

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

**FORM 10-Q/A**  
(Amendment No. 1)

(Mark One)

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

For the quarterly period ended September 30, 2017

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-21617

**ProPhase Labs, Inc.**

(Exact name of registrant as specified in its charter)

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

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

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

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

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

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company   
Emerging growth company

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

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

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

Class	Outstanding at November 13, 2017
Common Stock, \$0.0005 par value	12,428,461

ProPhase Labs, Inc. and Subsidiaries

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## EXPLANATORY NOTE

On August 10, 2018, the Company's management, after consultation and discussions with EisnerAmper LLP, the Company's independent registered public accounting firm, and the Audit Committee of the Board of Directors, concluded that the Company's previously issued audited consolidated financial statements for the fiscal year ended December 31, 2017 included in the Company's Annual Report on Form 10-K for such period and unaudited condensed consolidated financial statements for the fiscal quarters ended March 31, 2017, June 30, 2017, September 30, 2017 and March 31, 2018 (collectively with the fiscal year ended December 31, 2017, the "Restated and Revised Periods") included in the Company's Quarterly Reports on Form 10-Q for such periods should no longer be relied upon, and determined that these financial statements will be restated due to the identification of certain accounting errors related to income tax accounting.

The Company has determined that it miscalculated its income tax benefit by incorrectly utilizing certain net operating losses without taking into account the statutory limitation imposed by the State of Pennsylvania, which resulted in an overstatement of net income as discussed below. The Company also incorrectly determined the amount of income tax benefit allocable to continuing operations, which resulted in an overstatement of income from continuing operations, and an equal understatement of the gain on sale of discontinued operations, presented net of taxes, which had no impact on net income.

Based on its review, the Company has determined that its income tax expense was understated and its net income was overstated by approximately \$1.2 million for the fiscal year ended December 31, 2017. Concurrently with the filing of this Form 10-Q/A, the Company is filing an amendment on Form 10-K/A to its Annual Report on Form 10-K for the fiscal year ended December 31, 2017 to restate the audited consolidated financial statements included in the Form 10-K and amendments on Form 10-Q/A to its Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2017, June 30, 2017, September 30, 2017 and March 31, 2018 to correct the errors described above.

The corrections to the Restated and Revised Periods, which we refer to herein collectively as the "Restatement", were prepared following an independent review by the Company.

### *Description of the Restatement*

In completing our Federal and State income tax preparation review procedures for filing of the Federal and State income tax returns for the fiscal year ended December 31, 2017 during the second quarter of fiscal 2018, the Company identified an error in the accounting treatment of state Net Operating Loss (NOL) limitations which resulted in understatement of state income tax liability and expense of approximately \$0.8 million and a corresponding overstatement of net income for the nine months ended September 30, 2017. We also identified an error in our treatment of the reversal of certain valuation allowances in 2017 and their allocation between continuing and discontinued operations, resulting in the overstatement of the tax benefit allocated to continuing operations and an equal overstatement of the tax provision for discontinued operations of approximately \$16.0 million for the nine months ended September 30, 2017, and the understatement of the tax benefit allocated to continuing operations and an equal understatement of the tax provision for discontinued operations of approximately \$0.3 million for the three months ended September 30, 2017, which had no further impact on net income.

For additional information regarding the corrections to the financial statements in the Restated and Revised Periods, see Notes 2, 4 and 7 of the Condensed Consolidated Financial Statements included in Part I, Item 1, "Financial Statements".

### *Internal Controls Over Financial Reporting*

As a result of the Restatement, we also concluded that we had a material weakness related to our internal control over financial reporting. For more information regarding management's assessment of internal control over financial reporting and disclosure controls and procedures, as well as the related remediation actions, refer to Item 4 "Controls and Procedures" in this Quarterly Report on Form 10-Q/A.

### *Items Amended by this Form 10-Q/A*

This Form 10-Q/A amends and restates the entire contents of the original Form 10-Q. The portions of this Form 10-Q/A that have been revised to give effect to the Restatement and matters related thereto are as follows:

- Part I, Item 1. Financial Statements
- Part I, Item 2. Management's Discussions and Analysis of Financial Condition and Results of Operations
- Part I, Item 4. Controls and Procedures

In addition, the Company's Chief Executive Officer and Principal Accounting Officer have provided new certifications dated as of the date of this filing in connection with this Form 10-Q/A.

