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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

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)

Delaware	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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or shorter period that the registration was required to submit and post such files). Yes [X] 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 [X]

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

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

Class	Outstanding at November 14, 2016
Common Stock, $0.0005 par value	17,080,776

ProPhase Labs, Inc. and Subsidiaries

TABLE OF CONTENTS

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)

	September 30, 2016	December 31, 2015
	(unaudited)	
ASSETS		
Cash and cash equivalents (Note 2)	$ 375	$ 1,664
Accounts receivable, net (Note 2)	3,833	4,000
Inventory (Note 2)	4,198	4,331
Prepaid expenses and other current assets (Note 2)	1,329	1,884
Total current assets	9,735	11,879
Property, plant and equipment, net of accumulated depreciation of $5,025 and $4,708, respectively (Note 2)	3,052	2,950
Total assets	$ 12,787	$ 14,829
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Secured promissory notes, net (Note 3)	$ 1,484	$ -
Accounts payable	1,968	990
Accrued advertising and other allowances (Note 2)	2,298	2,508
Other current liabilities	503	1,036
Total current liabilities	6,253	4,534
Secured promissory notes, net (Note 3)	-	1,466
Total long term liabilities	-	1,466
COMMITMENTS AND CONTINGENCIES (Note 7)	-	-
STOCKHOLDERS' EQUITY		
Preferred stock, authorized 1,000,000, $.0005 par value, no shares issued (Note 4)	-	-
Common stock, $.0005 par value; authorized 50,000,000; issued: 26,313,593 shares (Note 4)	13	13
Additional paid-in-capital	56,378	56,377
Accumulated deficit	(19,115)	(16,819)
Treasury stock, at cost, 9,232,817 shares	(30,742)	(30,742)
Total stockholders' equity	6,534	8,829
Total liabilities and stockholders' equity	$ 12,787	$ 14,829

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		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net sales (Note 2)	$ 5,188	$ 4,390	$ 13,405	$ 12,441
Cost of sales (Note 2)	3,033	1,671	7,185	5,052
Gross profit	2,155	2,719	6,220	7,389
Operating expenses:				
Sales and marketing	676	699	4,043	4,221
Administration	1,140	1,222	3,941	4,834
Research and development	119	195	374	675
	1,935	2,116	8,358	9,730
Income (loss) from operations	220	603	(2,138)	(2,341)
Interest expense, net	(53)	(1)	(158)	(3)
Income (loss) before income tax	167	602	(2,296)	(2,344)
Income tax (Note 4)	-	-	-	-
Net income (loss)	$ 167	$ 602	$ (2,296)	$ (2,344)
Basic income (loss) per share:				
Net income (loss)	$ 0.01	$ 0.04	$ (0.13)	$ (0.14)
Diluted income (loss) per share:				
Net income (loss)	$ 0.01	$ 0.04	$ (0.13)	$ (0.14)
Weighted average common shares outstanding:				
Basic	17,081	16,597	17,081	16,171
Diluted	17,600	16,972	17,081	16,171

See accompanying notes to condensed consolidated financial statements

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

	Common Stock Shares Outstanding, Net of Shares of Treasury Stock	Par Value	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Total
Balance at December 31, 2015	17,080,776	$ 13	$ 56,377	$ (16,819)	$ (30,742)	$ 8,829
Net loss	-	-	-	(2,296)	-	(2,296)
Share-based compensation expense (Note 4)	-	-	1	-	-	1
Balance at September 30, 2016	17,080,776	$ 13	$ 56,378	$ (19,115)	$ (30,742)	$ 6,534

See accompanying notes to condensed consolidated financial statements

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

	Nine Months Ended	
	September 30, 2016	September 30, 2015
Cash flows from operating activities:		
Net loss	$ (2,296)	$ (2,344)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	317	260
Amortization of loan origination and warrant expenses	18	-
Share-based compensation expense	1	101
Gain on sale of equipment	-	(9)
Changes in operating assets and liabilities:		
Accounts receivable	167	3,070
Inventory	133	(1,599)
Accounts payable	978	252
Accrued advertising and other allowances	(210)	(1,557)
Other operating assets and liabilities, net	22	(659)
Net cash used in operating activities	(870)	(2,485)
Cash flows from investing activities:		
Capital expenditures	(419)	(678)
Proceeds from the sale of equipment	-	9
Net cash used in investing activities	(419)	(669)
Cash flows from financing activities:		
Proceeds from issuance of common stock	-	1,564
Net cash provided by financing activities	-	1,564
Net decrease in cash and cash equivalents	(1,289)	(1,590)
Cash and cash equivalents at beginning of period	1,664	2,926
Cash and cash equivalents at end of period	$ 375	$ 1,336
Supplemental disclosure of cash information		
Interest paid	$ 95	$ -

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") was initially organized in Nevada in July 1989. Effective June 18, 2015, we changed our state of incorporation from the State of Nevada to the State of Delaware. We are a manufacturer, marketer and distributor of a diversified range of homeopathic and health care 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 health care and cold remedy products to consumers through national chain, regional, specialty and local retail stores. Our flagship brand is Cold-EEZE ® and our principal product is Cold-EEZE ® cold remedy zinc gluconate lozenges, proven in clinical studies to reduce the duration and severity of symptoms of the common cold. In addition to Cold-EEZE ® cold remedy lozenges, we market and distribute non-lozenge forms of our proprietary zinc gluconate formulation, (i) Cold-EEZE ® cold remedy QuickMelts ® , (ii) Cold-EEZE ® Gummies (see below) and (iii) Cold-EEZE ® cold remedy Oral Spray. Each of our Cold-EEZE ® QuickMelts ® products are based on our proprietary zinc gluconate formulation in combination with certain (i) immune system support, (ii) energy, (iii) sleep and relaxation, and/or (iv) cold and flu symptom relieving active ingredients.

In Fiscal 2015, we introduced three new Cold-EEZE ® product line extensions: (i) a Cold-EEZE ® Multi-Symptom Relief for Cold and Flu lozenge, (ii) a Cold-EEZE ® Daytime and Nighttime Multi-Symptom Relief in liquid form for each of adults and children, and (iii) Cold-EEZE ® Natural Allergy Relief caplets for indoor and outdoor allergies. Shipments for these three new Cold-EEZE ® product line extensions began in the third quarter of Fiscal 2015. In Fiscal 2016, we expanded our Cold-EEZE ® product line further to include (i) Cold-EEZE ® Gummies Multi-Symptom Relief for Cold and Flu and (ii) Cold-EEZE ® Nighttime Multi-Symptom Relief for Cold and Flu QuickMelts ® . Shipments began for these two new products in the third quarter of Fiscal 2016.

We also perform contract manufacturing services of lozenge-based products for third parties. For the three and nine months ended September 30, 2016 and 2015, our revenues from operations have come principally from our OTC health care and cold remedy products.

