nevada in July 1989. Effective June 18, 2015, we changed our state of incorporation from the State of Nevada to the State of Delaware. We are a manufacturing and marketing company with deep experience with OTC consumer healthcare products and dietary supplements. We are engaged in the research, development, manufacture, distribution, marketing and sale of OTC consumer healthcare products and dietary supplements in the United States. This includes the development and marketing of dietary supplements under the TK Supplements® brand.

Our wholly-owned subsidiary, Pharmaloz Manufacturing, Inc. (“PMI”), is a full service contract manufacturer and private label developer of a broad range of non-GMO, organic and natural-based cough drops and lozenges and OTC drug and dietary supplement products.

In addition, we continue to actively pursue acquisition opportunities for other companies, technologies and products within and outside the consumer products industry.

We use a December 31 year-end for financial reporting purposes. References herein to “Fiscal 2019” shall mean the fiscal year ended December 31, 2019 and references to other “fiscal” years shall mean the year, which ended on December 31 of the year indicated. The term “we”, “us” or the “Company” as used herein also refer, where appropriate, to the Company, together with its subsidiaries unless the context otherwise requires.

**Discontinued Operations**

Prior to March 29, 2017, our flagship OTC drug brand was Cold-EEZE® and our principal product was Cold-EEZE® cold remedy zinc gluconate lozenges. In addition to Cold-EEZE® cold remedy lozenges, we also marketed and distributed non-lozenge forms of the proprietary zinc gluconate formulation, (i) Cold-EEZE® cold remedy QuickMelts®, (ii) Cold-EEZE® Gummies and (iii) Cold-EEZE® cold remedy oral spray.

Effective March 29, 2017, we sold our intellectual property rights and other assets related to our Cold-EEZE® brand and product line, including all then current and pipeline over-the-counter allergy, cold, flu, multi-symptom relief and immune support treatments for adults and children to the extent each was, or was intended to be, branded “Cold-EEZE®”, including all formulations and derivatives thereof (collectively referred to as the “Cold-EEZE® Business”) to Mylan Consumer Healthcare Inc. (formerly known as Meda Consumer Healthcare Inc.) (“MCH”) and Mylan Inc. (together with MCH, “Mylan”). As a result of the sale of the Cold-EEZE® business, for Fiscal 2017, we have classified as discontinued operations (i) all income and expenses attributable to the Cold-EEZE® business, (ii) the gain from the sale of the Cold-EEZE® business, and (iii) the income tax expense attributed to the sale of the Cold-EEZE® business. Excluded from the sale of the Cold-EEZE® business were our accounts receivable and inventory. We have also retained all liabilities associated with our Cold-EEZE® business operations arising prior to March 29, 2017.

For Fiscal 2019 and 2018, we incurred costs of \$40,000 and \$170,000, respectively, which was recorded as a loss on sale of discontinued operations, net of taxes.

**Continuing Operations**

We continue to own and operate our manufacturing facility and manufacturing business in Lebanon, Pennsylvania, and our headquarters in Doylestown, Pennsylvania. As part of the sale of the Cold-EEZE® business, we entered into a manufacturing agreement with Mylan and our wholly-owned subsidiary, Pharmaloz Manufacturing, Inc. (“PMI”), to supply various Cold-EEZE® lozenge products to Mylan. In addition to the production services we provide to Mylan under the manufacturing agreement, we also produce OTC healthcare and dietary supplement products for other third-party customers in addition to performing operational tasks such as warehousing and shipping.

We are also engaged in development and distribution of a product line of OTC dietary supplements under the brand name of TK Supplements®. The TK Supplements® product line comprises three men’s health products: (i) Legendz XL® for sexual health, (ii) Triple Edge XL®, an energy booster plus testosterone support, and (iii) Super ProstaFlow Plus™ for prostate and urinary health. In addition to developing direct-to-consumer (“Direct Response”) marketing strategies for Legendz XL®, we are currently in distribution in a national chain drug retailers and several regional retailers.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 2 – Summary of Significant Accounting Policies**

For Fiscal 2019 and 2018, our revenues from continuing operations have come principally from our OTC healthcare and dietary supplement contract manufacturing business and sales to retail customers of dietary supplement product.

***Basis of Presentation***

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated.

***Product Innovation, Seasonality of the Business and Liquidity***

Our net sales are derived principally from our contract manufacturing of OTC healthcare and dietary supplement products sold in the United States. In addition, we are engaged in market activities for the TK Supplements<sup>®</sup> product line of dietary supplements.

Our sales are influenced by and subject to (i) the timing of acceptance of our TK Supplement<sup>®</sup> products in the marketplace, and (ii) fluctuations in the timing of purchase and the ultimate level of demand for the OTC healthcare and cold remedy products that we manufacture for others, which are a function of the timing, length and severity of each cold season. Generally, a cold season is defined as the period from September to March when the incidence of the common cold rises as a consequence of the change in weather and other factors. We generally experience in the first, third and fourth quarter higher levels of net sales from our contract manufacturing of OTC healthcare and cold remedy products. Revenues are generally at their lowest levels in the second quarter when customer demand generally declines.

As a consequence of the timing of acceptance of our TK Supplements<sup>®</sup> products in the marketplace and the seasonality of our business, we realize variations in operating results and demand for working capital from quarter to quarter. As of December 31, 2019, we had working capital of approximately \$9.0 million, including \$0.9 million marketable securities available for sale. We believe our current working capital at December 31, 2019 is at an acceptable and adequate level to support our business for at least the next twelve months.

***Use of Estimates***

The preparation of financial statements and the accompanying notes thereto, in conformity with generally accepted accounting principles in the United States of America (“GAAP”), requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the respective reporting periods. Examples include the provision for bad debt, sales returns and allowances, inventory obsolescence, useful lives of property and equipment, impairment of property and equipment, income tax valuations and assumptions related to accrued advertising. When providing for the appropriate sales returns, allowances, cash discounts and cooperative incentive promotion costs (“sales allowances”), we apply a uniform and consistent method for making certain assumptions for estimating these provisions. These estimates and assumptions are based on historical experience, current trends and other factors that management believes to be relevant at the time the financial statements are prepared. Management reviews the accounting policies, assumptions, estimates and judgments on a quarterly basis. Actual results could differ from those estimates.

***Cash and Cash Equivalents***

We consider all highly liquid investments with an initial maturity of three months or less at the time of purchase to be cash equivalents. Cash equivalents include cash on hand and monies invested in money market funds. The carrying amount approximates the fair market value due to the short-term maturity of these investments.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Marketable Securities**

We have classified our investments in marketable securities as available-for-sale and as a current asset. Our investments in marketable securities are carried at fair value, with unrealized gains and losses included as a separate component of stockholders' equity. Realized gains and losses from our marketable securities are recorded as other interest income (expense). We initiated short term investments in marketable securities, which carry maturity dates between one and three years from date of purchase with interest rates of 1.65% - 3.09%, during Fiscal 2019. For Fiscal 2019 and 2018, we reported an unrealized gain of \$22,000 and \$54,000, respectively. We had an accumulated unrealized loss of \$2,000 and \$24,000 as of December 31, 2019 and 2018, respectively. Unrealized gains and losses are classified as other comprehensive income (loss) and cost is determined on a specific identification basis. The following is a summary of the components of our marketable securities and the underlying fair value input level tier hierarchy (see long-lived assets below) (in thousands):

	<b>As of December 31, 2019</b>		
	<b>Amortized Cost</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
U.S treasuries .....	\$ 125	\$ -	\$ 125
Corporate bonds .....	803	(2)	801
	\$ 928	\$ (2)	\$ 926

  

	<b>As of December 31, 2018</b>		
	<b>Amortized Cost</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
U.S treasuries .....	\$ 2,401	\$ (3)	\$ 2,398
Corporate bonds .....	4,310	(21)	4,289
	\$ 6,711	\$ (24)	\$ 6,687

We have determined that the unrealized losses are deemed to be temporary as of December 31, 2019. We believe that the unrealized losses generally are the result of increases in the risk premiums required by market participants rather than an adverse change in cash flows or a fundamental weakness in the credit quality of the issuer or underlying assets. We have the ability and intent to hold these investments until a recovery of fair value, which may be maturity. We do not consider the investment in corporate bonds to be other-than-temporarily impaired at December 31, 2019.

