FORM 10-Q
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(Mark One)

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

For the quarterly period ended June 30, 2013

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 0-21617

ProPhase Labs, Inc.

(Exact name of registrant as specified in its charter)

Nevada	23-2577138
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

621 N. Shady Retreat Road, Doylestown, Pennsylvania 18901
(Address of principal executive office) (Zip Code)

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at August 13, 2013
Common Stock, $0.0005 par value	15,858,787

ProPhase Labs, Inc. and Subsidiaries

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ProPhase Labs, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(in thousands, except share and per share amounts)

	June 30, 2013 (unaudited)	December 31, 2012
ASSETS		
Cash and cash equivalents (Note 2)	$ 4,058	$ 572
Accounts receivable	1,128	5,409
Inventory (Note 2)	3,289	2,051
Prepaid expenses and other current assets	520	2,687
Total current assets	8,995	10,719
Property, plant and equipment, net of accumulated depreciation of $3,980 and $3,860, respectively (Note 2)	2,495	2,365
Intangible asset, licensed technology (Note 6)	3,577	3,577
Total assets	$ 15,067	$ 16,661
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Accounts payable	$ 1,027	$ 1,296
Accrued advertising and other allowances	2,184	2,760
Other current liabilities	1,260	854
Total current liabilities	4,471	4,910
Other long term obligations	300	300
Total long term liabilities	300	300
Commitments and contingencies (Note 3)	-	-
STOCKHOLDERS' EQUITY:		
Common Stock, $.0005 par value; authorized 50,000,000; issued: 21,181,115 and 21,056,115 shares, respectively (Note 4)	11	11
Additional paid-in-capital	43,141	42,867
Accumulated deficit	(7,219)	(5,790)
Treasury stock, at cost 5,336,053 and 5,336,053 shares, respectively	(25,637)	(25,637)
Total stockholders' equity	10,296	11,451
Total liabilities and stockholders' equity	$ 15,067	$ 16,661

See accompanying notes to condensed consolidated financial statements

ProPhase Labs, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Net sales (Note 2)	$ 1,939	$ 1,894	$ 9,481	$ 7,912
Cost of sales (Note 2)	1,011	1,069	3,214	2,747
Gross profit	928	825	6,267	5,165
Operating expenses:				
Sales and marketing	709	820	4,072	3,997
Administration	1,723	1,408	3,221	2,900
Research and development	216	529	404	890
	2,648	2,757	7,697	7,787
Loss from operations	(1,720)	(1,932)	(1,430)	(2,622)
Interest and other income	1	2	1	5
Loss before income taxes	(1,719)	(1,930)	(1,429)	(2,617)
Income tax (benefit) (Note 5)	-	-	-	-
Net loss	$ (1,719)	$ (1,930)	$ (1,429)	$ (2,617)
Basic and diluted loss per share:				
Net loss	$ (0.11)	$ (0.13)	$ (0.09)	$ (0.18)
Weighted average common shares outstanding:				
Basic and diluted	15,845	14,831	15,799	14,811

See accompanying notes to condensed consolidated financial statements

ProPhase Labs, Inc. and Subsidiaries
Condensed Consolidated Statements of Stockholders' Equity
(in thousands, except share data)
(unaudited)

	Common Stock Shares Outstanding	Par Value	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Total
Balance at December 31, 2012	15,720,062	$ 11	$ 42,867	$ (5,790)	$ (25,637)	$ 11,451
Net income	-	-	-	(1,429)	-	(1,429)
Share-based compensation expense	-	-	79	-	-	79
Common shares issued (Note 4)	125,000	-	195	-	-	195
Balance at June 30, 2013	15,845,062	$ 11	$ 43,141	$ (7,219)	$ (25,637)	$ 10,296

See accompanying notes to condensed consolidated financial statements

ProPhase Labs, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Six Months Ended	
	June 30, 2013	June 30, 2012
Cash flows from operating activities:		
Net income (loss)	$ (1,429)	$ (2,617)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	120	121
Share-based compensation expense	79	163
Changes in operating assets and liabilities:		
Accounts receivable	4,281	2,281
Inventory	(1,237)	(453)
Accounts payable	(269)	(359)
Accrued advertising and other allowances	(576)	(1,072)
Other operating assets and liabilities, net	2,572	1,237
Net cash provided by (used in) operating activities	3,541	(699)
Cash flows from investing activities:		
Capital expenditures	(250)	(232)
Net cash used in investing activities	(250)	(232)
Cash flows from financing activities:		
Proceeds from issuance of common stock	195	-
Net cash provided by financing activities	195	-
Net increase (decrease) in cash and cash equivalents	3,486	(931)
Cash and cash equivalents at beginning of period	572	5,541
Cash and cash equivalents at end of period	$ 4,058	$ 4,610

See accompanying notes to condensed consolidated financial statements

ProPhase Labs, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1 – Organization and Business

ProPhase Labs, Inc. ("we", "us" or the "Company"), organized under the laws of the State of Nevada, is a manufacturer, marketer and distributor of a diversified range of homeopathic and health products that are offered to the general public. We are also engaged in the research and development of potential over-the-counter ("OTC") drug, natural base health products along with supplement, personal care and cosmeceutical products.

Our primary business is the manufacture, distribution, marketing and sale of OTC cold remedy products to consumers through national chain, regional, specialty and local retail stores. Our flagship brand is Cold-EEZEÒ Cold Remedy and our principal product is Cold-EEZEÒ zinc gluconate lozenges, proven in clinical studies to reduce the duration of the common cold by 42%. In addition to Cold-EEZE® cold remedy lozenges, we market and distribute two non-lozenge forms of our proprietary zinc gluconate formulation, Cold-EEZE ® QuickMelts® and Cold-EEZE® Oral Spray. In addition, we have expanded our Cold-EEZE® QuickMelts® product line and began shipments to retailers in July 2013 two new products, Cold-EEZE ® Plus Immune Support QuickMelts® and Cold-EEZE Plus Immune Support + Energy QuickMelts ®. Each of these new Cold-EEZE® QuickMelts® products are based on our proprietary zinc gluconate formulation in combination with certain immune system support and natural energy active ingredients. Cold-EEZE ® is an established product in the health care and cold remedy market. For the three and six months ended June 30, 2013 and 2012, our revenues from operations have come principally from our OTC cold remedy products.

We use a December 31 year-end for financial reporting purposes. References herein to the fiscal year ended December 31, 2013 shall be the term "Fiscal 2013" and references to other "Fiscal" years shall mean the year, which ended on December 31 of the year indicated. The term the "we", "us: or the "Company" as used herein also refer, where appropriate, to the Company, together with its subsidiaries unless the context otherwise requires.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial statements and within the rules of the Securities and Exchange Commission ("SEC") applicable to interim financial statements and therefore do not include all disclosures that might normally be required for financial statements prepared in accordance with generally accepted accounting principles in the United States ("GAAP"). The accompanying unaudited condensed consolidated financial statements have been prepared by management without audit and should be read in conjunction with our consolidated financial statements, including the notes thereto, appearing in our Annual Report on Form 10-K for the year ended December 31, 2012. In the opinion of management, all adjustments necessary for a fair presentation of the consolidated financial position, consolidated results of operations and consolidated cash flows, for the periods indicated, have been made. The results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of operating results that may be achieved over the course of the full year.

Note 2 – Summary of Significant Accounting Policies – continued

Seasonality of the Business

Our net sales are derived principally from our OTC cold remedy products. Currently, our sales are influenced by and subject to fluctuations in the timing of purchase and the ultimate level of demand for our products which are a function of the timing, length and severity of each 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. We generally experience in the third and fourth quarter higher levels of net sales along with a corresponding increase in marketing and advertising expenditures designed to promote our products during the cold season. Revenues and related marketing costs are generally at their lowest levels in the second quarter when consumer demand generally declines. We track health and wellness trends and develop retail promotional strategies to align our production scheduling, inventory management and marketing programs to optimize consumer purchases.

Use of Estimates

The preparation of financial statements and the accompanying notes thereto, in conformity with 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 and intangible assets, impairment of property and equipment and intangible assets, 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.