We use a December 31 year-end for financial reporting purposes. References herein to "Fiscal 2016" shall mean the fiscal year ended December 31, 2016 and references to other "Fiscal" years shall mean the year, which ended on December 31 of the year indicated. The term "we", "us" or the "Company" as used herein also refer, where appropriate, to the Company, together with its subsidiaries and consolidated variable interest entities 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 accounting principles generally accepted in the United States of America ("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, 2015. 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 nine months ended September 30, 2016 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 heath care and 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 first, 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.

As a consequence of the seasonality of our business, we realize variations in operating results and demand for working capital from quarter to quarter. As of September 30, 2016, we had working capital of approximately $3.5 million and 2,450,000 shares of Common Stock available for sale under the 2015 Equity line. We believe our current working capital, cash generated from operations and available 2015 Equity Line is an acceptable and adequate level of working capital to support our business for at least the next twelve months.

For the three and nine months ended September 30, 2016 and 2015, our net sales were principally related to domestic markets.

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.

Note 2 – Summary of Significant Accounting Policies – continued

Our primary product, Cold-EEZE ® cold remedy lozenges, utilizes a proprietary zinc gluconate formulation which has been clinically proven to reduce the severity and duration of common cold symptoms. 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 ® cold remedy lozenges, we market and distribute a variety of Cold-EEZE ® cold remedy QuickMelts ® , a Cold-EEZE ® cold remedy Oral Spray, a Cold-EEZE ® Natural Allergy Relief caplets, a Cold-EEZE ® Daytime and Nighttime Multi-Symptom Relief in a liquid form and our new Cold-EEZE ® Gummies Multi-Symptom Relief for Cold and Flu. We also manufacture, market and distribute an organic cough drop and a Vitamin C supplement. Each of the Cold-EEZE ® cold remedy Oral Spray, QuickMelts ® and Gummies products, Cold-EEZE ® Natural Allergy Relief caplets, Cold-EEZE ® liquid forms and organic lozenge products carry shelf-life expiration dates for which we aggregate such new 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.

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 September 30, 2016 and December 31, 2015, the financial statements include adjustments to reduce inventory for excess or obsolete inventory of $628,000 and $501,000, respectively. The components of inventory are as follows (in thousands):

	September 30, 2016	December 31, 2015
Raw materials	$ 1,663	$ 1,303
Work in process	291	530
Finished goods	2,244	2,498
	$ 4,198	$ 4,331

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. We use the straight-line method in computing depreciation for financial reporting purposes. Depreciation expense is computed in accordance with the following ranges of estimated asset lives: building and improvements - ten to thirty-nine years; machinery and equipment - three to seven years; computer 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 and other personal care products in order to compete on a national level and/or international level.

Note 2 – Summary of Significant Accounting Policies – continued

Our business is subject to federal and state laws and regulations adopted for the health and safety of users of our products. Our OTC health care and 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 September 30, 2016, our cash balance was $375,000 and our bank balance was $710,000. Of the total bank balance, $480,000 was covered by federal depository insurance and $230,000 was uninsured at September 30, 2016.

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. As a consequence of an evaluation of our customer's financial condition, payment patterns, balance due to us and other factors, we did not offset our account receivable with an allowance for bad debt at September 30, 2016 and December 31, 2015.

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, accounts payable, accrued expenses and notes payable are reflected in the Condensed Consolidated Financial Statements at carrying value which approximates fair value.

Note 2 – Summary of Significant Accounting Policies – continued

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.

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 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.

As of September 30, 2016 and December 31, 2015, we included a provision for sales allowances of $65,000 and $83,000, respectively. Additionally, accrued advertising and other allowances as of September 30, 2016 included (i) $1.6 million for estimated future sales returns and (ii) $667,000 for cooperative incentive promotion costs. As of December 31, 2015, accrued advertising and other allowances included (i) $1.4 million for estimated future sales returns and (ii) $786,000 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 (i) media advertising, presented as part of sales and marketing expense, (ii) cooperative incentive promotions and coupon program expenses, which are accounted for as part of net sales, and (iii) free product, which is accounted for as part of cost of sales. Advertising and incentive promotion expenses incurred for the three months ended September 30, 2016 and 2015 were $1.2 million and $645,000, respectively. Advertising and incentive promotion expenses incurred for the nine months ended September 30, 2016 and 2015 were $5.1 million and $4.2 million, respectively. Included in prepaid expenses and other current assets was $406,000 and $854,000 at September 30, 2016 and December 31, 2015, 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 Based Compensation

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

Note 2 – Summary of Significant Accounting Policies – continued

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 September 30, 2016 and 2015, we charged to operations zero and $34,000, respectively, for share-based compensation expense for the aggregate fair value of stock grants issued and vested stock options earned. For the nine months ended September 30, 2016 and 2015, we charged to operations $1,000 and $101,000, respectively, for share-based compensation expense for the aggregate fair value of stock grants issued and vested stock options earned.

Research and Development

Research and development costs are charged to operations in the period incurred. Research and development costs for the three months ended September 30, 2016 and 2015 were $119,000 and $195,000, respectively. Research and development costs for the nine months ended September 30, 2016 and 2015 were $374,000 and $675,000, respectively. Research and development costs are principally related to new product development initiatives and costs associated with our OTC health care and 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 we have 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 income taxes 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.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers", on revenue recognition. The new standard provides for a single five-step model to be applied to all revenue contracts with customers as well as requires additional financial statement disclosures that will enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows relating to customer contracts. Companies have an option to use either a retrospective approach or cumulative effect adjustment approach to implement the standard. As amended by ASU No. 2015-14 issued in August 2015, this ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2017, with early adoption permitted. We do not intend to early adopt and are currently assessing the impact of this update, but preliminarily believe that its adoption will not have a material impact on our consolidated financial statements.

Note 2 – Summary of Significant Accounting Policies – continued

In August 2014, the FASB issued ASU No. 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern". The amendments in this update state that in connection with preparing financial statements for each annual and interim reporting period, an entity's management should evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). The amendments in this update are effective for the annual reporting period beginning after December 15, 2016 and for annual periods and interim periods thereafter. Early application is permitted. The adoption of this update is not expected to have a material impact on our consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11 "Simplifying the Measurement of Inventory" which requires an entity to measure inventory balances at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The amendments in this update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. The adoption of this update is not expected have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 "Leases". The new standard will require most leases to be recognized on the balance sheet which will increase reported assets and liabilities. Lessor accounting remains substantially similar to current guidance. The new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2018, which for us is the first quarter of fiscal 2019 and mandates a modified retrospective transition method. We do not intend to early adopt and are currently assessing the impact of this update, but preliminarily believe that its adoption will not have a material impact on our consolidated financial statements.