**Inventory**

Inventory is valued at the lower of cost, determined on a first-in, first-out basis (FIFO), or net realizable value. Inventory items are analyzed to determine cost and the net realizable value and appropriate valuation adjustments are established. During 2019 and 2018, the Company wrote off certain inventory previously recorded. At December 31, 2019 and 2018, the financial statements include non-cash adjustments to reduce inventory for excess, obsolete or short-dated shelf-life inventory of \$168,000 and \$103,000, respectively. The components of inventory are as follows (in thousands):

	December 31, 2019	December 31, 2018
Raw materials .....	\$ 1,024	\$ 1,374
Work in process.....	299	371
Finished goods .....	136	158
	\$ 1,459	\$ 1,903

**Property, Plant and Equipment**

Property, plant and equipment are recorded at cost. We use the straight-line method in computing depreciation for financial reporting purposes. Depreciation expense is computed in accordance with the following ranges of estimated asset lives: building and improvements – ten to thirty-nine years; machinery and equipment – three to seven years; computer equipment and software – three to five years; and furniture and fixtures – five years.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

***Concentration of Risks***

Future revenues, costs, margins and profits will continue to be influenced by our ability to maintain our manufacturing availability and capacity together with our marketing and distribution capabilities and the regulatory requirements associated with the development of OTC consumer healthcare products, dietary supplements and other remedies in order to compete on a national level and/or international level.

Our business is subject to federal and state laws and regulations adopted for the health and safety of users of our products. The manufacturing and distribution of OTC healthcare and dietary supplement products are subject to regulations by various federal, state and local agencies, including the Food and Drug Administration (“FDA”) and, as applicable, the Homeopathic Pharmacopoeia of the United States.

Financial instruments that potentially subject us to significant concentrations of credit risk consist principally of cash investments, marketable securities, and trade accounts receivable. Our marketable securities are fixed income investments, which are highly liquid and can be readily purchased or sold through established markets.

We maintain cash and cash equivalents with certain major financial institutions. As of December 31, 2019, our cash and cash equivalents balance was \$0.4 million and our bank balance was \$0.5 million. Of the total bank balance, \$335,000 was covered by federal depository insurance and \$176,000 was uninsured at December 31, 2019.

Trade accounts receivable potentially subject us to credit concentrations from time-to-time as a consequence of the timing, payment pattern and ultimate purchase volumes or shipping schedules with our customers. We extend credit to our customers based upon an evaluation of the customer’s financial condition and credit history and generally we do not require collateral. Our customers include consumer products companies and large national chain, regional, specialty and local retail stores. These credit concentrations may impact our overall exposure to credit risk, either positively or negatively, in that our customers may be similarly affected by changes in economic, regulatory or other conditions that may impact the timing and collectability of amounts due to us. As a consequence of an evaluation of our customer’s financial condition, payment patterns, balance due to us and other factors, we did not offset our account receivable with an allowance for bad debt at December 31, 2019 and 2018.

***Long-lived Assets***

We review the carrying value of our long-lived assets with definite lives whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. When indicators of impairment exist, we determine whether the estimated undiscounted sum of the future cash flows of such assets is less than their carrying amounts. If less, an impairment loss is recognized in the amount, if any, by which the carrying amount of such assets exceeds their respective fair values. The determination of fair value is based on quoted market prices in active markets, if available, or independent appraisals; sales price negotiations; or projected future cash flows discounted at a rate determined by management to be commensurate with our business risk. The estimation of fair value utilizing discounted forecasted cash flows includes significant judgments regarding assumptions of revenue, operating and marketing costs; selling and administrative expenses; interest rates; property and equipment additions and retirements; industry competition; and general economic and business conditions, among other factors.

Fair value is based on the prices that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, a three-tier fair value hierarchy prioritizes the inputs used to measure fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

***Fair Value of Financial Instruments***

Cash and cash equivalents, marketable securities, accounts receivable, assets held for sale, accounts payable, and accrued expenses are reflected in the consolidated financial statements at carrying value which approximates fair value. We account for our marketable securities at fair value pursuant to Accounting Standards Codification, or ASC, 820-10, with the net unrealized gains or losses reported as a component of accumulated other comprehensive income or loss.

	<b>As of December 31, 2019</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Marketable debt securities				
U.S. government obligations .....	\$ -	\$ 125	\$ -	\$ 125
Corporate obligations.....	-	801	-	801
	\$ -	\$ 926	\$ -	\$ 926

  

	<b>As of December 31, 2018</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Marketable debt securities				
U.S. government obligations .....	\$ -	\$ 2,398	\$ -	\$ 2,398
Corporate obligations.....	-	4,289	-	4,289
	\$ -	\$ 6,687	\$ -	\$ 6,687

There were no transfers of marketable securities between Levels 1, 2 or 3 for the Fiscal 2019 and 2018.

***Revenue Recognition***

We account for revenue in accordance with ASC 606, which requires revenue recognized to represent the transfer of promised goods or services to customers at an amount that reflects the consideration which is expected to be received in exchange for those goods or services. We recognize revenue when performance obligations with our customers have been satisfied. At contract inception, we determine if a contract is within the scope of ASC Topic 606 and then evaluate the contract using the following five steps: (1) identify the contract with the customer; (2) identify the performance obligations; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations; and (5) recognize revenue when (or as) the entity satisfies a performance obligation.

We adopted ASC 606 as of January 1, 2018 using the modified retrospective method. For the years ended December 31, 2019 and 2018, there were no changes to our opening balances upon the adoption of ASC 606 and the amounts which would have been reported under the standards in effect prior to adoption.

***Performance Obligations***

We generate sales principally through two types of customers, contract manufacturing and retail customers. Sales from product shipments to contract manufacturing and retailer customers are recognized at the time ownership is transferred to the customer. Net sales from OTC healthcare contract manufacturing and retail dietary supplement product customers were \$9.0 million and \$0.9 million, respectively, for Fiscal 2019 and \$12.6 million and \$0.5 million, respectively, for Fiscal 2018. Revenue from retailer customers is reduced for trade promotions, estimated sales returns, cash discounts and other allowances in the same period as the related sales are recorded. No such allowance is applicable to our contract manufacturing customers. We make estimates of potential future product returns and other allowances related to current period revenue. We analyze historical returns, current trends, and changes in customer and consumer demand when evaluating the adequacy of the sales returns and other allowances.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account in accordance with ASC 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The combined duties and responsibilities within each contract will be considered one single performance obligation under ASC 606 as these items would not be separately identifiable from each other promise in the contract and we provide a significant service of integrating the duties with other promises in the contracts.



**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

*Transaction Price*

The transaction price is fixed based upon either (i) a combined Master Agreement and each related purchase order, or (ii) if there is no Master Agreement, the price per the individual purchase order received from each customer. The customers are invoiced at an agreed upon contractual price for each unit ordered and delivered by us.

Consistent with Company practice prior to the adoption of ASC 606, we do not collect sales tax or other similar taxes from customers. As such, there is no effect on the measurement of the transaction price.

*Recognize Revenue When the Company Satisfies a Performance Obligation*

Performance obligations related to contract manufacturing and retail customers are satisfied at a point in time when the goods are shipped to the customer as (i) we have transferred control of the assets to the customers upon shipping, and (ii) the customer obtains title and assumes the risks and rewards of ownership after the goods are shipped.

We do not accept returns in the contract manufacturing revenue stream. Our return policy for retailer customers accommodates returns for (i) discontinued products, (ii) store closings and (iii) products that have reached or exceeded their designated expiration date. We do not impose a period of time within which product may be returned. All requests for product returns must be submitted to us for pre-approval. The main components of our returns policy are: (i) we will accept returns that are due to damaged product that is un-saleable and such return request activity falls within an acceptable range, (ii) we will accept returns for products that have reached or exceeded designated expiration dates and (iii) we will accept returns in the event that we discontinue a product provided that the customer will have the right to return only such items that it purchased directly from us. We will not accept return requests pertaining to customer inventory “Overstocking” or “Resets”. We will accept return requests for only products in its intended package configuration. We reserve the right to terminate shipment of product to customers who have made unauthorized deductions contrary to our return policy or pursue other methods of reimbursement. We compensate the customer for authorized returns by means of a credit applied to amounts owed or to be owed and in the case of discontinued product only, also by way of an exchange. We do not have any significant product exchange history.

Under ASC 606, we continue to recognize revenue from contract manufacturing and retail customers at a point in time as we have an enforceable right to payment for goods as products are shipped to customers.