Our primary product, Cold-EEZE® lozenges, utilizes a proprietary zinc formulation which has been clinically proven to reduce the duration of the common cold. Factors considered in estimating the appropriate sales returns and allowances for this product include it being (i) a unique product with limited competitors, (ii) competitively priced, (iii) promoted, (iv) unaffected for remaining shelf-life as there is no product expiration date and (v) monitored for inventory levels at major customers and third-party consumption data. In addition to Cold-EEZE® lozenges, we market and distribute two additional forms of our proprietary zinc formulation, Cold-EEZE® QuickMelts® and Cold-EEZE® Oral Spray. We also manufacture, market and distribute an organic cough drop and a Vitamin C supplement ("Organix®"). Each of the Cold-EEZE® QuickMelts®, Cold-EEZE® Oral Spray and Organix® products carry shelf-life expiration dates for which we aggregate such product market experience data and update our sales returns and allowances estimates accordingly. Sales allowances estimates are tracked at the specific customer and product line levels and are tested on an annual historical basis, and reviewed quarterly. Additionally, we monitor current developments by customer, market conditions and any other occurrences that could affect the expected provisions relative to net sales for the period presented.

Cash Equivalents

We consider all highly liquid investments with a 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.

Note 2 – Summary of Significant Accounting Policies – continued

Inventory Valuation

Inventory is valued at the lower of cost, determined on a first-in, first-out basis (FIFO), or market. Inventory items are analyzed to determine cost and the market value and appropriate valuation adjustments are established. At June 30, 2013 and December 31, 2012, inventory included raw material, work in progress and packaging amounts of $1.6 million and $1.0 million, respectively, and finished goods of $1.7 million and $1.0 million, respectively.

Property, Plant and Equipment

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

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 drug, personal care or other products in order to continue 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. Our OTC cold remedy 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 and trade accounts receivable.

We maintain cash and cash equivalents with certain major financial institutions. As of June 30, 2013, our cash balance was $4.1 million and our bank balance was $4.4 million. Of the total bank balance, $696,000 was covered by federal depository insurance and $3.7 million was uninsured at June 30, 2013.

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 broad range of customers includes many 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. At June 30, 2013 and December 31, 2012, our largest accounts receivable balances are with four customers representing approximately 62% and three customers representing 54%, respectively, of our total trade receivable balance.

Our revenues are principally generated from the sale of OTC cold remedy products which represented approximately 91% and 91% of total revenues for each of the six months ended June 30, 2013 and 2012, respectively. A significant portion of our business is highly seasonal, which causes major variations in operating results from quarter to quarter. The third and fourth quarters generally represent the largest sales volume for the OTC cold remedy products. For the three and six months ended June 30, 2013 and 2012, our net sales were principally related to domestic markets.

Note 2 – Summary of Significant Accounting Policies – continued

Long-lived Assets

We review our 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.

Fair Value of Financial Instruments

Cash and cash equivalents, accounts receivable and accounts payable are reflected in the Condensed Consolidated Financial Statements at carrying value which approximates fair value because of the short-term maturity of these instruments. Determination of fair value of related party payables, if any, is not practicable due to their related party nature.

Revenue Recognition

Sales are recognized at the time ownership is transferred to the customer. Revenue is reduced for trade promotions, estimated sales returns, cash discounts and other allowances in the same period as the related sales are recorded. 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.

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 only accept return requests for product 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.

Note 2 – Summary of Significant Accounting Policies – continued

As of June 30, 2013 and December 31, 2012, we included a provision for sales allowances of $ 65,000 and $109,000, respectively, which are reported as a reduction to account receivables. Additionally, accrued advertising and other allowances as of June 30, 2013 included $ 1.5 million for estimated future sales returns and $679,000 for cooperative incentive promotion costs. As of December 31, 2012 accrued advertising and other allowances included $ 1.3 million for estimated future sales returns and $ 1.5 million for cooperative incentive promotion costs.

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 media advertising, presented as part of sales and marketing expense, cooperative incentive promotions and coupon program expenses, which are accounted for as part of net sales, and free product, which is accounted for as part of cost of sales. Advertising and incentive promotion expenses incurred for the three months ended June 30, 2013 and 2012 were $ 527,000 and $679,000, respectively. Advertising and incentive promotion expenses incurred for the six months ended June 30, 2013 and 2012 were $ 4.4 million and $4.1 million, respectively. Included in prepaid expenses and other current assets was $ 254,000 and $2.2 million at June 30, 2013 and December 31, 2012, respectively, relating to prepaid advertising and promotion expenses.

Shipping and Handling

Product sales carry shipping and handling charges to the purchaser, included as part of the invoiced price, which is classified as revenue. In all cases, costs related to this revenue are recorded in cost of sales.

Stock 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.

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 4). Stock options are exercisable during a period determined by us, but in no event later than ten years from the date granted. For the three months ended June 30, 2013 and 2012, we charged to operations $40,000 and $75,000, respectively, for share-based compensation expense for the aggregate fair value of stock grants issued and vested stock options earned. For the six months ended June 30, 2013 and 2012, we charged to operations $79,000 and $163,000, respectively, for share-based compensation expense for the aggregate fair value of stock grants issued and vested stock options earned.

Note 2 – Summary of Significant Accounting Policies – continued

Variable Interest Entity

On March 22, 2010, we, Phosphagenics Limited ("PSI Parent"), an Australian corporation, Phosphagenics Inc. ("PSI"), a Delaware corporation and subsidiary of PSI Parent, and Phusion Laboratories, LLC (the "Joint Venture"), a Delaware limited liability company, entered into a Limited Liability Company Agreement (the "LLC Agreement") of the Joint Venture and additional related agreements for the purpose of developing and commercializing, for worldwide distribution and sale, a wide range of non-prescription remedies using PSI Parent's proprietary patented TPM™ technology ("TPM"). TPM facilitates the delivery and depth of penetration of active molecules in pharmaceutical, nutraceutical, and other products. Pursuant to the LLC Agreement, we and PSI each own a 50% membership interest in the Joint Venture. The Joint Venture, of which we own a 50% membership interest, qualifies as a variable interest entity ("VIE"), we are the current primary beneficiary and we have consolidated the Joint Venture beginning with the quarter ended March 31, 2010. Expenses incurred to date by the Joint Venture have been principally for certain product research and development activities which have been charged to research and development expense by the Company.

Research and Development

Research and development costs are charged to operations in the period incurred. Research and development costs for the three months ended June 30, 2013 and 2012 were $216,000 and $529,000, respectively. Research and development costs for the six months ended June 30, 2013 and 2012 were $ 404,000 and $890,000, respectively. Research and development costs are principally related to new product development initiatives and costs associated with our OTC cold remedy products.

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 (see Note 5).

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 uncertain tax positions will be recorded as interest or administrative expense, respectively.

As a result of our continuing tax losses, we have recorded a full valuation allowance against a net deferred tax asset. Additionally, we have not recorded a liability for unrecognized tax benefits. The tax years 2006 and forward remain open to examination by the IRS. The tax years 2004 and forward remain open to examination by the various state taxing authorities to which we are subject.

Note 2 – Summary of Significant Accounting Policies – continued

Recently Issued Accounting Standards

In November 2008, the SEC issued for comment a proposed roadmap regarding the potential use by U.S. issuers of financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board ("IASB"). The proposed roadmap has since been superseded by an SEC work plan and no date is currently proposed that we could be required to prepare financial statements in accordance with IFRS. The SEC has targeted Fiscal 2013 to make a determination regarding the mandatory adoption of IFRS. We are currently assessing the impact that this potential change would have on our consolidated financial statements and we will continue to monitor the development of the potential implementation of IFRS.