In April 2016, the FASB issued ASU No. 2016-09, "Improvements to Employee Share-Based Payment Accounting". The new standard simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU No. 2016-09 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted for financial statements that have not already been issued. We do not intend to early adopt but preliminarily believe the adoption of this update is not expected to have a material impact on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses." The standard modifies the impairment model for most financial assets, including trade accounts receivables and loans, and will require the use of an "expected loss" model for instruments measured at amortized cost. Under this model, entities will be required to estimate the lifetime expected credit loss on such instruments and record an allowance to offset the amortized cost basis of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. The effective date of the standard is for fiscal years beginning after December 15, 2019 with early adoption permitted. We are currently evaluating the impact of adoption of this update on our consolidated financial statements.

Note 2 – Summary of Significant Accounting Policies – continued

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments" . The new standard attempts to reduce diversity in practice in how cash receipts and cash payments are presented and classified in the statement of cash flows. ASU No. 2016-15 provides guidance on eight specific cash flow issues. The new guidance will be effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. Early adoption is permitted including adoption in an interim period. We do not intend to early adopt and we are currently assessing the impact of adoption of this update will have on our consolidated financial statements.

Note 3 – Secured Promissory Notes and Other Obligations

Secured Promissory Notes

On December 11, 2015, we executed two Subscription Agreements (the "Subscription Agreements") with the investors named therein (the "Investors") providing for the purchase of 12% Secured Promissory Notes – Series A (" Notes") in the aggregate principal amount of up to $3.0 million and warrants to purchase shares of our Common Stock (the "Warrants").

Notes in the amount of $1.5 million and 51,000 Warrants, at an exercise price of $1.35 per share, which was equal to the closing price of our Common Stock on the date of investment, were issued by the Company and its wholly-owned subsidiaries, Pharmaloz Manufacturing, Inc. and Quigley Pharma, Inc. (collectively, the "Obligors"), and funded on December 11, 2015. We incurred loan origination costs of $22,000 which was recorded as a reduction of the Notes and the origination costs are charged to interest expense over the term of the loan. The Warrants have an exercise term equal to three years and are exercisable commencing on the date of issuance. The fair value of the Warrants at the date of grant was $14,000 which is recorded as a reduction of the Notes and is charged to interest expense over the term of the loan. At September 30, 2016, the $1.5 million Notes are reported net of $16,000 of the unamortized interest for the loan origination costs and unamortized interest for the Warrants. At September 30, 2016, other current liabilities include $54,000 for accrued interest under the terms of the Notes.

The Notes are secured by substantially all of our tangible and intangible assets. The Notes bear interest at the rate of 12% per annum, payable semi-annually and the principal is due and payable on June 15, 2017. The Notes may be pre-paid at any time prior to maturity without penalty. The effective interest, inclusive of the Warrant and loan origination costs, is 14.3% per annum. For the three and nine months ended September 30, 2016, we charged to interest expense $53,000 and $158,000, respectively, in connection with the Notes.

In connection with the issuance of the Notes, we entered into a security agreement with John E. Ligums, Jr. (an Investor and a shareholder in the Company), as collateral agent for the Investors (the "Security Agreement") to secure the timely payment and performance in full of the Obligors' obligations pursuant to the Notes. Under the Security Agreement, the Obligors grant to the Collateral Agent, for the benefit of the Investors a lien upon and security interest in the property and assets listed as collateral in the Security Agreement, including without limitation, all of the Obligors' personal property, inventory, equipment, general intangibles, cash and cash equivalents, and proceeds.

Godfrey 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.

Note 3 – Secured Promissory Notes and Other Obligations – continued

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 "Godfrey Settlement Agreement"), pursuant to which we resolved all disputes, including claims asserted by us and counterclaims asserted against us in the action. At each of September 30, 2016 and December 31, 2015, other current liabilities include $100,000, inclusive of accrued interest at the annual rate of 3.25%, for final installment payment due in December 2016 pursuant to the terms of the Godfrey Settlement Agreement.

Note 4 – Transactions Affecting Stockholders' Equity

Our authorized capital stock consists of 50 million shares of Common Stock and 1 million shares of preferred stock, $.0005 par value ("Preferred Stock").

Preferred Stock

On June 16, 2015, our shareholders approved the change to our state of incorporation from the State of Nevada to the State of Delaware pursuant to a plan of conversion ("Conversion Plan") and the filing of a certificate of incorporation in the State of Delaware. The Preferred Stock authorized under our certificate of incorporation may be issued from time to time in one or more series. As of September 30, 2016, no shares of Preferred Stock have been issued. Our board of directors has the full authority permitted by law to establish, without further stockholder approval, one or more series and the number of shares constituting each such series and to fix by resolution voting powers, preferences and relative, participating, optional and other special rights of each series of Preferred Stock, and the qualifications, limitations or restrictions thereof, if any. Subject to the limitation on the total number of shares of Preferred Stock that we have authority to issue under our certificate of incorporation, the board of directors is also authorized to increase or decrease the number of shares of any series, subsequent to the issue of that series, but not below the number of shares of such series then-outstanding. In case the number of shares of any series is so decreased, the shares constituting such decrease will resume the status that they had prior to the adoption of the resolution originally fixing the number of shares of such series. We may amend from time to time our certificate of incorporation and bylaws to increase the number of authorized shares of Preferred Stock or Common Stock or to make other changes or additions.

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 subsequently amended effective each of (i) May 23, 2008, (ii) August 18, 2009 and (iii) June 18, 2014. The Rights Agreement, as amended and restated, provides that each Right entitles the stockholder of record to purchase from the Company that number of shares of Common Stock having a combined market value equal to two times the Rights exercise price of $45. The Rights are not exercisable until the distribution date, which will be the earlier of a public announcement that a person or group of affiliated or associated persons has acquired 15% or more of the outstanding shares of Common Stock, or the announcement of an intention by a similarly constituted party to make a tender or exchange offer resulting in the ownership of 15% or more of the outstanding shares of Common Stock (such person, the "acquirer"). The Rights Agreement allows for an exemption for Ted Karkus, the Company's Chairman and Chief Executive Officer, to acquire up to 20% of our Common Stock without our Board of Directors declaring a dividend distribution.

Note 4 – Transactions Affecting Stockholders' Equity – continued

The dividend has the effect of diluting the acquirer by giving our other stockholders a 50% discount on our Common Stock's current market value for exercising the Rights. 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 share of Common Stock 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 June 18, 2024.

Equity Line of Credit

On July 30, 2015, we entered into a new equity line of credit agreement (such arrangement, the "2015 Equity Line") with Dutchess Opportunity Fund II, LP ("Dutchess"). Pursuant to the 2015 Equity Line, Dutchess committed to purchase, subject to certain restrictions and conditions, up to 3,200,000 shares of our Common Stock, over a period of 36 months from the effectiveness of the registration statement registering the resale of shares purchased by Dutchess pursuant to the Investment Agreement.

We may, at our discretion, draw on the 2015 Equity Line from time to time, as and when we determine appropriate in accordance with the terms and conditions of the 2015 Equity Line. The maximum number of shares that we are entitled to put to Dutchess in any one draw down notice shall not exceed 500,000 shares with a purchase price calculated in accordance with the 2015 Equity Line. We may deliver a notice for a subsequent put from time to time, following the one day pricing period for the prior put.