As of December 31, 2019 and 2018, we included a provision for sales allowances from continuing operations of \$0 and \$1,000, respectively, which are reported as a reduction to account receivables. Additionally, accrued advertising and other allowances from continuing operations as of December 31, 2019 included (i) \$37,000 for estimated returns which is reported as a liability and (ii) \$92,000 for corporative and incentive promotion costs which is also reported as a liability. In addition, accrued advertising and other allowances from discontinued operations as of December 31, 2019 included (i) \$132,000 for estimated returns, which is reported as a reduction to account receivables, and (ii) \$76,000 for cooperative incentive promotion costs, which is reported as accrued advertising and other allowances under current liabilities. As of December 31, 2018, accrued advertising and other allowances from discontinued operations included (i) \$181,000 for estimated future sales returns, which is reported as a reduction to account receivables, and (ii) \$88,000 for cooperative incentive promotion costs, which is reported as accrued advertising and other allowances under current liabilities.

As of December 31, 2019, we have deferred revenue of \$214,000 in relation to Research and Development (“R&D”) stability and release testing programs. As of December 31, 2018, deferred revenue was \$206,000. Deferred revenues primarily consist of amounts that have been billed to or received from customers in advance of revenue recognition and prepayments received from customers in advance for implementation, maintenance and other services, as well as initial subscription fees. We recognize deferred revenues as revenues when the services are performed and the corresponding revenue recognition criteria are met. Customer prepayments are generally applied against invoices issued to customers when services are performed and billed.

The following table disaggregates the Company’s deferred revenue by recognition period (in thousands):

Recognition Period	<u>Deferred Revenue</u>
0-12 Months .....	\$ 104
13-24 Months .....	49
Over 24 Months .....	<u>61</u>
Total .....	<u>\$ 214</u>

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

*Disaggregation of Revenue*

We disaggregate revenue from contracts with customers into two categories: contract manufacturing and retail customers. We determined that disaggregating revenue into these categories achieves the disclosure objective to depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

The following table disaggregates the Company’s revenue by revenue source for Fiscal 2019 and 2018 (in thousands):

Revenue by Customer Type	<b>For the Years Ended</b>	
	<b>December 31, 2019</b>	<b>December 31, 2018</b>
Contract manufacturing .....	\$ 8,974	\$ 12,633
Retail and others.....	902	493
Total revenue.....	\$ 9,876	\$ 13,126

*Practical Expedients Elected*

We have elected the following practical expedients in applying ASC 606 across all revenue relationships.

*Sales Tax Exclusion from the Transaction Price*

We exclude from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the Company from the customer.

*Shipping and Handling Activities*

We account for shipping and handling activities that we perform as activities to fulfill the promise to transfer the good.

*Advertising and Incentive Promotions*

Advertising and incentive promotion costs are expensed within the period in which they are utilized. Advertising and incentive promotion expense is comprised of (i) media advertising, presented as part of sales and marketing expense, (ii) cooperative incentive promotions and coupon program expenses, which are accounted for as part of net sales, and (iii) free product, which is accounted for as part of cost of sales. Advertising and incentive promotion expenses (i) incurred from continuing operations for Fiscal 2019 and 2018 were \$443,000 and \$264,000, respectively.

*Share-Based Compensation*

We recognize all share-based payments to employees and directors, including grants of stock options, as compensation expense in the financial statements based on their fair values. Fair values of stock options are determined through the use of the Black-Scholes option pricing model. The compensation cost is recognized as an expense over the requisite service period of the award, which usually coincides with the vesting period. We account for forfeitures as they occur.

Stock and stock options for the purchase of our common stock, \$0.0005 par value (“Common Stock”), have been granted to both employees and non-employees pursuant to the terms of certain agreements and stock option plans (see Note 5). Stock options are exercisable during a period determined by us, but in no event later than ten years from the date granted.

*Research and Development*

R&D costs are charged to operations in the period incurred R&D costs incurred for Fiscal 2019 and 2018 (i) from continuing operations were \$332,000 and \$398,000, respectively. R&D costs are principally related to personnel expenses and new product development initiatives and costs associated with our OTC health care products, dietary supplements and other remedies.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

***Income Taxes***

We utilize the asset and liability approach which requires the recognition of deferred tax assets and liabilities for the future tax consequences of events that have been recognized in our financial statements or tax returns. In estimating future tax consequences, we generally consider all expected future events other than enactments of changes in the tax law or rates. Until sufficient taxable income to offset the temporary timing differences attributable to operations and the tax deductions attributable to option, warrant and stock activities are assured, a valuation allowance equaling the total deferred tax asset is being provided.

We utilize a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than fifty percent likely of being realized upon ultimate settlement. Any interest or penalties related to income taxes will be recorded as interest or administrative expense, respectively.

As a result of our losses from continuing operations, we have recorded a full valuation allowance against a net deferred tax asset. Additionally, we have not recorded a liability for unrecognized tax benefit.

***Recently Adopted Accounting Standards***

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02, Leases (Topic 842) in order to increase transparency and comparability among organizations by, among other provisions, recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. For public companies, ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. In transition, entities may also elect a package of practical expedients that must be applied in its entirety to all leases commencing before the adoption date, unless the lease is modified, and permits entities to not reassess (a) the existence of a lease, (b) lease classification or (c) determination of initial direct costs, as of the adoption date, which effectively allows entities to carryforward accounting conclusions under previous GAAP. In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements, which provides entities an optional transition method to apply the guidance under Topic 842 as of the adoption date, rather than as of the earliest period presented. We adopted Topic 842 on January 1, 2019, using the optional transition method to apply the new guidance as of January 1, 2019, rather than as of the earliest period presented, and elected the package of practical expedients described above. The adoption of this standard did not have a material impact on our consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07 “Improvements to Nonemployee Share-Based Payment Accounting”, which simplifies the accounting for share-based payments granted to nonemployees for goods and services. Under the ASU, most of the guidance on such payments to nonemployees would be aligned with the requirements for share-based payments granted to employees. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, but not earlier than an entity’s adoption date of Topic 606. We adopted this standard on January 1, 2019. The adoption of this standard did not have a material impact on our consolidated financial statements.

***Recently Issued Accounting Standards, Not Yet Adopted***

In September 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326). The ASU sets forth a “current expected credit loss” (CECL) model which requires the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. In February 2020, the FASB issued ASU 2020-02, Financial Instruments - Credit Losses (Topic 326), which amends the effective date of the original pronouncement for smaller reporting companies. ASU 2016-13 and its amendments will be effective for the Company for interim and annual periods in fiscal years beginning after December 15, 2022. The Company is currently assessing the impact of the adoption of this ASU on its financial statements.

**PROPHASE LABS, INC & SUBSIDIARIES**  
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In December 2019, the FASB issued ASU No. 2019-12, “Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes (“ASU 2019-12”), which is intended to simplify various aspects related to accounting for income taxes. ASU 2019-12 removes certain exceptions to the general principles in Topic 740 and also clarifies and amends existing guidance to improve consistent application. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020, with early adoption permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements and related disclosures.

**Note 3 – Discontinued Operations, Sale of the Cold-EEZE® Business**

Effective March 29, 2017, we completed the sale of the Cold-EEZE® business to Mylan.

For Fiscal 2019 and 2018, we incurred costs of \$40,000 and \$170,000, respectively, which was recorded as a loss on sale of discontinued operations, net of taxes.

**Note 4 – Property, Plant and Equipment**

The components of property and equipment are as follows (in thousands):

	December 31, 2019	December 31, 2018	Estimated Useful Life
Land.....	\$ 504	\$ 504	
Building improvements.....	3,113	3,059	10-39 years
Machinery.....	4,285	4,126	3-7 years
Computer equipment.....	472	457	3-5 years
Furniture and fixtures.....	207	207	5 years
	8,581	8,353	
Less: accumulated depreciation.....	(6,252)	(5,854)	
Total property, plant and equipment, net.....	<u>\$ 2,328</u>	<u>\$ 2,499</u>	

Depreciation expense incurred for Fiscal 2019 and 2018 from continuing operations were \$398,000 and \$383,000, respectively.

**Note 5 – Transactions Affecting Stockholders’ Equity**

Our authorized capital stock consists of 50 million shares of Common Stock and one million shares of preferred stock, \$0.0005 par value (“Preferred Stock”) per share.