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2011-05, "Comprehensive Income (ASU Topic 220): Presentation of Comprehensive Income," ("ASU 2011-05") which amends current comprehensive income guidance. This accounting update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. Instead, comprehensive income must be presented in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. ASU 2011-05 was effective for fiscal periods beginning after December 15, 2011 with early adoption permitted. In December 2011, the FASB issued ASU 2011-12 "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05." This accounting update stated that the specific requirement to present items that are reclassified from other comprehensive income to net income alongside their respective components of net income and other comprehensive income will be deferred. In February 2013, the FASB issued ASU 2013-02 "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income". This accounting update requires companies to present the effects on the line items of net income of significant reclassifications out of accumulated other comprehensive income if the amount being reclassified is required under U.S. generally accepted accounting principles to be reclassified in its entirety to net income in the same reporting period. ASU 2013-02 is effective prospectively for fiscal years beginning after December 15, 2012. The adoption of ASU 2013-02 did not have a material impact on our consolidated financial position, results of operations or cash flows.

Note 3 – Commitments and Contingencies

Settlement Agreement

In November 2004 we commenced an action against John C. Godfrey, Nancy Jane Godfrey, and Godfrey Science and Design, Inc. (together the "Godfreys") for injunctive relief regarding the ownership of the Cold-EEZE ® trademark. The Godfreys subsequently asserted against us counterclaims and sought monetary damages and injunctive and declaratory relief relative to the Cold-EEZE ® trademark and other intellectual property.

On December 20, 2012, we and the Godfreys, including the Estate of Nancy Jane Godfrey, entered into a Settlement Agreement and Mutual General Release (the "Settlement Agreement"), pursuant to which we resolved all disputes, including claims asserted by us and counterclaims asserted against us in the action. Pursuant to the terms of the Settlement Agreement, we paid the Godfreys $ 2.1 million in December 2012 and we agreed to make four additional annual payments of $100,000 due in December of each of the next four years. Each annual payment in the amount of $ 100,000 will accrue interest at the per annum rate of 3.25%. Under the Settlement Agreement, the Godfreys assigned, transferred and conveyed to us all of their right, title, and interest in U.S. Trademark Registration No. 1,838,542 for the trademark Cold-EEZE ®, among other intellectual property associated with such trademark. As a result of the Settlement Agreement, we realized $1.0 million benefit due to the reduction of the previously recorded accrued royalties and commission obligation of $ 3.5 million. At December 31, 2012 and June 30, 2013, other current liabilities and other long term obligation include $ 100,000 and $300,000, respectively, for the four additional annual installment payments.

Note 3 – Commitments and Contingencies – continued

We have estimated future minimum obligations over the next five years, including the remainder of Fiscal 2013, as follows (in thousands):

Fiscal Year	Employment Contracts	Settlement Agreement	Total
2013	$ 512	$ 100	$ 612
2014	1,025	100	1,125
2015	555	100	655
2016	-	100	100
2017	-		
Total	$ 2,092	$ 400	$ 2,492

Note 4 – Transactions Affecting Stockholders' Equity

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 Plan was amended effective May 23, 2008 and further amended effective August 18, 2009. The Rights Agreement, as amended, provides that each Right entitles the stockholder of record to purchase from the Company that number of common shares 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, 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. 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, 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 September 25, 2018.

The 1997 Option Plan

On December 2, 1997, our Board of Directors approved a Stock Option Plan (the "1997 Plan"), which was amended in 2005, and provided for the granting of up to 4.5 million shares of Common Stock. Under the 1997 Plan, we were permitted to grant options to employees, officers or directors of the Company at variable percentages of the market value of stock at the date of grant. No incentive stock option could be exercisable more than ten years after the date of grant or five years after the date of grant where the individual owns more than ten percent of the total combined voting power of all classes of stock. Stockholders approved the 1997 Plan in Fiscal 1998. No options were granted under this Plan for the six month periods ended June 30, 2013 or 2012.

Note 4 – Transactions Affecting Stockholders' Equity – continued

As of June 30, 2013, we are precluded from issuing any additional options or grants in the future under the 1997 Plan pursuant to the terms of the plan document. Options previously granted continue to be available for exercise at any time prior to such options' respective expiration dates, but in no event later than ten years from the date granted. At June 30, 2013, there are 99,000 options outstanding under the 1997 Plan with various expiration dates ranging from October 2013 through December 2015, depending upon the date of grant.

The 2010 Equity Compensation Plan

On May 5, 2010, our shareholders approved the 2010 Equity Compensation Plan which was subsequently amended, restated and approved by shareholders on April 24, 2011 and further amended and approved by shareholders on May 6, 2013 (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 equal to 1.6 million shares plus up to 900,000 shares that are authorized for issuance but unissued under the 1997 Plan for an aggregate of 2.5 million shares. The 1997 Plan expired on December 2, 2007 and no additional awards may be made. As of June 30, 2013, 1,449,750 of the options issued under the 1997 Plan prior to December 2007 expired unexercised or were terminated (the "Expired Options"). As a consequence, these shares are deemed and remain unissued which up to a maximum of 900,000 shares became available for issuance under the 2010 Plan and the remaining 450,750 options are deemed cancelled. We granted 15,000 options under the 2010 Plan for the three and six months ended June 30, 2013. At June 30, 2013, there are 705,159 shares of Common Stock that may be issued pursuant to the terms of the 2010 Equity Compensation Plan.

The 2010 Directors' Equity Compensation Plan

On May 5, 2010, our shareholders approved the 2010 Directors' Equity Compensation Plan which was subsequently amended and approved by shareholders on May 6, 2013. A primary purpose of the 2010 Directors' Equity Compensation Plan is to provide us with the ability to pay all or a portion of the fees of directors in restricted stock instead of cash. The 2010 Directors' Equity Compensation Plan provides that the total number of shares of Common Stock that may be issued under the 2010 Directors' Equity Compensation Plan is equal to 425,000. No shares were granted under this plan for the three or six months ended June 30, 2013. At June 30, 2013, there are 192,605 shares of Common Stock that may be issued pursuant to the terms of the 2010 Directors' Equity Compensation Plan.

There were no stock options exercised for the three or six months ended June 30, 2013 or 2012.

Equity Line of Credit

On November 21, 2012, we entered into the equity line of credit agreement (such arrangement, the "Equity Line") with Dutchess Opportunity Fund II, LP ("Dutchess") whereby Dutchess committed to purchase, subject to certain restrictions and conditions, up to 2,500,000 shares of our Common Stock, over a period of 36 months from the first trading day following the effectiveness of the registration statement registering the resale of shares purchased by Dutchess pursuant to the Equity Line. On November 26, 2012, we filed a registration statement with Securities and Exchange Commission ("SEC") to register for sale for up to 2,500,000 shares of our Common Stock and the registration statement was deemed effective by the SEC on December 12, 2012.

We may draw on the facility from time to time, as and when we determine appropriate in accordance with the terms and conditions of the Equity Line. The maximum amount that we are entitled to put to Dutchess in any one draw down notice is the greater of (i) 500% of the average daily volume of our Common Stock traded on the NASDAQ Global Market for the one (1) trading day prior to the date of delivery of the applicable draw down notice, multiplied by the closing price for such trading day, or (ii) $250,000.

Note 4 – Transactions Affecting Stockholders' Equity – continued

The purchase price under the Equity Line is set at ninety-five percent (95%) of the lowest daily volume weighted average price ("VWAP") of our Common Stock during the five (5) consecutive trading day period beginning on the date of delivery of the applicable draw down notice. We have the right to withdraw all or any portion of any put, except that portion of the put that has already been sold to a third party, including any portion of a put that is below the minimum acceptable price set forth on the put notice, before the closing. In the event Dutchess receives more than a five percent (5%) return on the net sales for a specific put, Dutchess must remit such excess proceeds to us; however, in the event Dutchess receives less than a five percent (5%) return on the net sales for a specific put Dutchess has the right to use any such excess proceeds to off-set against the aggregated deficit proceeds.

There are put restrictions applied on days between the draw down notice date and the closing date with respect to that particular put. During such time, we are not allowed to deliver another draw down notice. In addition, Dutchess is not obligated to purchase shares if its total number of shares beneficially held at that time would exceed 9.99% of the number of shares of our Common Stock as determined in accordance with Rule 13d-1(j) of the Securities Exchange Act of 1934, as amended. In addition, we are not permitted to draw on the facility unless there is an effective registration statement to cover the resale of the shares.