The purchase price shall be set at ninety-five percent (95%) of the volume weighted average price (VWAP) of the Common Stock during the one trading day immediately following our put 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 will have the right to deduct from the proceeds of the put amount on the applicable closing date so Dutchess's return will equal five percent (5%).

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 entitled to deliver another draw down notice. In addition, Dutchess will not be obligated to purchase shares if Dutchess' total number of shares beneficially held at that time would exceed 4.99% of the number of shares of 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.

Pursuant to the terms of the 2015 Equity Line, we are obligated to file one or more registrations statements with the SEC to register the resale by Dutchess of the shares of Common Stock issued or issuable under the 2015 Equity Line. In addition, we are obligated to use all commercially reasonable efforts to have the registration statement declared effective by the SEC within 90 days after the registration statement is filed. On August 4, 2015, we filed a registration statement for the underlying shares of the 2015 Equity Line with the SEC and the registration statement was declared effective by the SEC on August 21, 2015.

Note 4 – Transactions Affecting Stockholders' Equity – continued

During the period August 21, 2015 through September 30, 2015, we sold an aggregate of 750,000 shares of Common Stock to Dutchess under and pursuant to the 2015 Equity Line and we derived net proceeds of $1.0 million. The sales of the shares under the 2015 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 September 30, 2016, we have 2,450,000 shares of our Common Stock available for sale, at our discretion, under the terms of the 2015 Equity Line and covered pursuant to a registration statement.

In June 2015, we sold an aggregate of 438,480 shares of our Common Stock to Dutchess under and pursuant to an equity line of credit agreement (such arrangement, the "2014 Equity Line") and we derived net proceeds of $524,000. The sales of the shares under the 2014 Equity Line were deemed to be exempt from registration under the Securities Act of 1933, as amended in reliance upon Section 4(a)(2) (or Regulation D promulgated thereunder). The 2014 Equity Line was terminated by the Company in July 2015 (see 2015 Equity Line above).

The 2010 Equity Compensation Plan

On May 5, 2010, our stockholders approved the 2010 Equity Compensation Plan which was subsequently amended, restated and approved by stockholders on April 24, 2011, and further amended and approved by stockholders on May 6, 2013, and further amended and approved by stockholders on May 24, 2016 (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 3.2 million shares, including 900,000 shares that are authorized for issuance but unissued under a 1997 incentive stock option plan and 700,000 shares added to the 2010 Plan effective May 24, 2016. No options were granted under the 2010 Plan for the nine months ended September 30, 2016 or 2015. There were no stock options exercised for the nine months ended September 30, 2016 or 2015. At September 30, 2016, there were 1,706,500 options outstanding under the 2010 Plan and 726,159 options available to be issued pursuant to the terms of the 2010 Plan.

The 2010 Directors' Equity Compensation Plan

On May 5, 2010, our stockholders approved the 2010 Directors' Equity Compensation Plan which was subsequently amended and approved by stockholders 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. For the nine months ended September 30, 2016 or 2015, no shares were granted to directors. At September 30, 2016, there were 147,808 shares of Common Stock that may be issued pursuant to the terms of the 2010 Directors' Equity Compensation Plan.

Note 5 – Income Taxes

As of December 31, 2015, we have net operating loss carry-forwards of approximately $44.5 million for federal purposes that will expire beginning in Fiscal 2020 through 2034. Additionally, there are net operating loss carry-forwards of $21.9 million for state purposes that will expire beginning in Fiscal 2020 through 2034. 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. As a consequence of the accumulated losses of the Company, we believe that this allowance is required due to the uncertainty of realizing these tax benefits in the future.

Note 6 – Joint Venture

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 ("Phusion"), a Delaware limited liability company, entered into a Limited Liability Company Agreement (the "LLC Agreement") of Phusion 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 Phusion joint venture. Phusion qualifies as a variable interest entity and we have consolidated Phusion in our financial statements.

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.

On October 17, 2014, we initiated a demand for arbitration with the American Arbitration Association, case number 01-14-0001-7373. The Phosphagenics Entities (defined below) have made counter claims of breaches against the Company and Phusion (see Note 7). At September 30, 2016, cash and cash equivalents includes $166,000 which is available to be used by Phusion to fund future product development initiatives.

Note 7– Commitments and Contingencies

PROPHASE LABS, INC. PROPHASE LABS, INC. FOR THE BENEFIT OF PHUSION LABORATORIES, LLC vs. Phosphagenics, Inc., Phosphagenics, LTD and Phusion Laboratories, LLC as a nominal defendant

On October 17, 2014, we initiated a demand for arbitration with the American Arbitration Association, case number 01-14-0001-7373. This demand for arbitration pertains to our Phusion joint venture and the matter is against Phosphagenics, Inc. and Phosphagenics LTD (collectively known as the "Phosphagenics Entities"). We have raised certain claims based upon the Phosphagenics Entities' alleged breach of a certain amended and restated license agreement for the exploitation of certain intellectual property and, separately, breach of the Phusion joint venture operating agreement as between the Company and the Phosphagenics Entities. The Phosphagenics Entities have made counter claims of breaches against the Company and Phusion. The arbitration hearing was held during December 2015 and January 2016 and the evidentiary hearing is now concluded. Each of the parties submitted to the arbitrator their post-hearing briefs on or before March 15, 2016. At this time while no prediction as to the outcome of this action can be made, we anticipate an arbitral ruling will likely be rendered prior to December 31, 2016 and we do not expect a material adverse outcome.

Note 7– Commitments and Contingencies – continued

We have estimated future minimum obligations over the next five years, including the remainder of Fiscal 2016, as follows (in thousands):

Fiscal Year	Employment Contracts	Godfrey Settlement Agreement	Notes	Total
2016	256	100	-	356
2017	1,025	-	1,500	2,525
2018	256	-	-	256
2019	-	-	-	-
2020	-	-	-	-
Total	$ 1,537	$ 100	$ 1,500	$ 3,137

Note 8 – 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 (loss) per share also utilize the treasury stock method which prescribes a theoretical buy-back of shares from the theoretical proceeds of all options and warrants outstanding during the period. Options and warrants outstanding to acquire shares of our Common Stock at September 30, 2016 and 2015 were 1,757,500 and 1,739,500, respectively.

For the three months ended September 30, 2016 and 2015, there were 519,162 and 375,253 Common Stock Equivalents, respectively, which were in the money, that were included in the earnings per share computation. For the nine months ended September 30, 2016 and 2015, dilutive earnings (loss) 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 nine months ended September 30, 2016 and 2015, there were 342,248 and 335,454 Common Stock Equivalents, respectively, which were in the money, that were excluded from the earnings (loss) per share computation as a consequence of their anti-dilutive effect.