***Preferred Stock***

The Preferred Stock authorized under our certificate of incorporation may be issued from time to time in one or more series. As of December 31, 2019, no shares of Preferred Stock have been issued. Our board of directors have the full authority permitted by law to establish, without further stockholder approval, one or more series of Preferred Stock and the number of shares constituting each such series and to fix by resolution voting powers, preferences and relative, participating, optional and other special rights of each series of Preferred Stock, and the qualifications, limitations or restrictions thereof, if any. Subject to the limitation on the total number of shares of Preferred Stock that we have authority to issue under our certificate of incorporation, the board of directors is also authorized to increase or decrease the number of shares of any series, subsequent to the issue of that series, but not below the number of shares of such series then-outstanding. In case the number of shares of any series is so decreased, the shares constituting such decrease will resume the status that they had prior to the adoption of the resolution originally fixing the number of shares of such series. We may, subject to any required stockholder approval amend from time to time our certificate of incorporation to increase the number of authorized shares of Preferred Stock or Common Stock or to make other changes or additions to our capital structure or the terms of our capital stock.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

***Stockholder Rights Plan***

On September 8, 1998, our Board of Directors declared a dividend distribution of Common Stock Purchase Rights (each individually, a “Right” and collectively, the “Rights”) payable to the stockholders of record on September 25, 1998, thereby creating a Stockholder Rights Plan (the “Rights Agreement”). The Rights Agreement was subsequently amended effective each of (i) May 23, 2008, (ii) August 18, 2009, (iii) June 2014 and (iv) January 6, 2017. The Rights Agreement, as amended and restated, provides that each Right entitles the stockholder of record to purchase from the Company that number of common shares of Common Stock having a combined market value equal to two times the Rights exercise price of \$45. The Rights are not exercisable until the distribution date, which will be the earlier of a public announcement that a person or group of affiliated or associated persons has acquired 15% or more of the outstanding common shares of Common Stock, or the announcement of an intention by a similarly constituted party to make a tender or exchange offer resulting in the ownership of 15% or more of the outstanding common shares of Common Stock (such person, the “acquirer”). The Rights Agreement, as amended and restated, allows for an exemption for Ted Karkus, our Chairman and Chief Executive Officer, to acquire up to 20% of our Common Stock without our Board of Directors declaring a dividend distribution.

The dividend has the effect of giving the stockholder a 50% discount on the share’s current market value for exercising such right. In the event of a cashless exercise of the Right, and the acquirer has acquired less than 50% beneficial ownership of the Company, a stockholder may exchange one Right for one common share of the Company. The Rights Agreement, as amended and restated, includes a provision pursuant to which our Board of Directors may exempt from the provisions of the Rights Agreement an offer for all outstanding shares of our Common Stock that the directors determine to be fair and not inadequate and to otherwise be in the best interests of the Company and its stockholders, after receiving advice from one or more investment banking firms. The expiration date of the Rights Agreement, as amended, is June 18, 2024.

On February 16, 2018, our board of directors, approved the termination of the Rights Agreement effective February 20, 2018. As a consequence of the termination of the Rights Agreement, all of the Rights distributed to our stockholders expired on February 20, 2018.

***2015 Equity Line of Credit***

On July 30, 2015, we entered into an equity line of credit agreement (the “2015 Equity Line”) with Dutchess Opportunity Fund II, LP (“Dutchess”). Pursuant to the 2015 Equity Line, Dutchess committed to purchase, subject to certain restrictions and conditions, up to 3,200,000 shares of our Common Stock, over a period of 36 months from the effectiveness of the registration statement registering the resale of shares purchased by Dutchess pursuant to the investment agreement. The 2015 Equity Line of Credit expired in July 2018.

***Common Stock Dividends***

On May 7, 2018, the Board declared a special cash dividend of \$1.00 per share on the Company’s common stock to holders of record on May 21, 2018, resulting in the payment of \$11.7 million to stockholders on June 5, 2018.

On December 24, 2018, the Board declared a special cash dividend of \$0.25 per share on the Company’s common stock to holders of record on January 10, 2019, resulting in the payment of \$2.9 million to stockholders on January 24, 2019.

On November 20, 2019, the Board declared a special cash dividend of \$0.25 per share on the Company’s common stock to holders of record on December 3, 2019, resulting in the payment of \$2.9 million to stockholders on December 12, 2019.

***The 2010 Directors’ Equity Compensation Plan***

On May 5, 2010, our stockholders approved the 2010 Directors’ Equity Compensation Plan which, was has been subsequently amended and restated by our stockholders (the “2010 Directors’ Plan”). A primary purpose of the 2010 Directors’ Plan is to provide us with the ability to pay all or a portion of the fees of directors in stock instead of cash. The 2010 Directors’ Plan provides that the total number of shares of Common Stock that may be issued under the 2010 Directors’ Plan is equal to 675,000 shares.

During Fiscal 2019 and 2018, 24,074 shares and 14,948 shares, respectively, were granted to our directors under the 2010 Directors’ Plan. We recorded \$62,000 and \$45,000 of director fees during Fiscal 2019 and Fiscal 2018, respectively, in connection with these grants.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

At December 31, 2019, there were 358,786 shares of Common Stock that may be issued pursuant to the terms of the 2010 Directors' Plan.

***The 2010 Equity Compensation Plan***

On May 5, 2010, our stockholders approved the 2010 Equity Compensation Plan, which has been subsequently amended and restated by our stockholders (the "2010 Plan"). The 2010 Plan provides that the total number of shares of Common Stock that may be issued under the 2010 Plan is 3.9 million shares.

During Fiscal 2019, the Company granted 200,000 stock options at an exercise price of \$2.01, the closing price of the Company's common stock on the date of grant, to certain employees. The stock options will vest in four equal annual installments beginning on the date of grant.

During Fiscal 2018, the company granted 30,000 options, exercisable at \$2.35 per share and subject to vesting over a three-year term, to a consultant pursuant to the terms of the 2010 Plan and we granted 160,000 options to employees, exercisable at \$3.18 per share and subject to vesting over four years, to employees pursuant to the terms of the 2010 Plan. We use the Black-Scholes option pricing model to determine the fair value of the stock options at the date of grant. Options to non-employees are valued at initial issuance, then revalued at each reporting date until the date the options vest and at which point the final fair value is determined. Based upon our limited historical experience, we determined the expected term of the stock option grants to be 4.5 – 4.75 years, calculated using the "simplified" method in accordance with the SEC Staff Accounting Bulletin 110. We use the "simplified" method since our historical data does not provide a reasonable basis upon which to estimate expected term.

During Fiscal 2018 there were 490,000 options exercised, including 250,000 shares that were exercised pursuant to a cashless exercise. We derived \$337,500 from the exercise of options in 2018. No options were exercised under the 2010 Plan during Fiscal 2019.

At December 31, 2019, there were 782,000 stock options outstanding and 528,659 options available to be issued pursuant to the terms of the 2010 Plan. We will recognize approximately \$401,000 of share-based compensation expense over a weighted average period of 2.1 years.

***The 2018 Stock Incentive Plan***

On April 12, 2018, our stockholders approved the 2018 Stock Incentive Plan (the "2018 Stock Plan"). The 2018 Stock Plan provides for the grant of incentive stock options to eligible employees of the Company, and for the grant of nonstatutory stock options to eligible employees, directors and consultants. The purpose of the 2018 Stock Plan is to advance the interests of the Company and its stockholders by providing an incentive to attract, retain, and reward persons performing services for the Company and by motivating such persons to contribute to the growth and profitability of the Company. The 2018 Stock Plan provides that the total number of shares that may be issued pursuant to the 2018 Stock Plan is 2.3 million shares. At April 12, 2018, all 2.3 million shares have been granted in the form of stock options to Ted Karkus (the "CEO Option"), our Chief Executive Officer and no stock options have been exercised under the 2018 Stock Plan. We use the Black-Scholes option pricing model to determine the fair value of the stock options and Warrants at the date of grant. Based upon our limited historical experience, we determined the expected term of the stock option grants to be 4.5 years, calculated using the "simplified" method in accordance with the SEC Staff Accounting Bulletin 110. We use the "simplified" method since our historical data does not provide a reasonable basis upon which to estimate expected term. We will recognize approximately \$577,000 of share-based compensation expense over a weighted average period of 1.2 years.