In March 2013, we sold an aggregate of 125,000 shares of Common Stock to Dutchess under and pursuant to the Equity Line and we derived approximately $195,000 in net proceeds. The sales of the shares under the Equity Line were deemed to be exempt from registration under the Securities Act of 1933, as amended in reliance upon Section 4(2) (or Regulation D promulgated thereunder). We did not sell shares of our Common Stock under or pursuant to the Equity Line for the three months ended June 30, 2013. At June 30, 2013, we have 1,491,278 shares of our Common Stock available for sale, at our discretion, under the terms of the Equity Line to Dutchess.

Note 5 – 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.

Note 5 – Income Taxes – continued

Certain exercises of options and warrants, and restricted stock issued for services that became unrestricted resulted in reductions to taxes currently payable and a corresponding increase to additional-paid-in-capital for prior years. In addition, certain tax benefits for option and warrant exercises totaling $6.4 million are deferred and will be credited to additional-paid-in-capital when our net operating loss carry-forward attributable to these exercises are utilized. Consequently, these net operating loss carryforward will not be available to offset our current income tax expense. As of December 31, 2012, we had net operating loss carry-forwards of approximately $ 37.7 million for federal purposes that will expire beginning in Fiscal 2020 through 2032. Additionally, there are net operating loss carry-forwards of $ 21.4 million for state purposes that will expire beginning Fiscal 2018 through 2032. 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, we have recorded a full valuation allowance equaling the total deferred tax asset at June 302013 and December 31, 2012. As of June 30, 2013 and December 31, 2012, we have no unrecognized tax benefits.

The major jurisdiction for which we file income tax returns is the United States. The Internal Revenue Service ("IRS") has examined our tax year ended September 30, 2005 and has made no changes to the filed tax returns. The tax years 2006 and forward remain open to examination by the IRS. The tax years 2004 and forward remain open to examination by the various state taxing authorities to which we are subject.

Note 6 – Investment in a Joint Venture

On March 22, 2010, we, PSI Parent, PSI and the Joint Venture entered into the LLC Agreement of the Joint Venture and additional related agreements for the purpose of developing and commercializing, for worldwide distribution and sale, a wide range of non-prescription remedies using PSI Parent's proprietary patented TPM.

In connection with the LLC Agreement, PSI Parent granted to us, pursuant to the terms of a License Agreement, dated March 22, 2010 (the "Original License Agreement"), (i) an exclusive, royalty-free, world-wide (subject to certain limitations), paid-up license to exploit OTC drugs and certain other products that embody certain of PSI Parent's TPM-related patents and related know-how (collectively, the "PSI Technology") and (ii) a non-exclusive, royalty-free, world-wide (subject to certain limitations), paid-up license to exploit certain compounds that embody the PSI Technology for use in a product combining one or more of such compounds with an OTC drug or in a product that is part of a regimen that includes the application of an OTC drug.

The Joint Venture is managed by a four-person Board of Managers, with two managers appointed by each member. The LLC Agreement contains other normally found terms in such arrangements, including provisions relating to governance of the Joint Venture, indemnification obligations of the Joint Venture, allocation of profits and losses, the distribution of funds to the members and restrictions on transfer of a member's interest.

Pursuant to the Original License Agreement, we issued 1,440,000 shares of our Common Stock having an aggregate value of approximately $ 2.6 million to PSI Parent (such shares, the "PSI Shares"), and made a one-time payment to PSI Parent of $ 1.0 million.

In accordance with a Contribution Agreement, dated March 22, 2010 (the "Contribution Agreement"), by and among us, PSI Parent, PSI, and the Joint Venture, we transferred, conveyed and assigned to the Joint Venture all of our rights, title and interest in, to and under the Original License Agreement, and the Joint Venture assumed, and undertook to pay, discharge and perform when due, all of our liabilities and obligations under and arising pursuant to the Original License Agreement (such actions, collectively, the "Assignment and Assumption").

Note 6 – Investment in a Joint Venture – continued

Pursuant to the Contribution Agreement and in order to reflect the Assignment and Assumption, we, PSI Parent and the Joint Venture entered into an Amended and Restated License Agreement, dated March 22, 2010 (the "Amended License Agreement"), which amends and restates the Original License Agreement to reflect that the Joint Venture is the licensee thereunder and which otherwise contains substantially the same terms as the Original License Agreement. The Joint Venture has the right to grant one or more sub-licenses of the rights granted under the Amended License Agreement to one or more third parties for reasonable consideration in any part of the applicable territory. The Amended License Agreement provides that PSI Parent shall not, directly or through third parties, exploit the covered intellectual property during the term thereof, subject to certain limitations. The Amended License Agreement will remain in effect until the expiration of the last to expire of the patents included within the PSI Technology or any extensions thereof. Either party may terminate the Amended License Agreement upon written notice to the other party in the event of certain events involving bankruptcy or insolvency. The Amended License Agreement also contains, among other things, provisions concerning the treatment of confidential information, the ownership of intellectual property and indemnification obligations.

Pursuant to the LLC Agreement, we and PSI each own a 50% membership interest in the Joint Venture. PSI Parent will conduct and oversee much of the product development, formulation, testing and other research and development needed by the Joint Venture, and we will oversee much of the production, distribution, sales and marketing. The LLC Agreement provides that each member may be required, from time to time and subject to certain limitations, to make capital contributions to the Joint Venture to fund its operations, in accordance with agreed upon budgets for products to be developed. Specifically, we contributed in Fiscal 2010 $500,000 in cash as initial capital and we are committed to fund up to $ 2.0 million, subject to agreed upon budgets (which have not been established to date), toward the initial development and marketing costs of new products for the Joint Venture. The newly formed Joint Venture has not engaged in any financial transactions, other than organizational expenses and general market and initial product evaluation and analysis. At June 30, 2013, cash and cash equivalents includes $381,000 which is expected to be used by the Joint Venture to fund future product development initiatives currently under consideration by PSI Parent, PSI and us.

Our determination is that the Joint Venture qualifies as a VIE and that we are the primary beneficiary. As a consequence, we have consolidated the Joint Venture financial statements beginning with the quarter ended March 31, 2010. In Fiscal 2010, we recorded the $ 3.6 million payment noted above representing the estimated fair value to acquire the product license as an intangible asset. We currently estimate the expected remaining useful life of the product license to be approximately 13.75 years which we will begin amortizing the cost of intangible asset once product commercialization is completed with PSI Parent and the OTC drug products begin to ship to our retail customers. Since inception, the newly formed Joint Venture has not engaged in any financial transactions, other than certain organizational expenses and general market and product evaluation and analysis. Furthermore, the liabilities and other obligations incurred, if any, by the Joint Venture is without recourse to us and do not create a claim on our general assets.

Due to multiple factors affecting our capital position, including the payment we made in December 2012 under the Settlement Agreement (see Note 3) and some of the product market research performed, we expect to modify the Joint Venture's product development plans to stagger and/or defer into future periods certain product development initiatives due to the pre-commercialization investments required. We expect to continue pre-commercialization research and product development initiatives during the latter half of Fiscal 2013. Furthermore, we do not expect that the Joint Venture will derive any meaningful revenues, if any, until its commercialization efforts are completed which is not expected to occur until at the earliest the latter half of Fiscal 2014 when we traditionally seek to launch new products.

ProPhase Labs, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 7 – Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income or loss attributable to common stockholders by the weighted-average number of shares of our Common Stock outstanding for the period. Diluted earnings (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 earnings per share also utilizes 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 June 30, 2013 and 2012 were 1,301,500 and 1,312,750, respectively.

For the three and six months ended June 30, 2013 and 2012 dilutive earnings per share is the same as basic earnings per share due to (i) the inclusion of Common Stock, in the form of stock options and warrants ("Common Stock Equivalents"), would have an anti-dilutive effect on the loss per share or (ii) there were no Common Stock Equivalents for the respective period. For the three months ended June 30, 2013 and 2012, there were 359,271 and 20,962 Common Stock Equivalents, respectively, which were in the money, that were excluded from the earnings per share computation. For the six months ended June 30, 2013 and 2012, there were 401,849 and 56,363 Common Stock Equivalents, respectively, which were in the money, that were excluded from the earnings per share computation.