Note 8 – Earnings (Loss) Per Share – continued

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):

	Three Months Ended September 30, 2016			Three Months Ended September 30, 2015			Nine Months Ended September 30, 2016			Nine Months Ended September 30, 2015		
	Income	Shares	EPS	Income	Shares	EPS	Loss	Shares	EPS	Loss	Shares	EPS
Basic income (loss) per share	$ 167	17,081	$ 0.01	$ 602	16,597	$ 0.04	$ (2,296)	17,081	$ (0.13)	$ (2,344)	16,171	$ (0.14)
Dilutives:												
Options	-	519	-	-	375	-	-	-	-	-	-	-
Diluted income (loss) per share	$ 167	17,600	$ 0.01	$ 602	16,972	$ 0.04	$ (2,296)	17,081	$ (0.13)	$ (2,344)	16,171	$ (0.14)

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

General

ProPhase Labs, Inc. ("we", "us", "ProPhase" or the "Company") was initially organized in Nevada in July 1989. Effective June 18, 2015, we changed our state of incorporation from the State of Nevada to the State of Delaware. We are a manufacturer, marketer and distributor of a diversified range of homeopathic and health care 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 health care and cold remedy products to consumers through national chain, regional, specialty and local retail stores. Our flagship brand is Cold-EEZE ® and our principal product is Cold-EEZE ® cold remedy zinc gluconate lozenges, proven in clinical studies to reduce the duration and severity of symptoms of the common cold. In addition to Cold-EEZE ® cold remedy lozenges, we market and distribute non-lozenge forms of our proprietary zinc gluconate formulation, (i) Cold-EEZE ® cold remedy QuickMelts ® and (ii) Cold-EEZE ® cold remedy Oral Spray. Each of our Cold-EEZE ® QuickMelts ® products are based on our proprietary zinc gluconate formulation in combination with certain (i) immune system support, (ii) energy, (iii) sleep and relaxation, and/or (iv) cold and flu symptom relieving active ingredients.

In Fiscal 2016, we expanded our Cold-EEZE ® product line further to include (i) Cold-EEZE ® Gummies Multi-Symptom Relief for Cold and Flu and (ii) Cold-EEZE ® Nighttime Multi-Symptom Relief for Cold and Flu QuickMelts ® . Shipments began for these two new products in the third quarter of Fiscal 2016. In Fiscal 2015, we introduced three new Cold-EEZE ® product line extensions: (i) a Cold-EEZE ® Multi-Symptom Relief for Cold and Flu lozenge, (ii) a Cold-EEZE ® Daytime and Nighttime Multi-Symptom Relief in liquid form for each of adults and children, and (iii) Cold-EEZE ® Natural Allergy Relief caplets for indoor and outdoor allergies. Shipments for these three new Cold-EEZE ® product line extensions began in the third quarter of Fiscal 2015.

We also perform contract manufacturing services of lozenge-based products for third parties. For the three and nine months ended September 30, 2016 and 2015, our revenues from operations have come principally from our OTC health care and cold remedy products.

Product Development

Our flagship Cold-EEZE ® brand has generally performed well within the cough-cold category over the past several years. Although we continue to expand our Cold-EEZE ® product offerings, some retailers are limiting and/or reallocating shelf and promotional space away from the cough-cold category to other product categories. With cough-cold shelf and promotional space at a premium, opportunities in the future to introduce new Cold-EEZE ® products in the cough-cold category may be limited. Therefore, to continue to grow our Company, we are in the process of implementing a series of new product development and pre-commercialization initiatives in the dietary supplement category.

Initial dietary supplement product development activities were completed in the fourth quarter of Fiscal 2015 under the brand name of TK Supplements ® . The inaugural TK Supplements ® product line is comprised of three men's health products: (i) Legendz XL ™ for sexual health, (ii) Triple Edge XL ™ , a daily energy booster plus testosterone support, and (iii) Super ProstaFlow *Plus* ™ for prostate and urinary health. We have produced and continue to refine our direct response television spots and we have initiated TV and Digital media testing for the first of the three TK Supplements ® products, Legendz XL ™ , during the nine months ended September 30, 2016. We have developed an integrated network of strategic vendors including a call center and a fulfillment center as well as the online infrastructure necessary to execute a direct to consumer marketing and sales strategy.

We recently completed a broad series of clinical studies which support important product claims which have now been incorporated in our product packaging and marketing communication. Our next goal is to introduce Legendz XL ™ in retail stores (which is typically a nine to twelve month process) leveraging our existing infrastructure and retail distribution platform. Our new Legendz XL ™ website is now live: www.LegendzXL.com. We expect to further refine our consumer engagement, TV spots, TV media plans and websites as we seek to obtain retail distribution of Legendz XL ™ . If we are successful in achieving retail distribution, we will then ramp up the media spend for our Direct Response TV spots to support this retail launch with the added benefit that it would also generate additional direct to consumer sales. As with any new product launch, we anticipate losses from the TK Supplements ® initiatives as we optimize our direct response strategy.

While management anticipates the growth potential in this category may be better, the risks associated with introducing new products that do not leverage the Cold-EEZE ® brand name may be higher. Therefore, no assurance can be made that our new product efforts will be successful and/or profitable.

Additionally, we are active in exploring new product technologies, applications, product line extensions and other new product opportunities consistent with our Company and brand image, and our standard of proven consumer benefit and efficacy.

Seasonality of the Business

Our net sales are derived principally from our OTC health care and 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 ("Cold Season") when the incidence of the common cold and flu rises as a consequence of the change in weather and other factors. We generally experience in the first, third and fourth quarter higher levels of net sales 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.

Strategic Initiatives

In August 2016, management initiated a process to explore and evaluate a wide range of strategic initiatives and alternatives to further enhance shareholder value. These include the possible sale of core assets of the Company as well as explore a range of potential acquisitions. We are working with Bourne Partners, a boutique investment bank focused on the consumer health and pharmaceutical industries, to assist in the strategic review. This process has been approved by the Board of Directors. There can be no assurance that this review process will result in any transactions or other strategic alternatives of any kind. We do not intend to disclose developments or provide updates on the progress or status of this process unless we determine further disclosure is appropriate or required.

Financial Condition and Results of Operations
Results from Operations for the Three Months Ended September 30, 2016
as Compared to the Three Months Ended September 30, 2015

For the three months ended September 30, 2016, net sales were $5.2 million as compared to $4.4 million for the three months ended September 30, 2015. For the three months ended September 30, 2016, net sales of OTC health care and cold remedy products were $3.8 million as compared to net sales of $3.9 million for three months ended September 30, 2015. For the three months ended September 30, 2016 and 2015, our contract manufacturing operations generated net sales to third party customers of $1.4 million and $497,000, respectively. The increase in net sales from period to period is due principally to an increase in our contract manufacturing operations from non-related third party entities to produce lozenge-based products.