The 2018 Plan requires certain proportionate adjustments to be made to the stock options granted under the 2018 Plan upon the occurrence of certain events, including a special distribution (whether in the form of cash, shares, other securities, or other property) in order to maintain parity. Accordingly, the Compensation Committee of the board of directors, as required by the terms of the 2018 Stock Plan, adjusted the terms of the CEO Option, such that the exercise price of the CEO Option was reduced from \$3.00 per share to \$2.00 per share, effective as of September 5, 2018, the date the special \$1.00 special cash dividend was paid to stockholders. The exercise price of the CEO Option was further reduced from \$2.00 to \$1.75 per share, effective as of January 24, 2019, the date the \$0.25 special cash dividend was paid to stockholders. The exercise price of the CEO Option was further reduced from \$1.75 to \$1.50 per share, effective as of December 12, 2019, the date another \$0.25 special cash dividend was paid to stockholders.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The following table summarizes stock options activities during Fiscal 2019 and 2018 for both 2010 Plan and 2018 Stock Plan (in thousands, except per share data). All outstanding options are expected to vest.

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Life (in years)</u>	<u>Total Intrinsic Value</u>
Outstanding as of January 1, 2018.....	980	\$ 1.82	4.8	\$ 52
Granted .....	2,490	2.08	4.3	-
Exercised .....	(490)	1.64	-	-
Outstanding as of December 31, 2018.....	<u>2,980</u>	<u>1.82</u>	<u>4.8</u>	<u>3,235</u>
Granted .....	200	2.01	6.9	
Forfeited/expired.....	(98)	2.81	-	-
Outstanding as of December 31, 2019.....	<u>3,082</u>	<u>\$ 1.67</u>	<u>3.7</u>	<u>\$ 1,085</u>
Options vested and exercisable.....	1,656	\$ 1.59	3.4	\$ 665

The following table summarizes weighted average assumptions used in determining the fair value of the stock options at the date of grant during Fiscal 2019 and 2018:

	<u>For the Years Ended</u>	
	<u>December 31, 2019</u>	<u>December 31, 2018</u>
Exercise price .....	\$ 2.01	\$ 2.52
Expected term in years .....	4.5	4.5
Expected volatility (annual) .....	42%	40%
Risk-free interest rate .....	2%	2%
Expected dividend yield (per share) .....	0%	0%

The fair value of the stock options at the time of the grant in Fiscal 2019 and 2018 was \$148,000 and \$1.8 million, respectively. For Fiscal 2019 and 2018, we charged to operations \$682,000 and \$590,000, respectively, for share-based compensation expense for the aggregate fair value of the vested stock options earned.

**Note 6 – Defined Contribution Plans**

We maintain the ProPhase Labs, Inc. 401(k) Savings and Retirement Plan, a defined contribution plan for our employees. Our contributions to the plan are based on the amount of the employee plan contributions and compensation. Our contributions to the plan in Fiscal 2019 and 2018 were \$84,000 and \$90,000, respectively.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 7 – Income Taxes**

The components of the provision (benefit) for income taxes, in the consolidated statements of operations are as follows (in thousands):

	<u>Year Ended</u> <u>12/31/2019</u>	<u>Year Ended</u> <u>12/31/2018</u>
Continuing Operations		
Current:		
Federal.....	\$ -	\$ -
State.....	-	103
	<u>-</u>	<u>103</u>
Deferred:		
Federal.....	-	-
State.....	-	-
Income taxes from Continuing Operations.....	<u>-</u>	<u>103</u>
Discontinued Operations		
Current		
Federal.....	\$ -	\$ -
State.....	-	-
	<u>-</u>	<u>-</u>
Deferred		
Federal.....	-	-
State.....	-	-
Income taxes from Discontinued Operations .....	<u>-</u>	<u>-</u>
Total .....	<u>\$ -</u>	<u>\$ 103</u>

A reconciliation of the statutory federal income tax expense (benefit) to the effective tax is as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Statutory rate – federal .....	\$ (660)	\$ (341)
State taxes, net of federal benefit.....	(7)	306
Permanent differences and other .....	<u>145</u>	<u>243</u>
Income tax from continuing operation before valuation allowance ..	(522)	208
Change in valuation allowance.....	<u>(522)</u>	<u>(105)</u>
Income tax expense .....	-	103
Total .....	<u>\$ -</u>	<u>\$ 103</u>

The tax effects of the primary “temporary differences” between values recorded for assets and liabilities for financial reporting purposes and values utilized for measurement in accordance with tax laws giving rise to our deferred tax assets are as follows (in thousands):

	<u>Year Ended December 31,</u>	
	<u>2019</u>	<u>2018</u>
Net operating loss and capital loss carryforward.....	\$ 4,605	\$ 4,081
Depreciation.....	(93)	(109)
Other.....	198	216
Valuation allowance.....	<u>(4,710)</u>	<u>(4,188)</u>
Total .....	<u>\$ -</u>	<u>\$ -</u>



**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

We recognize tax assets and liabilities for the future tax consequences related to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and for net operating loss carryforwards. Management evaluated the deferred tax assets for recoverability using a consistent approach that considers the relative impact of negative and positive evidence, including historical profitability and projections of future reversals of temporary differences and future taxable income. We are required to establish a valuation allowance for deferred tax assets if management determines, based on available evidence at the time the determination is made, that it is not more likely than not that some portion or all of the deferred tax assets will be realized.

A valuation allowance for all of our net deferred tax assets has been provided as we are unable to determine, at this time, that the generation of future taxable income against which the net operating losses (“NOL”) carryforwards could be used is more likely than not. As a result of ongoing losses from continuing operations the Company has concluded that it is more likely than not that it will not realize all of its deferred tax assets relating to federal and state filing jurisdictions. As of December 31, 2019, there is a valuation allowance of \$4.7 million. As of December 31, 2019, the Company has state NOL carryforwards of \$1.1 million, which begin to expire in 2024 and federal NOL carryforwards of \$3.5 million. The amount of the federal NOL generated prior to the 2017 legislation commonly referred to as the Tax Cuts and Jobs Act (“TCJA”) of \$2.6 million may be carried forward for 20 years and begins to expire in 2032. The remaining amount of \$0.9 million federal NOL generated in years 2018 and 2019 may be carried forward indefinitely and its utilization is limited to 80% of taxable income.

We file a consolidated federal income tax return and separate company state returns as well as combined state returns where applicable.

**Note 8 – Other Current Liabilities**

The following table sets forth the components of other current liabilities at December 31, 2019 and 2018, respectively (in thousands):

	December 31, 2019	December 31, 2018
Accrued expenses .....	\$ 218	\$ 167
Accrued benefits.....	25	23
Accrued payroll .....	57	195
Accrued vacation.....	5	66
Sales tax payable .....	-	3
Income taxes payable .....	-	106
Deferred revenue .....	104	206
Total other current liabilities .....	<u>\$ 409</u>	<u>\$ 766</u>

**Note 9 – Commitments and Contingencies**

Escrow Receivable

We have indemnification obligations to Mylan Consumer Healthcare Inc. (formerly known as Meda Consumer Healthcare Inc.) (“MCH”) and Mylan Inc. (together with MCH, “Mylan”) under the asset purchase agreement pursuant to which we sold the Cold-EEZE® business to Mylan, that may require us to make future payments to Mylan and other related persons for any damages incurred by Mylan or such related persons as a result of any breaches of our representations, warranties, covenants or agreements contained in the asset purchase agreement, or arising from the Retained Liabilities (as such term is defined in the asset purchase agreement) or certain third party claims specified in the asset purchase agreement. Generally, our representations and warranties survive for a period of 24 months from the closing date, which was March 29, 2017, other than certain fundamental representations which survive until the expiration of the applicable statute of limitations. There is a limited indemnification cap with respect to a majority of the Company’s indemnification obligations under the asset purchase agreement with the exception of claims for actual fraud, the breach of any fundamental representations and certain other items, which have a larger indemnification cap (i.e., the purchase price).

Pursuant to the terms of the asset purchase agreement, we, Mylan, and an escrow agent entered into an Escrow Agreement at closing, pursuant to which Mylan deposited \$5 million of the aggregate purchase price for the Cold-EEZE® business into an escrow account established with the Escrow Agent in order to satisfy, in whole or in part, certain of our indemnity obligations under the asset purchase agreement.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The terms of the Escrow Agreement provide that if, as of September 29, 2018, there were funds remaining in the escrow account, then the escrow account would be reduced by the difference, if a positive number, of (i) \$2.5 million minus (ii) the aggregate amount of all escrow claims asserted by Mylan prior to this date that had either been paid out of the escrow account or were pending as of such date, and, within two business days of such date, the Escrow Agent would disburse such difference, if a positive number, to us. In addition, within two business days of March 29, 2019, the Escrow Agent will release any funds remaining in the escrow account to us minus any amounts being reserved for escrow claims asserted by Mylan prior to such date. Upon the resolution of any pending escrow claims, the Escrow Agent would then, within two business days of receipt of joint instructions or a final order from a court (as described in the Escrow Agreement) disburse such reserved amount to the parties entitled to such funds. As described below, in August 2018, Mylan asserted an indemnification claim against us, for a yet to be determined amount. Accordingly, the distributions were not released to us on September 29, 2018 or March 29, 2019.