A reconciliation of the applicable numerators and denominators of the income statement periods presented, as reflected in the results of continuing operations, is as follows (in thousands, except per share amounts):

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	Three Months Ended June 30, 2013			Three Months Ended June 30, 2012			Six Months Ended June 30, 2013			Six Months Ended June 30, 2012		
	Loss	Shares	EPS	Loss	Shares	EPS	Loss	Shares	EPS	Loss	Shares	EPS
Basic earnings (loss) per share	$ (1,719)	15,845	$ (0.11)	$ (1,930)	14,831	$ (0.13)	$ (1,429)	15,799	$ (0.09)	$ (2,617)	14,811	$ (0.18)
Dilutives:												
Options	-	-	-	-	-	-	-	-	-	-	-	-
Diluted loss per share	$ (1,719)	15,845	$ (0.11)	$ (1,930)	14,831	$ (0.13)	$ (1,429)	15,799	$ (0.09)	$ (2,617)	14,811	$ (0.18)

Item 2. Managements Discussion and Analysis of Financial Condition and Results of Operations.

General

ProPhase Labs, Inc. ("we", "us", "ProPhase" or the "Company"), organized under the laws of the State of Nevada, is a manufacturer, marketer and distributor of a diversified range of homeopathic and health products that are offered to the general public. We are also engaged in the research and development of potential over-the-counter ("OTC") drug, natural base health products along with supplements, personal care and cosmeceutical products.

Our primary business is currently the manufacture, distribution, marketing and sale of OTC cold remedy products to consumers through national chain, regional, specialty and local retail stores. Our flagship brand is Cold-EEZE ® Cold Remedy and our principal product is Cold-EEZE ® zinc gluconate lozenges, proven in clinical studies to reduce the duration and severity of the common cold symptoms by 42%. In addition to our Cold-EEZE ® cold remedy lozenges, we market and distribute two non-lozenge forms of our proprietary zinc gluconate formulation, Cold-EEZE ® QuickMelts® and Cold-EEZE® Oral Spray. In addition, we have expanded our Cold-EEZE® QuickMelts® product line and began shipments to retailers in July 2013 two new products, Cold-EEZE® Plus Immune Support QuickMelts® and Cold-EEZE Plus Immune Support + Energy QuickMelts ®. Each of these new Cold-EEZE® QuickMelts® products are based on our proprietary zinc gluconate formulation in combination with certain immune system support and natural energy ingredients. Cold-EEZE® is an established product in the health care and cold remedy market. For the three and six months ended June 30, 2013 and 2012, our revenues from operations have come principally from our OTC cold remedy products.

Seasonality of the Business

Our net sales are derived principally from our OTC cold remedy products. Currently, our sales are influenced by and subject to fluctuations in the timing of purchase and the ultimate level of demand for our products which are a function of the timing, length and severity of each 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. We generally experience in the third and fourth quarter higher levels of net sales along with a corresponding increase in marketing and advertising expenditures designed to promote our products during the cold season. Revenues and related marketing costs are generally at their lowest levels in the second quarter when consumer demand generally declines. We track health and wellness trends and develop retail promotional strategies to align our production scheduling, inventory management and marketing programs to optimize consumer purchases.

Financial Condition and Results of Operations
Results from Operations for the Three Months Ended June 30, 2013 as Compared to the Three Months Ended June 30, 2012

For the three months ended June 30, 2013, net sales were $1.9 million as compared to $1.9 million for the three months ended June 30, 2012. For the three months ended June 30, 2013, net sales of OTC cold remedy products were $1.5 million as compared to net sales of $1.5 million for three months ended June 30, 2012. For the three months ended June 30, 2013 and 2012, our contract manufacturing operations generated net sales to third party customers of $413,000 and $383,000, respectively.

Cost of sales for the three months ended June 30, 2013 were $1.0 million as compared to $1.1 million for the three months ended June 30, 2012. For the three months ended June 30, 2013 as compared to the three months ended June 30, 2012, we realized a gross margin of 47.9% and 43.6%, respectively. The increase of 4.3% in gross margin is principally due to a decrease in production overhead costs of $75,000 and fluctuations in our product mix shipped from period to period. Gross margins are principally 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, if any, retail cooperative incentive promotion and the timing of shipments to customers which are factors of the seasonality of our sales activities and products.

Sales and marketing expense for the three months ended June 30, 2013 decreased $111,000 to $709,000 as compared to $820,000 for the three months ended June 30, 2012. The decrease in sales and marketing expense for the three months ended June 30, 2013 as compared to the three months ended June 30, 2012 was principally due to a decrease in our marketing expenditures.

General and administration expense for the three months ended June 30, 2013 was $1.7 million as compared to $1.4 million for the three months ended June 30, 2012. The increase in general and administration expense for the three months ended June 30, 2013 compared to the three months ended June 30, 2012 was principally due to an increase in professional and legal fees.

Research and development costs during the three months ended June 30, 2013 decreased $313,000 to $216,000, as compared to $529,000 for the three months ended June 30, 2012. The decrease in research and development costs for the three months ended June 30, 2013 as compared to the three months ended June 30, 2012 was due principally to a decrease in the amount and timing of our development cost expenditures. Additionally, we continue to engage in market analysis, research and development activities that we determine are appropriate and we may increase our research and development activities in future periods as a consequence of (i) research and commercialization of potential new OTC products and/or (ii) costs associated with our Joint Venture.

Interest and other income for the three months ended June 30, 2013 was $1,000 as compared to $2,000 for the three months ended June 30, 2012. The decrease of $1,000 for the three months ended June 30, 2013 as compared to the three months ended June 30, 2012 was the result of a decrease in amounts invested in interest bearing bank accounts.

As a consequence of the effects of the above, the net loss for the three months ended June 30, 2013, was $1.7 million, or ($0.11) per share, as compared to a net loss of $1.9 million, or ($0.13) per share, for the three months ended June 30, 2012.

Financial Condition and Results of Operations
Results from Operations for the Six Months Ended June 30, 2013
as Compared to the Six Months Ended June 30, 2012

For the six months ended June 30, 2013, net sales increased $1.6 million to $9.5 million as compared to $7.9 million for the six months ended June 30, 2012. For the six months ended June 30, 2013, net sales of OTC cold remedy products were $8.6 million as compared to net sales of $7.2 million for the six months ended June 30, 2012. For the six months ended June 30, 2013 and 2012, our contract manufacturing operations generated net sales to third party customers of $839,000 and $694,000, respectively.

Net sales of OTC cold remedy products increased for the six months ended June 30, 2013 as compared to the six months ended June 30, 2012 due to an increase in our retail customers' purchases from period to period in an effort by those retailers to maintain adequate shelf and warehouse stock to meet an increase consumer demand of our OTC cold remedy products as a result of an increase in the incidence of the upper respiratory illness during the three months ended March 31, 2013 as compare to the three months ended March 31, 2012. The timing, stocking and ultimate level of demand of retailer purchases of our OTC cold remedy products are affected by the change in the timing and the comparative severity of the respective Cold Season as well as the effects of the timing and scope of our marketing and promotional efforts to increase consumer awareness and to influence purchase decisions.

Cost of sales for the six months ended June 30, 2013 were $3.2 million as compared to $2.7 million for the six months ended June 30, 2012. For the six months ended June 30, 2013 as compared to the six months ended June 30, 2012, we realized a gross margin of 66.1% and 65.3%, respectively, an increase of 0.8%. The increase of 0.8% in gross margin is principally due to a decrease in production overhead costs of $125,000 and fluctuations in our product mix shipped from period to period. Gross margins are principally 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, if any, retail cooperative incentive promotion and the timing of shipments to customers which are factors of the seasonality of our sales activities and products.

Sales and marketing expense for the six months ended June 30, 2013 increased $75,000 to $4.1 million as compared to $4.0 million for the six months ended June 30, 2012. The increase in sales and marketing expense for the six months ended June 30, 2013 as compared to the six months ended June 30, 2012 was principally due to an increase in our advertising expenditures.