Cost of sales for the three months ended September 30, 2016 were $3.0 million as compared to $1.7 million for the three months ended September 30, 2015. For the three months ended September 30, 2016 and 2015, we realized a gross margin of 41.5% and 61.9%, respectively. The decrease of 20.4% in gross margin from the prior period is principally due to (i) initial distribution expenses and sales allowances attributed to the launch of the new Cold-EEZE ® Gummies Multi-Symptom Relief for Cold and Flu, (ii) a decrease in the absorption of fixed production costs, (iii) fluctuations in our product mix shipped from period to period, (iv) an increase in certain commodity costs to convert in July 2016 to non-GMO ingredients for our lozenge products, and (v) an increase in contract manufacturing net sales which carry lower gross margins. Gross margins are generally influenced by fluctuations in quarter-to-quarter production volume, fixed production costs and related overhead absorption, raw ingredient costs, inventory mark to market write-downs, 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 September 30, 2016 was $676,000 as compared to $699,000 for the three months ended September 30, 2015. The decrease of $23,000 in sales and marketing expense for the three months ended September 30, 2016 as compared to the three months ended September 30, 2015 was principally due to the net effects of (i) an increase in our marketing expenditures, offset by (ii) a decrease in personnel and other sales costs.

General and administration ("G&A") expenses for the three months ended September 30, 2016 was $1.1 million as compared to $1.2 million for the three months ended September 30, 2015. The decrease of $81,000 in G&A expense for the three months ended September 30, 2016 as compared to the three months ended September 30, 2015 was principally due to a decrease in professional and legal fees.

Research and development costs during the three months ended September 30, 2016 was $119,000, as compared to $195,000 for the three months ended September 30, 2015. The decrease in research and development costs for the three months ended September 30, 2016 as compared to the three months ended September 30, 2015 was due principally to a decrease in the amount and timing of our product development expenditures.

Interest expense for the three months ended September 30, 2016 and 2015 was $53,000 and 1,000, respectively. The increase in interest expense for the three months ended September 30, 2016 as compared to September 30, 2015 was due principally to the interest expense, inclusive of warrant and loan origination costs, incurred pursuant to the issuance of the secured promissory notes in December 2015.

As a consequence of the effects of the above, the net income for the three months ended September 30, 2016 was $167,000, or $0.01 per share, as compared to a net income of $602,000, or $0.04 per share, for the three months ended September 30, 2015.

Financial Condition and Results of Operations
Results from Operations for the Nine Months Ended September 30, 2016
as Compared to the Nine Months Ended September 30, 2015

For the nine months ended September 30, 2016, net sales were $13.4 million as compared to $12.4 million for the nine months ended September 30, 2015. For the nine months ended September 30, 2016, net sales of OTC health care and cold remedy products were $10.0 million as compared to net sales of $11.1 million for the nine months ended September 30, 2015. The increase in net sales from period to period is due principally to the net effects of an increase of $2.0 million in our contract manufacturing operations from non-related third party entities to produce lozenge-based products, offset by a decrease in net sales of OTC health care and cold remedy products (principally in the period January through March 2016 as compared to January through March 2015) due to the timing of customer purchases, product mix shipped from period to period and lower consumer demand as a consequence of several factors including the decreased incidence and severity of upper respiratory illnesses, principally from January through March 2016 as compared to the prior year January through March 2015. According to IMS Health (a healthcare industry information provider), key industry statistics reveal that the incidence of upper respiratory illness across the country declined approximately 11% for the period January through March 2016 as compared to the prior year January through March 2015. The category of cough and cold product sales, including our Cold-EEZE ® sales, are highly correlated to the incidence of upper respiratory illness.

Cost of sales for the nine months ended September 30, 2016 were $7.2 million as compared to $5.1 million for the nine months ended September 30, 2015. For the nine months ended September 30, 2016 and 2015, we realized a gross margin of 46.4% and 59.4%, respectively. The decrease of 13% in gross margin from the prior period is principally due to (i) initial distribution expenses and sales allowances attributed to the launch of the new Cold-EEZE ® Gummies Multi-Symptom Relief for Cold and Flu, (ii) a decrease in the absorption of fixed production costs, (iii) fluctuations in our product mix shipped from period to period, (iv) an increase in certain commodity costs to convert in July 2016 to non-GMO ingredients for our lozenge products, and (v) an increase in contract manufacturing net sales which carry lower gross margins. Gross margins are generally influenced by fluctuations in quarter-to-quarter production volume, fixed production costs and related overhead absorption, raw ingredient costs, inventory mark to market write-downs, 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 nine months ended September 30, 2016 was $4.0 million as compared to $4.2 million for the nine months ended September 30, 2015. The decrease of $178,000 in sales and marketing expense for the nine months ended September 30, 2016 as compared to the nine months ended September 30, 2015 was principally due to (i) a decrease in our marketing expenditures and (ii) a decrease in personnel and other sales costs.

G&A expenses for the nine months ended September 30, 2016 was $3.9 million as compared to $4.8 million for the nine months ended September 30, 2015. The decrease of $893,000 in G&A expense for the nine months ended September 30, 2016 as compared to the nine months ended September 30, 2015 was principally due to a decrease in professional and legal fees.

Research and development costs during the nine months ended September 30, 2016 was $374,000, as compared to $675,000 for the nine months ended September 30, 2015. The decrease in research and development costs for the nine months ended September 30, 2016 as compared to the nine months ended September 30, 2015 was due principally to a decrease in the amount and timing of our product development expenditures.

Interest expense for the nine months ended September 30, 2016 and 2015 was $158,000 and $3,000, respectively. The increase in interest expense for the nine months ended September 30, 2016 as compared to September 30, 2015 was due principally to the interest expense, inclusive of warrant and loan origination costs, incurred pursuant to the issuance of the secured promissory notes in December 2015.

As a consequence of the effects of the above, the net loss for the nine months ended September 30, 2016 was $2.3 million, or ($0.13) per share, as compared to a net loss of $2.3 million, or ($0.14) per share, for the nine months ended September 30, 2015.

Liquidity and Capital Resources

Our aggregate cash and cash equivalents as of September 30, 2016 were $375,000 compared to $1.7 million at December 31, 2015. The decrease of $1.3 million in our cash balance for the nine months ended September 30, 2016 was principally due to (i) cash used in operations of $870,000 and (ii) capital expenditures of $419,000. Our working capital declined to $3.5 million at September 30, 2016 as compared to $7.3 million as of December 31, 2015 due principally to (i) the classification of the $1.5 million Notes as a current liability due to its June 15, 2017 maturity date and (ii) general fluctuations in working capital due to the seasonality of our business.

Secured Promissory Notes

On December 11, 2015, we executed two Subscription Agreements (the "Subscription Agreements") with the investors named therein (the "Investors") providing for the purchase of 12% Secured Promissory Notes – Series A (" Notes") in the aggregate principal amount of up to $3.0 million and warrants to purchase shares of our Common Stock (the "Warrants").