On May 31, 2018, we received notice of a claim for \$800,000 in losses against the escrow amount. We resolved this claim pursuant to a settlement agreement, effective October 16, 2018, pursuant to which \$160,000 of the funds held in escrow were released to Mylan. This expense is reflected in discontinued operations in the third quarter of 2018.

On August 2, 2018, we received notice of an indemnification claim from Mylan in relation to certain product advertising claims brought against Mylan related to certain Cold-EEZE<sup>®</sup> products. Pursuant to the terms of the asset purchase agreement, we have elected to assume the defense of these claims on behalf of Mylan. We dispute these product advertising claims and intend to vigorously contest such claims. While we believe these claims are without merit, we are currently negotiating a settlement of these claims. We expect to collect the remaining escrow balance within the next three months, net of an immaterial settlement amount. In the event we are unable to reach a reasonable settlement agreement, however, and the remaining escrow funds are insufficient to cover the losses asserted under these claims or the legal fees associated with defending these claims, we may be required to pay amounts in excess of what is remaining in the escrow account, which could have an adverse impact on our operations.

Manufacturing Agreement

In connection with the asset purchase agreement, the Company and its wholly-owned subsidiary, PMI, entered into a manufacturing agreement (the “Manufacturing Agreement”) with Mylan. Pursuant to the terms of the Manufacturing Agreement, Mylan (or an affiliate or designee) purchased the inventory of the Company’s Cold-EEZE<sup>®</sup> brand and product line, and PMI will manufacture certain products for Mylan, as described in the Manufacturing Agreement, at prices that reflect current market conditions for such products and include an agreed upon mark-up on our costs. Unless terminated sooner by the parties, the Manufacturing Agreement will remain in effect until March 29, 2022. Thereafter, the Manufacturing Agreement may be renewed by Mylan for up to five successive one-year periods by providing notice of its intent to renew not less than 90 days prior to the expiration of the then-current term.

Employment Agreements

On February 16, 2018, our board of directors approved the Amended and Restated 2015 Executive Employment Agreement with Ted Karkus, our Chief Executive Officer (the “Amended Employment Agreement”), which became effective February 23, 2018, and was approved by stockholders at a special meeting of stockholders held on April 12, 2018. Pursuant to the terms of the Amended Employment Agreement, Mr. Karkus voluntarily agreed to reduce his base salary from the rate set forth in his prior employment agreement (*i.e.*, not less than \$675,000 per annum) to a base salary of \$125,000 per annum (the “Term Base Salary”) through February 22, 2021. Unless otherwise determined by the mutual agreement of the Company and Mr. Karkus, on February 22, 2021 and thereafter, Mr. Karkus’s salary will increase from the Term Base Salary to not less than \$675,000 per annum.

In consideration of Mr. Karkus’s voluntary reduction in salary, our board of directors awarded Mr. Karkus a stock option to purchase 2,300,000 shares of our Common Stock at an exercise price of \$3.00 per share on February 23, 2018. The CEO Option will vest and be exercisable in 35 equal monthly installments of 63,888 options and one monthly installment of 63,290 options, subject to his continued employment, and subject to accelerated vesting in the event Mr. Karkus’s employment is terminated for any reason other than by us for Cause or by Mr. Karkus without Good Reason (as such terms are defined in the Amended Employment Agreement). The CEO Option is be exercisable for a five year term commencing on the date of grant. The CEO Option was granted pursuant to the 2018 Stock Plan, which was also adopted and approved by our board of directors on February 16, 2018. The 2018 Plan, like the Amended Employment Agreement, received stockholder approval at a special meeting of stockholders held on April 12, 2018 at which time the CEO Option were considered granted for accounting purposes. The 2018 Plan authorizes the issuance of up to 2,300,000 shares pursuant to stock options granted under the 2018 Plan, all of which were issued to Mr. Karkus as part of the CEO Option.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

As discussed further in Note 5, as required by the terms of the 2018 Stock Plan, in order to maintain parity, the Compensation Committee of the board of directors adjusted the exercise price of the CEO Option on May 7, 2018, such that the exercise price of the CEO Option was reduced from \$3.00 per share to \$2.00 per share, effective as of June 5, 2018, the date the special \$1.00 cash dividend was paid, from \$2.00 to \$1.75 per share, effective as of January 24, 2019, the date the special \$0.25 cash dividend was paid, and from \$1.75 to \$1.50 per share, effective as of December 12, 2019, the date another special \$0.25 cash dividend was paid in order to maintain parity.

Future Obligations

We have estimated future minimum obligations over the next five years as of December 31, 2019, as follows (in thousands):

	<b>Employment Contracts</b>
2020 .....	\$ 125
2021 .....	595
2022 .....	675
2023 .....	675
2024 .....	675
Total .....	\$ 2,745

Other Litigation

In the normal course of our business, we are named as a defendant in legal proceedings. It is our policy to vigorously defend litigation and/or enter into settlements of claims where management deems appropriate.

On November 12, 2019, Craig Cunningham filed an action in the United States District Court for the Eastern District of Texas against TK Supplements, Inc., one of our wholly-owned subsidiaries (“TK Sub”), asserting two class claims and alleging that, by sending plaintiff text messages to his cellular telephone number without his prior express consent and notwithstanding its listing on the Do No Call Registry, TK Sub violated the Telephone Consumer Protection Act, 47 U.S.C. § 227(b)(3)(B) and 47 U.S.C. § 227(c)(5). Plaintiff seeks to represent a class of (i) all residents within the United States to whom TK Sub or its agents sent text messages to the person’s cellular telephone number in the past four years and (ii) all residents within the United States to whom TK Sub or its agents placed two or more telemarketing phone calls to the person’s residential telephone number that was listed on the Do Not Call Registry in the past four years. On January 8, 2020, TK Supplements filed its Answer and Defenses to the Complaint. We intend to defend this matter vigorously.

**Note 10 – Loss Per Share**

Basic loss per share for continuing and discontinued operations are computed by dividing the respective net loss attributable to common stockholders by the weighted-average number of shares of our Common Stock outstanding for the period. Diluted loss per share reflects the potential dilution that could occur if securities or other contracts to issue Common Stock were exercised or converted into Common Stock or resulted in the issuance of Common Stock that shared in the earnings of the entity. Diluted loss per share also utilize the treasury stock method which prescribes a theoretical buy-back of shares from the theoretical proceeds of all options and warrants outstanding during the period. Options and warrants outstanding to acquire shares of our Common Stock at December 31, 2019 and 2018 were 3,082,000 and 2,980,000, respectively.

For Fiscal 2019 and 2018, dilutive loss per share were the same as basic earnings per share due to the inclusion of Common Stock in the form of stock options and warrants (“Common Stock Equivalents”), when in a net loss position would have an anti-dilutive effect on loss per share. For Fiscal 2019, there were 3,082,000 that were excluded from the loss per share computation as a consequence of their anti-dilutive effect. For Fiscal 2018, there were 2,980,000 that were excluded from the loss per share computation as a consequence of their anti-dilutive effect.

**PROPHASE LABS, INC & SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 11 – Significant Customers**

Revenue from continuing operations for Fiscal 2019 and 2018 was \$9.9 million and \$13.1 million, respectively. Three third-party contract manufacturing customers accounted for 36.5%, 30.5% and 11.1%, respectively, of Fiscal 2019 revenues from continuing operations. Three third-party contract manufacturing customers accounted for 45.7%, 31.1% and 10.9%, respectively, of our revenue from continuing operations for Fiscal 2018. The loss of sales to any of these large third-party contract manufacturing customers could have a material adverse effect on our business operations and financial condition.