General and administration expense for the six months ended June 30, 2013 was $3.2 million as compared to $2.9 million for the six months ended June 30, 2012. The increase in general and administration expense for the six months ended June 30, 2013 compared to the six months ended June 30, 2012 was principally due to an increase in professional and legal fees.

Research and development costs during the six months ended June 30, 2013 decreased $486,000 to $404,000, as compared to $890,000 for the six months ended June 30, 2012. The decrease in research and development costs for the six months ended June 30, 2013 as compared to the six months ended June 30, 2012 was due principally to a decrease the amount and timing in our research expenditures. Additionally, we continue to engage in market analysis, research and development activities that we determine are appropriate and we may increase our research and development activities in future periods as a consequence of (i) research and commercialization of potential new OTC products and/or (ii) costs associated with our Joint Venture.

Interest and other income for the six months ended June 30, 2013 was $1,000 as compared to $5,000 for the six months ended June 30, 2012. The decrease of $4,000 for the six months ended June 30, 2013 as compared to the six months ended June 30, 2012 was the result of a decrease in amounts invested in interest bearing bank accounts.

As a consequence of the effects of the above, the net loss for the six months ended June 30, 2013, was $1.4 million, or ($0.09) per share, as compared to net loss of $2.6 million, or ($0.18) per share, for the six months ended June 30, 2012.

Liquidity and Capital Resources

Our aggregate cash and cash equivalents as of June 30, 2013 were $4.1 million as compared to $572,000 at December 31, 2012. The increase of $3.5 million in our cash balance for the six months ended June 30, 2013 was principally due to the net effect of (i) cash provided by operations of $3.5 million principally as a consequence of the net effect of (a) a decrease of accounts receivable of $4.3 million, (b) a decrease to prepaid expenses, comprised principally of prepaid advertising, of $2.2 million, offset by (c) our net loss of $1.4 million, and (d) an increase in inventory of $1.2 million, (ii) net proceeds of $195,000 from the sale of our Common Stock, offset by (iii) capital expenditures of $250,000. Our working capital was $4.5 million and $5.8 million as of June 30, 2013 and December 31, 2012, respectively.

On November 21, 2012, we entered into the equity line of credit agreement (such arrangement, the "Equity Line") with Dutchess Opportunity Fund II, LP ("Dutchess") whereby Dutchess committed to purchase, subject to certain restrictions and conditions, up to 2,500,000 shares of our Common Stock, over a period of 36 months from the first trading day following the effectiveness of the registration statement registering the resale of shares purchased by Dutchess pursuant to the Equity Line. On November 26, 2012, we filed a registration statement with Securities and Exchange Commission ("SEC") to register for sale for up to 2,500,000 shares of our Common Stock and the registration statement was deemed effective by the SEC on December 12, 2012.

We may draw on the facility from time to time, as and when we determine appropriate in accordance with the terms and conditions of the Equity Line. The maximum amount that we are entitled to put to Dutchess in any one draw down notice is the greater of (i) 500% of the average daily volume of our Common Stock traded on the NASDAQ Global Market for the one (1) trading day prior to the date of delivery of the applicable draw down notice, multiplied by the closing price for such trading day, or (ii) $250,000.

The purchase price under the Equity Line is set at ninety-five percent (95%) of the lowest daily volume weighted average price (VWAP) of our Common Stock during the five (5) consecutive trading day period beginning on the date of delivery of the applicable draw down notice. We have the right to withdraw all or any portion of any put, except that portion of the put that has already been sold to a third party, including any portion of a put that is below the minimum acceptable price set forth on the put notice, before the closing. In the event Dutchess receives more than a five percent (5%) return on the net sales for a specific put, Dutchess must remit such excess proceeds to us; however, in the event Dutchess receives less than a five percent (5%) return on the net sales for a specific put Dutchess has the right to use any such excess proceeds to off-set against the aggregated deficit proceeds.

There are put restrictions applied on days between the draw down notice date and the closing date with respect to that particular put. During such time, we are not allowed to deliver another draw down notice. In addition, Dutchess is not obligated to purchase shares if its total number of shares beneficially held at that time would exceed 9.99% of the number of shares of our Common Stock as determined in accordance with Rule 13d-1(j) of the Securities Exchange Act of 1934, as amended. In addition, we are not permitted to draw on the facility unless there is an effective registration statement to cover the resale of the shares.

In March 2013, we sold an aggregate of 125,000 shares of Common Stock to Dutchess under and pursuant to the Equity Line and we derived approximately $195,000 in net proceeds. The sales of the shares under the Equity Line were deemed to be exempt from registration under the Securities Act of 1933, as amended in reliance upon Section 4(2) (or Regulation D promulgated thereunder). At June 30, 2013, we have 1,491,278 shares of our Common Stock available for sale, at our discretion, under the terms of the Equity Line to Dutchess.

Management believes that its strategy to maintain Cold-EEZE ® as a recognized brand name, its broader range of products, its adequate manufacturing capacity, together with its current working capital and its available Equity Line, if exercised, should provide a source of capital to fund normal business operations. Our operations support the current research and development expenditures related to new products. In addition to the funding from operations, we may in the short and long term raise capital through the issuance of securities or secure other financing sources to support such product development research, new product acquisitions or a venture investment or acquisition. Such funding through the issuance of equity securities would result in the dilution of current stockholders' ownership in the Company. Should our product development initiatives progress on certain formulations, additional development expenditures may require substantial financial support and may necessitate the consideration of alternative approaches such as licensing, joint venture, or partnership arrangements that we determine will meet our long term goals and objectives. Ultimately, should internal working capital be insufficient and external funding methods or other business arrangements become unattainable, it would likely result in the deferral or abandonment of future development relative to current and prospective product development initiatives and formulations.

Management is not aware of any 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. Our business is subject to (i) seasonal variations, (ii) changes in the scope, timing and cost of our marketing campaigns and (iii) the retail and consumer acceptance of our products, thereby impacting liquidity and working capital during the course of our fiscal year.

Management believes that cash generated from operations, along with our current cash balances, will be sufficient to finance working capital and capital expenditure requirements to fund normal business operations for at least the next twelve months. However, we may require additional capital to support, among other items, (i) new product introductions, (ii) expansion of our product marketing and promotion activities, (iii) additional research development activities, (iv) further investment in our Joint Venture, (v) venture investments or acquisitions, and/or (vi) support current operations. Since late Fiscal 2008, there has been volatility in the capital and financial markets due at least in part to the constricted global economic environment resulting in uncertainty and access to financing is uncertain. Moreover, consumer and as a consequence, customer spending habits may be adversely affected by the current uncertain economic environment. These conditions could have an adverse effect on our industry and business, including our financial condition, results of operations and cash flows.

To the extent that we do not generate sufficient cash from operations, we may need to incur indebtedness 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.

Capital Expenditures

Capital expenditures during the remainder of Fiscal 2013 are not expected to be material.

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.

Certain Risk Factors

Our business is regulated by various agencies of the states and localities where our products are sold. Governmental regulations in foreign countries where we plan to commence or expand sales may prevent or delay entry into a market or prevent or delay the introduction, or require the reformulation of certain of our products. In addition, no prediction can be made as to whether new domestic or foreign legislation regulating our activities will be enacted. Any new legislation could have a material adverse effect on our business, financial condition and operations. Non-compliance with any applicable requirements may subject us or the manufacturers of our products to agency action, including warning letters, fines, product recalls, seizures and injunctions.

The manufacturing, processing, formulation, packaging, labeling and advertising of our OTC cold remedy products are subject to regulation by several federal agencies, including (i) the Food and Drug Administration ("FDA"), (ii) the Federal Trade Commission ("FTC"), (iii) the Consumer Product Safety Commission, (iv) the United States Department of Agriculture, (v) the United States Postal Service, (vi) the United States Environmental Protection Agency and (vii) the United States Occupational Safety and Health Administration.