Notes in the amount of $1.5 million and 51,000 Warrants, at an exercise price of $1.35 per share, which was equal to the closing price of our Common Stock on the date of investment, were issued by the Company and its wholly-owned subsidiaries Pharmaloz Manufacturing, Inc. and Quigley Pharma, Inc. (collectively, the "Obligors") and funded on December 11, 2015. We incurred loan origination costs of $22,000 which was recorded as a reduction of the Notes and the origination costs are charged to interest expense over the term of the loan. The Warrants have an exercise term equal to three years and are exercisable commencing on the date of issuance. The fair value of the Warrants at the date of grant was $14,000 which is recorded as a reduction of the Notes and is charged to interest expense over the term of the loan. At September 30, 2016, the $1.5 million Notes are reported net of $16,000 of the unamortized interest for the loan origination costs and unamortized interest for the Warrants. At September 30, 2016, other current liabilities include $54,000 for accrued interest under the terms of the Notes.

The Notes are secured by substantially all of our tangible and intangible assets. The Notes bear interest at the rate of 12% per annum, payable semi-annually and the principal is due and payable on June 15, 2017. The Notes may be pre-paid at any time prior to maturity without penalty. The effective interest, inclusive of the Warrant and loan origination costs, is 14.3% per annum. For the three and nine months ended September 30, 2016, we charged to interest expense $53,000 and $158,000, respectively, in connection with the Notes.

Equity Line of Credit

On July 30, 2015, we entered into a new equity line of credit agreement (such arrangement, the "2015 Equity Line") with Dutchess Opportunity Fund II, LP ("Dutchess"). Pursuant to the 2015 Equity Line, Dutchess committed to purchase, subject to certain restrictions and conditions, up to 3,200,000 shares of our Common Stock, over a period of 36 months from the effectiveness of the registration statement registering the resale of shares purchased by Dutchess pursuant to the Investment Agreement.

We may, at our discretion, draw on the 2015 Equity Line from time to time, as and when we determine appropriate in accordance with the terms and conditions of the 2015 Equity Line. The maximum number of shares that we are entitled to put to Dutchess in any one draw down notice shall not exceed 500,000 shares with a purchase price calculated in accordance with the 2015 Equity Line. We may deliver a notice for a subsequent put from time to time, following the one day pricing period for the prior put.

The purchase price shall be set at ninety-five percent (95%) of the volume weighted average price (VWAP) of the Common Stock during the one trading day immediately following our put 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 will have the right to deduct from the proceeds of the put amount on the applicable closing date so Dutchess's return will equal five percent (5%).

There are put restrictions applied on days between the draw down notice date and the closing date with respect to that particular put. In addition, Dutchess will not be obligated to purchase shares if Dutchess' total number of shares beneficially held at that time would exceed 4.99% of the number of shares of 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.

Pursuant to the terms of the 2015 Equity Line, we are obligated to file one or more registrations statements with the SEC to register the resale by Dutchess of the shares of Common Stock issued or issuable under the 2015 Equity Line. In addition, we are obligated to use all commercially reasonable efforts to have the registration statement declared effective by the SEC within 90 days after the registration statement is filed. On August 4, 2015, we filed a registration statement for the underlying shares of the 2015 Equity Line with the SEC and the registration statement was declared effective by the SEC on August 21, 2015.

During the period August 21, 2015 through September 30, 2015, we sold an aggregate of 750,000 shares of Common Stock to Dutchess under and pursuant to the 2015 Equity Line and we derived net proceeds of $1.0 million. The sales of the shares under the 2015 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 September 30, 2016, we have 2,450,000 shares of our Common Stock available for sale, at our discretion, under the terms of the 2015 Equity Line and covered pursuant to a registration statement.

In June 2015, we sold an aggregate of 438,480 shares of our Common Stock to Dutchess under and pursuant to an equity credit agreement (such arrangement, the "2014 Equity Line") and we derived net proceeds of $524,000. The sales of the shares under the 2014 Equity Line were deemed to be exempt from registration under the Securities Act of 1933, as amended, in reliance upon Section 4(a)(2) (or Regulation D promulgated thereunder). The 2014 Equity Line was terminated by the Company in July 2015 (see 2015 Equity Line above).

General

As a consequence of the seasonality of our business, we realize variations in operating results and demand for working capital from quarter to quarter. As of September 30, 2016, we had working capital of approximately $3.5 million and 2,450,000 shares of Common Stock available for sale under the 2015 Equity line. We believe our current working capital, cash generated from operations and available 2015 Equity Line is an acceptable and adequate level of working capital to support our business for at least the next twelve months.

In August 2016, management initiated a process to explore and evaluate a wide range of strategic initiatives and alternatives to further enhance shareholder value. These include the possible sale of core assets of the Company as well as explore a range of potential acquisitions. We are working with Bourne Partners, a boutique investment bank focused on the consumer health and pharmaceutical industries, to assist in the strategic review.

Our operations support the current research and development expenditures related to new products. In addition to the funding from operations, it is likely that we will in the short and long term raise additional capital through the issuance of securities or secure other financing sources to support , among other items, (i) new product introductions, (ii) expansion of our product marketing and promotion activities, (iii) additional research and development activities, (iv) venture investments or acquisitions, and/or (v) support current operations. Any 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 prove to 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 other trends, events or uncertainties that have or are reasonably likely to have a material negative impact upon our (i) short-term or long-term liquidity, or (ii) net sales or income from continuing operations. Any challenge to our patent or trademark rights could have a material adverse effect on our future; however, we are not aware of any condition that would make such an event probable. Our business is subject to seasonal variations thereby impacting our liquidity and working capital during the course of our fiscal year.

To the extent that we do not generate sufficient cash from operations, 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.

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 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 health care and 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.

We face significant technological risks inherent in developing new products. We may be subject to delays and/or ultimately unable to successfully implement our business plan and strategy to develop and commercialize one or more non-prescription remedies and/or dietary supplements. The commercialization and ultimate product market acceptance is subject to, among other influences, consumer purchasing trends, demand for our product, health and wellness trends, regulatory factors, retail acceptance and overall economic and market conditions. As a consequence, we may suspend or abandon some or all of our proposed new products before they 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.

We have aligned our operations to focus principally in the research, development, manufacture, marketing and sale of OTC health care and cold remedy and consumer products, natural based health products and other supplement and cosmeceutical products. In addition, we may seek to acquire from third parties or enter into other arrangements with respect to new formulations, ingredients, applications and other products developed by third parties who may be seeking our commercialization, marketing and distribution expertise. There can be no assurance that we will be able to effectuate our business plan successfully or that we will have revenue growth. In addition, we may not be successful in acquiring or otherwise entering into any new lines of business and, if we are successful in doing so, there can be no assurance that such new business will achieve profitability.

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.