We are subject to account receivable credit concentrations from time-to-time as a consequence of the timing, payment pattern and ultimate purchase volumes or shipping schedules with our customers. These concentrations may impact our overall exposure to credit risk, either positively or negatively, in that our customers may be similarly affected by changes in economic, regulatory or other conditions that may impact the timing and collectability of amounts due to us. Three of our customers represented 70%, 14% and 11% of our total trade receivable balances at December 31, 2019 and one customer represented 82% of our total trade receivable balances at December 31, 2018.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None

**Item 9A. Controls and Procedures**

Disclosure Controls and Procedures

We carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of December 31, 2019. This evaluation was carried out under the supervision and with the participation of our Principal Executive Officer and Principal Financial and Accounting Officer. Based upon that evaluation, our Principal Executive Officer and Principal Financial and Accounting Officer concluded that our disclosure controls and procedures were effective as of December 31, 2019.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed with or submitted to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Principal Executive Officer and Principal Financial and Accounting Officer, to allow timely decisions regarding required disclosure.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining an adequate system of internal control over financial reporting. Our system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Our internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets;
- provide reasonable assurance that our transactions are recorded as necessary to permit preparation of our financial statements in accordance with accounting principles generally accepted in the United States of America, and that our receipts and expenditures are being made only in accordance with authorizations of our management and our directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Further, because of changes in conditions, effectiveness of internal controls over financial reporting may vary over time. Our system contains self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

Our management conducted an evaluation of our effectiveness of the system of internal control over financial reporting based on the framework in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework). Based upon our review, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that the Company's internal controls over financial reporting were effective as of December 31, 2019.

Changes in Internal Control Over Financial Reporting

During 2018, we and our independent registered public accounting firm, identified material weaknesses in our internal control over financial reporting. A "material weakness" is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. Following the filing of our original annual report on Form 10-K for Fiscal 2017 and during the financial statement close process for the second quarter ended September 30, 2018 in connection with the preparation of our 2017 Federal and State income tax returns, management identified a material weakness that existed as of December 31, 2017, primarily related to our lack of adequate controls over the accounting for recording of income tax expense and the allocation of income tax expense/benefit between continuing and discontinued operations.

During the twelve months ended December 31, 2019, management implemented a remediation plan to enhance our technical accounting review for complex income tax reporting, supplemented our accounting team with the engagement of a new third-party tax consulting firm to assist us in the technical review of our income tax reporting, and reorganized the level of documentation, technical oversight and review. Management enhanced our internal controls over the accounting for income taxes to improve the transparency in the overall tax process. As of December 31, 2019, management has determined that the material weakness described above has been remediated.

Except as described above, there was no change in our internal control over financial reporting identified in connection with evaluation required by paragraph (d) of Rules 13a-15 or 15d-15 under the Exchange Act that occurred during the period covered by this report that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

**Item 9B. Other Information**

None

### **PART III**

#### **Item 10. Directors, Executive Officers and Corporate Governance**

The information required under this item is incorporated by reference from the Company's Proxy Statement for the 2020 Annual Meeting of Stockholders (the "2020 Proxy Statement") which is to be filed with the SEC not later than 120 days after the close of our fiscal year ended December 31, 2019 and is hereby incorporated by reference.

#### **Item 11. Executive Compensation**

The information required under this item is incorporated by reference to the 2020 Proxy Statement.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required under this item is incorporated by reference from the 2020 Proxy Statement.

#### **Item 13. Certain Relationships and Related Transactions and Director Independence**

The information required under this item is incorporated by reference from the 2020 Proxy Statement.

#### **Item 14. Principal Accountant Fees and Services**

The information required under this item is incorporated by reference from the 2020 Proxy Statement.

## PART IV

### Item 15. Exhibits and Financial Statement Schedules

#### (a)(1) Financial Statements.

The following consolidated financial statements of ProPhase Labs, Inc., together with the report thereon of EisnerAmper LLP, an independent registered public accounting firm, are included in this Annual Report on Form 10-K.

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#### (a)(2) Financial Statement Schedules.

All schedules have been omitted because they are not required or because the required information is given in the consolidated financial statements or Notes thereto set forth under Item 8 above.

#### (a)(3) Exhibits

<b>Exhibit</b>	<b>Description</b>
2.1†+	Asset purchase agreement, dated January 6, 2017, by and between ProPhase Labs, Inc., Meda Consumer Healthcare Inc. and Mylan Inc., as Buyer Guarantor (incorporated by reference to Exhibit 2.1 of the Current Report on Form 8-K (File No. 000-21617) filed on March 29, 2017).
2.2†+	Manufacturing Agreement, dated March 29, 2017, by and between Meda Consumer Healthcare Inc., Pharmaloz Manufacturing, Inc. and Prophase Labs, Inc. (incorporated by reference to Exhibit 2.2 of the Current Report on Form 8-K (File No. 000-21617) filed on March 29, 2017).
3.1	Certificate of Incorporation of the Company, (incorporated by reference to Exhibit 3.3 of the Current Report on Form 8-K (File No. 000-21617) filed on June 19, 2015).
3.2	Amended and Restated Bylaws of the Company (as of February 16, 2018) (incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K (File No. 000-21617) filed on February 21, 2018).
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 of Form 10-KSB/A (File No. 000-21617) filed on April 4, 1997).
4.2	Form of Voting Agreement, dated January 6, 2017, by and between Meda Consumer Healthcare Inc. and the undersigned stockholders of ProPhase Labs, Inc. (incorporated by reference to Exhibit 4.1 of the Current Report on Form 8-K (File No. 000-21617) filed on January 9, 2017).
4.3	Description of Common Stock
10.1	Form of Indemnification Agreement between the Company and each of its Officers and Directors, dated August 19, 2009 (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K (File No. 000-21617) filed on August 19, 2009).
10.2*	Amended and Restated 2010 Equity Compensation Plan (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K (File No. 000-21617) filed on May 24, 2018).
10.3*	Amended and Restated 2010 Directors' Equity Compensation Plan (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K (File No. 000-21617) filed on May 24, 2018).
10.4*	Form of Option Agreement pursuant to 2010 Equity Compensation Plan (incorporated by reference to Exhibit 10.2 of the Quarterly Report on Form 10-Q (File No. 000-21617) filed on May 15, 2017).
10.5*	Form of Option Agreement pursuant to 2010 Directors' Equity Compensation Plan (incorporated by reference to Exhibit 10.5 of the Current Report on Form 8-K (File No. 000-21617) filed on May 10, 2010).
10.6*	Form of Restricted Stock Award Agreement pursuant to 2010 Directors' Equity Compensation Plan (incorporated by reference to Exhibit 10.6 of the Current Report on Form 8-K (File No. 000-21617) filed on May 10, 2010).
10.7*	Amended and Restated 2015 Executive Employment Agreement with Ted Karkus, effective February 23, 2018 (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K (File No. 000-21617) filed on February 21, 2018).
10.8*	2018 Stock Incentive Plan (incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K (File No. 000-21617) filed on February 21, 2018).
21.1	Subsidiaries of ProPhase Labs, Inc.
23.1**	Consent of EisnerAmper LLP, Independent Registered Public Accounting Firm.



<b>Exhibit</b>	<b>Description</b>
31.1**	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2**	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of the Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of the Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Indicates a management contract or compensatory plan or arrangement

† Confidential treatment granted as to portions of the exhibit. Confidential materials omitted and filed separately with the Securities and Exchange Commission.

+ Certain schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish supplementally a copy of any omitted schedule or exhibit to the Securities and Exchange Commission upon request.

40**	101 INS — XBRL Instance Document
41**	101 SCH — XBRL Taxonomy Extension Schema Document
42**	101 CAL — XBRL Taxonomy Extension Calculation Linkbase Document
43**	101 DEF — XBRL Taxonomy Extension Definition Linkbase Document
44**	101 LAB — XBRL Taxonomy Extension Label Linkbase Document
45**	101 PRE — XBRL Taxonomy Extension Presentation Linkbase Document

#### **Item 16. Form 10-K Summary**

**None.**

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### PROPHASE LABS, INC.

By: /s/ Ted Karkus

Ted Karkus, Chairman of the Board,  
Chief Executive Officer and Director

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Ted Karkus and Monica Brady, jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his or her substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Ted Karkus</u> Ted Karkus	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	March 26, 2020
<u>/s/ Monica Brady</u> Monica Brady	Chief Financial Officer (Principal Financial Officer)	March 26, 2020
<u>/s/ Jason Barr</u> Jason Barr	Director	March 26, 2020
<u>/s/ Louis Gleckel</u> Louis Gleckel	Director	March 26, 2020
<u>/s/ Warren Hirsch</u> Warren Hirsch	Director	March 26, 2020

**PROPHASE LABS, INC.**  
**DESCRIPTION OF COMMON STOCK**

ProPhase Labs, Inc. (the “Company”) has one class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) – common stock, par value \$0.0005 per share (the “Common Stock”). The Common Stock trades on The Nasdaq Capital Market under the trading symbol “PRPH.”