In addition to OTC and prescription drug products, the FDA regulates the safety, manufacturing, labeling and distribution of dietary supplements, including vitamins, minerals and herbs, food additives, food supplements and cosmetics. The FTC also has overlapping jurisdiction with the FDA to regulate the promotion and advertising of vitamins, OTC drugs, cosmetics and foods. In addition, certain of our OTC cold remedy products are homeopathic remedies which are subject to standards established by the Homeopathic Pharmacopoeia of the United States ("HPUS"). HPUS sets the standards for source, composition and preparation of homeopathic remedies which are officially recognized under the Federal Food, Drug and Cosmetics Act, as amended.

Preclinical development, clinical trials, product manufacturing, labeling, distribution and marketing of potential new products are also subject to federal and state regulation in the United States and other countries. Clinical trials and product marketing and manufacturing are subject to the rigorous review and approval processes of the FDA and foreign regulatory authorities. To obtain approval of a new drug product, a company must demonstrate through adequate and well-controlled clinical trials that the drug product is safe and effective for its intended use. Obtaining FDA and other required regulatory approvals is lengthy and expensive. Typically, obtaining regulatory approval for pharmaceutical products requires substantial resources and takes several years. The length of this process depends on the type, complexity and novelty of the product and the nature of the disease or other indication to be treated. Preclinical studies must comply with FDA regulations. Clinical trials must also comply with FDA regulations to ensure safety of the human subjects in the trial and may require large numbers of test subjects, complex protocols and possibly lengthy follow-up periods. Consequently, satisfaction of government regulations may take several years, may cause delays in introducing potential new products for considerable periods of time and may require imposing costly procedures upon our activities. If regulatory approval of new products is not obtained in a timely manner or not at all, we could be materially adversely affected. Even if regulatory approval of new products is obtained, such approval may impose limitations on the indicated uses for which the products may be marketed which could also materially adversely affect our business, financial condition and future operations.

The Joint Venture is at its early stage of development where product and market research has been initiated and new product initiatives are being evaluated and prioritized for future development and commercialization. Prior to any new product being available for sale, substantial resources will have to be committed to commercialize a product which may include research, development, preclinical testing, clinical trials, manufacturing scale-up and regulatory approval. The Joint Venture may disrupt our ongoing operations, divert management from day-to-day responsibilities and increase our expenses.

We face significant technological risks inherent in developing these products. The Joint Venture may be subject to delays and/or ultimately unable to successfully implement its business plan and strategy to develop and commercialize one or more non-prescription remedies using certain patented and proprietary TPM™ that exploit certain compounds that embody the TPM™ for use in a product combining one or more of such compounds with an OTC drug. The commercialization and ultimate product market acceptance is subject to, among other influences, consumer purchasing trends, demand for our OTC drug, health and wellness trends, regulatory factors, retail acceptance and overall economic and market conditions. As a consequence, w e may suspend or abandon some or all of our proposed new products before they become commercially viable. Even if we 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.

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 capability and the requirements associated with the development of potential OTC drug and other medicinal products in order to continue to compete on a national and international level. Our business development is dependent on continued conformity with government regulations, a reliable information technology system capable of supporting continued growth and continued reliable sources for product and materials to satisfy consumer demand. Many of our competitors have substantially greater capital resources, technical staffs, facilities, marketing resources, product development, distribution and experience than we do. As a consequence, our competitors may have certain advantages, including the ability to allocate greater resources for new product development, marketing and other purposes.

Readers should carefully review the risk factors described in other sections of this filing as well as in other documents we file from time to time with the Securities and Exchange Commission.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Our significant accounting policies are described in Note 2 of Notes to Condensed Consolidated Financial Statements included under Item 1 of this Part I. However, certain accounting policies are deemed "critical", as they require management's highest degree of judgment, estimates and assumptions. These accounting estimates and disclosures have been discussed with Audit Committee of our Board of Directors. A discussion of our critical accounting policies, 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:

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 primary product, Cold-EEZE® lozenges, utilizes a proprietary zinc formulation which has been clinically proven to reduce the duration of the common cold. Factors considered in estimating the appropriate sales returns and allowances for this product include it being (i) a unique product with limited competitors, (ii) competitively priced, (iii) promoted, (iv) unaffected for remaining shelf-life as there is no product expiration date and (v) monitored for inventory levels at major customers and third-party consumption data. In addition to Cold-EEZE ® lozenges we market and distribute two additional forms of our proprietary zinc formulation, Cold-EEZE® QuickMelts® and Cold-EEZE® Oral Spray. We also manufacture, market and distribute an organic cough drop and a Vitamin C supplement ("Organix®"). Each of the Cold-EEZE® QuickMelts®, Cold-EEZE® Oral Spray and Organix® products carry shelf-life expiration dates for which we aggregate such product market experience data and update our sales returns and allowances estimates accordingly. Sales allowances estimates are tracked at the specific customer and product line levels and are tested on an annual historical basis, and reviewed quarterly. Additionally, we monitor current developments by customer, market conditions and any other occurrences that could affect the expected provisions relative to net sales for the period presented.

Our return policy 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 fall 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 item that it purchased directly from us. We will not accept return requests pertaining to customer inventory "Overstocking" or "Resets". We will only accept return requests for product 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.

We classify product returns into principally three categories, (i) non-routine returns, (ii) obsolete product and (iii) product mix realignment by certain of our customers. "Non-routine" returns are defined as product returned to us as a consequence of unanticipated circumstances principally due to (i) retail store closings or (ii) unexpected poor retail sell through to consumers causing us to discontinue the product. "Obsolete" returns are defined as product returned to us as a consequence of product shelf-life "use by" expiration date. **"**Product mix realignment" returns are defined as product returned to us due to initiatives by the trade to discontinue purchasing certain of our products. Product mix realignment returns are generally nominal and are frequently related to discontinued or soon to be discontinued products.

As of June 30, 2013 and December 31, 2012, we included a provision for sales allowances of $65,000 and $109,000, respectively, which are reported as a reduction to account receivables. Additionally, accrued advertising and other allowances as of June 30, 2013 included $1.5 million for estimated future sales returns and $679,000 for cooperative incentive promotion costs. As of December 31, 2012 accrued advertising and other allowances included $1.3 million for estimated future sales returns and $1.5 million for cooperative incentive promotion costs. A one percent deviation for these Sales Allowance provisions for the six months ended June 30, 2013 and 2012 would affect net sales by approximately $107,000 and $96,000, respectively.

Income Taxes

As of December 31, 2012, we have net operating loss carry-forwards of approximately $37.7 million for federal purposes that will expire beginning in Fiscal 2020 through Fiscal 2032. Additionally, there are net operating loss carry-forwards of approximately $21.4 million for state purposes that will expire beginning in Fiscal 2018 through Fiscal 2032. Until sufficient taxable income to offset the temporary timing differences attributable to operations and the tax deductions attributable to option, warrant and stock are assured, a valuation allowance equaling the total deferred tax asset is being provided. Management believes that this allowance is required due to the uncertainty of realizing these tax benefits in the future. The uncertainty arises largely due to substantial marketing and research and development costs.

Recently Issued Accounting Standards

In November 2008, the SEC issued for comment a proposed roadmap regarding the potential use by U.S. issuers of financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board ("IASB"). The proposed roadmap has since been superseded by an SEC work plan and no date is currently proposed that we could be required to prepare financial statements in accordance with IFRS. The SEC has targeted Fiscal 2013 to make a determination regarding the mandatory adoption of IFRS. We are currently assessing the impact that this potential change would have on our consolidated financial statements and we will continue to monitor the development of the potential implementation of IFRS.

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2011-05, "Comprehensive Income (ASU Topic 220): Presentation of Comprehensive Income," ("ASU 2011-05") which amends current comprehensive income guidance. This accounting update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. Instead, comprehensive income must be presented in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. ASU 2011-05 was effective for fiscal periods beginning after December 15, 2011 with early adoption permitted. In December 2011, the FASB issued ASU 2011-12 "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05." This accounting update stated that the specific requirement to present items that are reclassified from other comprehensive income to net income alongside their respective components of net income and other comprehensive income will be deferred. In February 2013, the FASB issued ASU 2013-02 "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income". This accounting update requires companies to present the effects on the line items of net income of significant reclassifications out of accumulated other comprehensive income if the amount being reclassified is required under U.S. generally accepted accounting principles to be reclassified in its entirety to net income in the same reporting period. ASU 2013-02 is effective prospectively for fiscal years beginning after December 15, 2012. The adoption of ASU 2013-02 did not have a material impact on our consolidated financial position, results of operations or cash flows.