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 ® cold remedy lozenges, utilizes a proprietary zinc gluconate formulation which has been clinically proven to reduce the severity and duration of common cold symptoms. 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 ® cold remedy lozenges, we market and distribute a variety of Cold-EEZE ® cold remedy QuickMelts ® , a Cold-EEZE ® cold remedy Oral Spray, Cold-EEZE ® Natural Allergy Relief caplets, a Cold-EEZE ® Daytime and Nighttime Multi-Symptom Relief in a liquid form and our new Cold-EEZE ® Gummies Multi-Symptom Relief for Cold and Flu. We also manufacture, market and distribute an organic cough drop and a Vitamin C supplement. Each of the Cold-EEZE ® cold remedy Oral Spray, QuickMelts ® and Gummies products, Cold-EEZE ® Natural Allergy Relief caplets, Cold-EEZE ® liquid forms and organic lozenge products carry shelf-life expiration dates for which we aggregate such new 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 September 30, 2016 and December 31, 2015, we included a provision for sales allowances of $65,000 and $83,000, respectively. Additionally, accrued advertising and other allowances as of September 30, 2016 included (i) $1.6 million for estimated future sales returns and (ii) $667,000 for cooperative incentive promotion costs. As of December 31, 2015, accrued advertising and other allowances included (i) $1.4 million for estimated future sales returns and (ii) $786,000 for cooperative incentive promotion costs.

Income Taxes

As of December 31, 2015, we have net operating loss carry-forwards of approximately $44.5 million for federal purposes that will expire beginning in Fiscal 2020 through 2034. Additionally, there are net operating loss carry-forwards of $21.9 million for state purposes that will expire beginning in Fiscal 2020 through 2034. 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. As a consequence of the accumulated losses of the Company, we believe that this allowance is required due to the uncertainty of realizing these tax benefits in the future.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers", on revenue recognition. The new standard provides for a single five-step model to be applied to all revenue contracts with customers as well as requires additional financial statement disclosures that will enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows relating to customer contracts. Companies have an option to use either a retrospective approach or cumulative effect adjustment approach to implement the standard. As amended by ASU No. 2015-14 issued in August 2015, this ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2017, with early adoption permitted. We do not intend to early adopt and are currently assessing the impact of this update, but preliminarily believe that its adoption will not have a material impact on our consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern". The amendments in this update state that in connection with preparing financial statements for each annual and interim reporting period, an entity's management should evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). The amendments in this update are effective for the annual reporting period beginning after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The adoption of this update is not expected to have a material impact on our consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11 "Simplifying the Measurement of Inventory" which requires an entity to measure inventory balances at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The amendments in this update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. The adoption of this update is not expected to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 "Leases". The new standard will require most leases to be recognized on the balance sheet which will increase reported assets and liabilities. Lessor accounting remains substantially similar to current guidance. The new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2018, which for us is the first quarter of fiscal 2019 and mandates a modified retrospective transition method. We do not intend to early adopt and are currently assessing the impact of this update, but preliminarily believe that its adoption will not have a material impact on our consolidated financial statements.

In April 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting. The new standard simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU No. 2016-09 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted for financial statements that have not already been issued. We do not intend to early adopt but preliminarily believe the adoption of this update is not expected to have a material impact on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses." The standard modifies the impairment model for most financial assets, including trade accounts receivables and loans, and will require the use of an "expected loss" model for instruments measured at amortized cost. Under this model, entities will be required to estimate the lifetime expected credit loss on such instruments and record an allowance to offset the amortized cost basis of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. The effective date of the standard is for fiscal years beginning after December 15, 2019 with early adoption permitted. We are currently evaluating the impact of adoption of this update on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments" . The new standard attempts to reduce diversity in practice in how cash receipts and cash payments are presented and classified in the statement of cash flows. ASU No. 2016-15 provides guidance on eight specific cash flow issues. The new guidance will be effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. Early adoption is permitted including adoption in an interim period. We do not intend to early adopt and we are currently assessing the impact of adoption of this update will have on our consolidated financial statements.

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 principal product, Cold-EEZE ®, and our ability to successfully develop and commercialize our new products within the cough-cold category or other categories such as dietary supplements;
- Changes in our retail and distribution customers strategic business plans including, but not limited to, (i) expansions, mergers, and/or consolidations, (ii) retail shelf space allocations for products within each outlet and in particular the cough/cold category in which we compete, (iii) changes in their private label assortment and (iv) product selections, distribution allocation, merchandising programs and retail pricing of our products as well as competitive products;
- The general financial and economic uncertainty, fluctuations in consumer confidence and the 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 our key employees; 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, 2015, as well as in other documents we file from time to time with the SEC 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.

The management of the Company, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of September 30, 2016. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of that date, the Company's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. During the quarter ended September 30, 2016, there were no changes in our internal control over financial reporting that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurances that the objectives of the control system will be met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. However, our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives.

Part II. Other Information

Item 1. Legal Proceedings.

PROPHASE LABS, INC. PROPHASE LABS, INC. FOR THE BENEFIT OF PHUSION LABORATORIES, LLC vs. Phosphagenics, Inc., Phosphagenics, LTD and Phusion Laboratories, LLC as a nominal defendant

On October 17, 2014, we initiated a demand for arbitration with the American Arbitration Association, case number 01-14-0001-7373. This demand for arbitration pertains to our Phusion joint venture and the matter is against Phosphagenics, Inc. and Phosphagenics LTD (collectively known as the "Phosphagenics Entities"). We have raised certain claims based upon the Phosphagenics Entities' alleged breach of a certain amended and restated license agreement for the exploitation of certain intellectual property and, separately, breach of the Phusion joint venture operating agreement as between the Company and the Phosphagenics Entities. The Phosphagenics Entities have made counter claims of breaches against the Company and Phusion. The arbitration hearing was held during December 2015 and January 2016 and the evidentiary hearing is now concluded. Each of the parties submitted to the arbitrator their post-hearing briefs on or before March 15, 2016. At this time while no prediction as to the outcome of this action can be made, we anticipate an arbitral ruling will likely be rendered prior to December 31, 2016 and we do not expect a material adverse outcome.

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
(5)	101	INS — XBRL Instance Document
(6)	101	SCH — XBRL Taxonomy Extension Schema Document
(7)	101	CAL — XBRL Taxonomy Extension Calculation Linkbase Document
(8)	101	DEF — XBRL Taxonomy Extension Definition Linkbase Document
(9)	101	LAB — XBRL Taxonomy Extension Label Linkbase Document
(10)	101	PRE — XBRL Taxonomy Extension Presentation Linkbase Document

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: November 14, 2016

By: */s/ Robert V. Cuddihy, Jr.*

Robert V. Cuddihy, Jr.
Chief Operating Officer and Chief Financial Officer
(Principal Accounting and Financial Officer)

Date: November 14, 2016

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: November 14, 2016

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: November 14, 2016

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 Delaware corporation (the "Registrant"), in connection with the Registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2016, 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)
November 14, 2016

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 Delaware corporation (the "Registrant"), in connection with the Registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2016, 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)
November 14, 2016