*The following summary description sets forth some of the general terms and provisions of the Common Stock. Because this is a summary description, it does not contain all of the information that may be important to you. For a more detailed description of the Common Stock, you should refer to the Company’s Certificate of Incorporation (the “Certificate”) and the Amended and Restated Bylaws (the “Bylaws”), which are filed as exhibits to the Annual Report on Form 10-K to which this description is filed as an exhibit.*

The Company’s authorized capital stock consists of 51,000,000 shares, all with a par value of \$0.0005 per share, 50,000,000 of which are designated as Common Stock and 1,000,000 of which are designated as preferred stock.

### **General**

The holders of Common Stock are entitled to one vote per share on all matters to be voted upon by the stockholders, except on matters relating solely to terms of preferred stock. Subject to preferences that may be applicable to any outstanding preferred stock, the holders of Common Stock will be entitled to receive ratably such dividends, if any, as may be declared from time to time by the board of directors out of funds legally available therefor. In the event of the Company’s liquidation, dissolution or winding up, the holders of Common Stock will be entitled to share ratably in all assets remaining after payment of liabilities, subject to prior distribution rights of preferred stock, if any, then outstanding. The holders of Common Stock have no preemptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions applicable to the Common Stock.

### **Anti-Takeover Effects of Delaware Law and Our Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws**

The provisions of Delaware law and the Certificate and Bylaws, could discourage or make it more difficult to accomplish a proxy contest or other change in the Company’s management or the acquisition of control by a holder of a substantial amount of the Company’s voting stock. It is possible that these provisions could make it more difficult to accomplish, or could deter, transactions that stockholders may otherwise consider to be in their best interests or in the Company’s best interests. These provisions are intended to enhance the likelihood of continuity and stability in the composition of the Company’s board of directors and in the policies formulated by the board of directors and to discourage certain types of transactions that may involve an actual or threatened change of control. These provisions are designed to reduce the Company’s vulnerability to an unsolicited acquisition proposal and to discourage certain tactics that may be used in proxy fights. Such provisions also may have the effect of preventing changes in the Company’s management.

*Delaware Statutory Business Combinations Provision.* The Company is subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, or the DGCL. Section 203 prohibits a publicly-held Delaware corporation from engaging in a “business combination” with an “interested stockholder” for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is, or the transaction in which the person became an interested stockholder was, approved in a prescribed manner or another prescribed exception applies. For purposes of Section 203, a “business combination” is defined broadly to include a merger, asset sale or other transaction resulting in a financial benefit to the interested stockholder, and, subject to certain exceptions, an “interested stockholder” is a person who, together with his or her affiliates and associates, owns, or within three years prior, did own, 15% or more of the corporation’s voting stock.

*Blank-Check Preferred Stock.* The Company’s board of directors is authorized to issue, without stockholder approval, preferred stock, the rights of which will be determined at the discretion of the board of directors and that, if issued, could operate as a “poison pill” to dilute the stock ownership of a potential hostile acquirer to prevent an acquisition that the board of directors does not approve.

*Special Meetings of Stockholders.* Special meetings of the stockholders may be called at any time only by the Chairman of the board of directors or the board of directors, subject to the rights of the holders of any series of preferred stock then outstanding.

*No Written Consent of Stockholders.* The Bylaws provide that all stockholder actions are required to be taken by a vote of the stockholders at an annual or special meeting, and that stockholders may not take any action by written consent in lieu of a meeting.

*Advance Notice Provisions for Stockholder Proposals and Stockholder Nominations of Directors.* The Bylaws provide that, for nominations to the board of directors or for other business to be properly brought by a stockholder before a meeting of stockholders, the stockholder must first have given timely notice of the proposal in writing to the Company's Secretary. For an annual meeting, a stockholder's notice generally must be delivered not less than 90 days or more than 120 days prior to the anniversary of the previous year's annual meeting.

*Election and Removal of Directors.* Except as may otherwise be provided by the DGCL, any director or the entire board of directors may be removed, with or without cause, at an annual meeting or a special meeting called for that purpose, by the affirmative vote of the holders of a majority of the shares then entitled to vote at an election of directors. Vacancies on the board of directors resulting from the removal of directors and newly created directorships resulting from any increase in the number of directors may be filled solely by the affirmative vote of a majority of the remaining directors then in office. This system of electing and removing directors may discourage a third party from making a tender offer or otherwise attempting to obtain control of the Company, because it generally makes it more difficult for stockholders to replace a majority of our directors. The Certificate and Bylaws do not provide for cumulative voting in the election of directors.

*Exclusive Jurisdiction.* The Bylaws provide that, unless the Company consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Company, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Company to the Company or the Company's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the DGCL, the Certificate of Incorporation or the Bylaws, or (iv) any action asserting a claim against the Company governed by the internal affairs doctrine."

#### **Transfer Agent and Registrar**

The transfer agent and registrar for the Company's common stock is American Stock Transfer & Trust Company, LLC.

## SUBSIDIARIES OF PROPHASE LABS, INC.

<b>Subsidiaries</b>	<b>State or other Jurisdiction of Incorporation</b>	<b>Ownership Percentage</b>
Pharmaloz Manufacturing Inc.	Delaware	100 %
Phusion Labs Manufacturing, Inc.	Delaware	100 %
ProPhase Digital Media, Inc.	Delaware	100 %
Quigley Pharma Inc.	Delaware	100 %
TK Supplements, Inc.	Delaware	100 %

The above subsidiaries are included in the consolidated financial statements for the year ended December 31, 2019.

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements of ProPhase Labs, Inc. and Subsidiaries on Form S-8 (No. 333-73456, No. 333-61313, No. 333-10059, No. 333-14687, No. 333-26589, No. 333-132770, No. 333-169697, No. 333-189875, No. 333-217484, No. 333-224369 and No. 333-225496), Form SB-2 (No. 333-31241) and Forms S-3 (No. 333-86976, No. 333-104148, No. 333-119748, No. 333-185167, No. 333-196352, No. 333-206090 and No. 333-225875) of our report dated March 26, 2020, on our audits of the consolidated financial statements as of December 31, 2019 and 2018 and for each of the years then ended, which report is included in this Annual Report on Form 10-K to be filed on or about March 26, 2020.

*/s/ EisnerAmper LLP*

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EISNERAMPER LLP

Iselin, New Jersey

March 26, 2020

**OFFICER'S CERTIFICATION PURSUANT TO  
RULE 13a-14(a)/15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934**

I, Ted Karkus, certify that:

1. I have reviewed this Annual Report on Form 10-K of ProPhase Labs, Inc.;
2. Based on my knowledge, this Annual Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Annual Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Annual Report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 131-15(f) and 15d015(f) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Annual Report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this Annual Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 26, 2020

By: /s/ Ted Karkus

Ted Karkus  
Chairman of the Board and Chief Executive Officer  
(Principal Executive Officer)

**OFFICER'S CERTIFICATION PURSUANT TO  
RULE 13a-14(a)/15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934**

I, Monica Brady, certify that:

1. I have reviewed this Annual Report on Form 10-K of ProPhase Labs, Inc.;
2. Based on my knowledge, this Annual Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Annual Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Annual Report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 131-15(f) and 15d015(f) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Annual Report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this Annual Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 26, 2020

By: /s/ Monica Brady

Monica Brady  
Chief Financial Officer  
(Principal Financial Officer)



**PROPHASE LABS, INC.**  
**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**  
**PURSUANT TO RULE 13a-14(b) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**AND 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO**  
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ted Karkus, Chief Executive Officer of ProPhase Labs, Inc., a Delaware corporation (the “Registrant”), in connection with the Registrant’s Annual Report on Form 10-K for the period ended December 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), do hereby represent, warrant and certify, in compliance with Rule 13a-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

*/s/ Ted Karkus*

\_\_\_\_\_  
Ted Karkus  
Chairman of the Board and  
Chief Executive Officer  
(Principal Executive Officer)

March 26, 2020

**PROPHASE LABS, INC.**  
**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER**  
**PURSUANT TO RULE 13a-14(b) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**AND 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO**  
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Monica Brady, Chief Financial Officer of ProPhase Labs, Inc., a Delaware corporation (the “Registrant”), in connection with the Registrant’s Annual Report on Form 10-K for the period ended December 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), do hereby represent, warrant and certify, in compliance with Rule 13a-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

*/s/ Monica Brady*

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Monica Brady  
Chief Financial Officer  
(Principal Financial Officer)

March 26, 2020