Forward-Looking Statements

This Quarterly Report on Form 10-Q 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"). These forward looking statements relate to future events or our future financial performance and involve 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. 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. This Report may contain forward-looking statements attributed to third parties relating to their estimates regarding the growth of our markets. You are cautioned that such forward looking statements are not guarantees of future performance and that all forward-looking statements address matters that involve risk and uncertainties, and 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 Report.

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

- The ability of our management to successfully implement our business plan and strategy;
- Our ability to fund our operations including the cost and availability of capital and credit;
- 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 dependence on sales from our main product, Cold-EEZE ® Cold Remedy and our ability to successfully develop and commercialize our new products;
- The uncertain length and severity of the current general financial and economic downturn, the timing and strength of an economic recovery, if any, and their impacts on our business including demand for our products;
- Our ability to protect our proprietary rights;
- Our continued ability to comply with regulations relating to our current products and 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;
- Potential disruptions in our ability to manufacture our products or our access to raw materials;
- Seasonal fluctuations in demand for our products;
- Our ability to attract, retain and motivate key employees;
- The ability of our Joint Venture to successfully implement its business plan and strategy to develop and commercialize one or more non-prescription remedies using certain patented and proprietary technology; and
- Other risks identified in this Report.

You should also consider carefully the statements under other sections of this Report and our Annual Report on Form 10-K for the year ended December 31, 2012, 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 the date of this 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.

Item 3. 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 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 due to a reduction in the availability of credit, financial market volatility and recession.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that material information required to be disclosed by us in the reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms, and that the information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. We performed an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures as of the end of the period covered by this report. Based on our review, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level as of the end of the period covered by this Report.

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. 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 June 30, 2013.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the six months ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings.

PROPHASE LABS, INC.(formerly THE QUIGLEY CORPORATION) vs. Guy Quigley, Gary Quigley, Scanda Systems Limited, Scanda Systems LTD, Chilesha Holdings LTD, Kevin Brogan, Innerlight Holdings, Inc., George Longo, Graham Brandon AND Pacific Rim Pharmaceuticals LTD

On August 23, 2010, we initiated an action in the Court of Common Pleas of Bucks County, Pennsylvania Civil Action No. 2010-08227. This action is against certain former officers and directors of the Company, including a shareholder that beneficially owns approximately 9.5% of our Common Stock, and against certain third parties. The Company has asserted claims arising from, among other things, a variety of transactions and payments previously made or entered into by the Company. All of the transactions and events that are the subject of this litigation occurred prior to June 2009 and the installation of the current board of directors. We are seeking recovery of monetary damages and other relief. Pre-trial discovery is on-going at this time and a date certain for trial has been ordered for June 9, 2014. At this time, no prediction as to the outcome of this action can be made.

GUY QUIGLEY VS. TED KARKUS, ROBERT V. CUDDIHY, JR., MARK BURNETT, MARK LEVENTHAL, MARK FRANK, LOUIS GLECKEL, MD, JAMES McCUBBIN AND PROPHASE LABS, INC. AS A NOMINAL DEFENDANT

We were named as a nominal defendant in a purported derivative complaint filed on February 2, 2012 by stockholder and former director and Chief Executive Officer Guy Quigley in the Court of Common Pleas of Philadelphia County, Pennsylvania (No. 111200409). The complaint also names as a defendant each of our directors and executive officers. Among other things, the suit alleges various breaches of fiduciary and other duties, and seeks recovery of unspecified damages and other relief. Prior to filing this complaint, the plaintiff applied to the same court for permission to take pre-complaint discovery on the basis that the plaintiff required such discovery in order to assert claims. The court denied the plaintiff's request. We believe the lawsuit is without merit and intend to vigorously defend against it. On April 5, 2013, the court entered an order allowing limited pre-trial discovery limited to demand futility and plaintiff adequacy issues, which was completed by July 12, 2013. We filed a motion to dismiss on July 26, 2013 on demand futility and plaintiff adequacy issues and this motion is currently pending. At this time, no prediction as to the outcome of this action can be made.

As noted above, we previously commenced litigation against the plaintiff, Guy Quigley, and other parties in August 2010 in the Bucks County Court of Common Pleas, Pennsylvania (No. 2010-08227). The August 2010 action remains pending.

PROPHASE LABS, INC.(formerly THE QUIGLEY CORPORATION) vs. Guy Quigley, KARIBA HOLDINGS, LIMITED, WENDY QUIGLEY, Gary Quigley, FRANCES QUIGLEY (A/K/A FRANCES BOSTON) AND JOSEPHINE QUIGLEY (A/K/A JOSEPHINE GLEESON)

On July 19, 2012, we initiated an action in the Court of Common Pleas of Bucks County, Pennsylvania ("Kariba Complaint") (No. 2011-09815). The Kariba Complaint names as defendants (i) a former officer and director of the Company, who is a shareholder that beneficially owns approximately 9.5% of our Common Stock, (ii) certain family members of such former officer and director, some of whom are former employees of the Company, and (iii) certain third parties. The Company has asserted claims arising from, among other things, a variety of transactions and payments previously made or entered into by the Company. The Kariba Complaint asserts additional claims not previously asserted in the action ProPhase Labs, Inc. (formerly The Quigley Corporation) vs. Guy Quigley, Gary Quigley, Scanda Systems Limited, Scanda Systems LTD, Chilesha Holdings LTD, Kevin Brogan, Innerlight Holdings, Inc., George Longo, Graham Brandon, Pacific Rim Pharmaceuticals LTD and Joe Doe Defendants (No. 2010-08227). All of the transactions and events that are the subject of the Kariba Complaint occurred prior to June 2009 and the installation of the current board of directors. We are seeking recovery of monetary damages and other relief. Pre-trial discovery is on-going and at this time, no prediction as to the outcome of this action can be made.

Item 1A. Risk Factors.

Not applicable

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

None

Item 3. Defaults Upon Senior Securities.

None

Item 4. Mine Safety Disclosures.

Not applicable

Item 5. Other Information.

None

Item 6. Exhibits

(1)	Exhibit 31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(2)	Exhibit 31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(3)	Exhibit 32.1	Certification by the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(4)	Exhibit 32.2	Certification by the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ProPhase Labs, Inc.

By: /s/ Ted Karkus
Ted Karkus
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

Date: August 13, 2013

By: /s/ Robert V. Cuddihy, Jr.
Robert V. Cuddihy, Jr.
Chief Operating Officer and Chief Financial Officer
(Principal Accounting and Financial Officer)

Date: August 13, 2013

EXHIBIT 31.1

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 Quarterly Report on Form 10-Q of ProPhase Labs, Inc.;

2. Based on my knowledge, this Quarterly 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 Quarterly Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly 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 Quarterly 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 13a-15(f) and 15d-15(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 Quarterly 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 Quarterly 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: August 13, 2013

By: /s/ Ted Karkus
Ted Karkus
Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)

EXHIBIT 31.2

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

I, Robert V. Cuddihy, Jr., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of ProPhase Labs, Inc.;

2. Based on my knowledge, this Quarterly 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 Quarterly Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly 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 Quarterly 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 13a-15(f) and 15d-15(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 Quarterly 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 Quarterly 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: August 13, 2013

By: /s/ Robert V. Cuddihy, Jr.
Robert V. Cuddihy, Jr.
Chief Operating Officer and
Chief Financial Officer
(Principal Accounting and
Financial Officer)

EXHIBIT 32.1

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 Nevada corporation (the "Registrant"), in connection with the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2013, 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)
August 13, 2013

EXHIBIT 32.2

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, Robert V. Cuddihy, Jr., Chief Financial Officer of ProPhase Labs, Inc., a Nevada corporation (the "Registrant"), in connection with the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2013, 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/ Robert V. Cuddihy, Jr.
Robert V. Cuddihy, Jr.
Chief Operating Officer and Chief Financial Officer
(Principal Accounting and Financial Officer)
August 13, 2013