Except as described above, no other changes have been made to the Company's Quarterly Report on Form 10-Q ended September 30, 2017 (the "Original Filing"). This Form 10-Q/A speaks as of the date of the Original Filing and does not reflect events that may have occurred after the date of the Original Filing or modify or update any disclosures that may have been affected by subsequent events.

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, <u>2017</u> (unaudited) (as restated)	<u>December 31,</u> 2016
<b>ASSETS</b>		
Cash and cash equivalents (Note 3)	\$ 3,897	\$ 441
Marketable securities, available for sale (Note 3)	23,641	-
Escrow receivable, current	2,500	-
Accounts receivable, net (Note 3)	1,113	5,770
Inventory (Note 3)	1,992	2,736
Prepaid expenses and other current assets (Note 3)	568	680
Assets held for sale (Note 4)	22	-
Total current assets	<u>33,733</u>	<u>9,627</u>
Property, plant and equipment, net of accumulated depreciation of \$5,369 and \$5,134, respectively (Note 3)	2,849	3,175
Escrow receivable	2,500	-
Total assets	<u>\$ 39,082</u>	<u>\$ 12,802</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Secured promissory notes, net (Note 5)	\$ -	\$ 1,490
Accounts payable	503	2,156
Accrued advertising and other allowances (Note 3)	1,288	2,805
Other current liabilities	322	389
Due to Mylan, Inc. and affiliates (Note 4)	319	-
Income taxes payable (Note 7)	751	-
Total current liabilities	<u>3,183</u>	<u>6,840</u>
COMMITMENTS AND CONTINGENCIES (Note 8)	-	-
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock, authorized 1,000,000, \$.0005 par value, no shares issued (Note 6)	-	-
Common stock, \$.0005 par value; authorized 50,000,000; issued: 27,046,593 and 26,313,593 shares, respectively (Note 6)	13	13
Additional paid-in-capital	57,347	56,378
Retained earnings (Accumulated deficit)	21,118	(19,687)
Accumulated other comprehensive loss	(35)	-
Treasury stock, at cost, 14,618,132 and 9,232,817 shares (Note 6)	(42,544)	(30,742)
Total stockholders' equity	<u>35,899</u>	<u>5,962</u>
Total liabilities and stockholders' equity	<u>\$ 39,082</u>	<u>\$ 12,802</u>

See accompanying notes to condensed consolidated financial statements

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

	Three Months Ended		Nine Months Ended	
	September 30, 2017 (as restated)	September 30, 2016	September 30, 2017 (as restated)	September 30, 2016
Net sales (Note 3)	\$ 3,040	\$ 1,402	\$ 5,716	\$ 3,439
Cost of sales (Note 3)	2,608	1,205	5,060	2,929
Gross profit	432	197	656	510
Operating expenses (Note 3):				
Sales and marketing	150	153	486	686
Administration	1,124	734	3,510	2,881
Research and development	60	43	318	202
	1,334	930	4,314	3,769
Other income (expense), net	125	(53)	222	(158)
Loss from continuing operations before income taxes (Note 7)	(777)	(786)	(3,436)	(3,417)
Income tax benefit from continuing operations	305	-	1,322	-
Loss from continuing operations	(472)	(786)	(2,114)	(3,417)
Discontinued operations (Note 4):				
Income from discontinued operations	-	953	530	1,121
Gain (loss) on sale of discontinued operations, net of taxes	(305)	-	42,389	-
Income (loss) from discontinued operations	(305)	953	42,919	1,121
Net income (loss)	\$ (777)	\$ 167	\$ 40,805	\$ (2,296)
Other comprehensive loss:				
Unrealized loss on marketable securities (Note 3):	(35)	-	(35)	-
Total comprehensive income (loss)	\$ (812)	\$ 167	\$ 40,770	\$ (2,296)
Basic earnings (loss) per share:				
Loss from continuing operations	\$ (0.03)	\$ (0.05)	\$ (0.13)	\$ (0.20)
Income (loss) from discontinued operations	(0.02)	0.06	2.58	0.07
Net income	\$ (0.05)	\$ 0.01	\$ 2.45	\$ (0.13)
Diluted earnings (loss) per share:				
Loss from continuing operations	\$ (0.03)	\$ (0.04)	\$ (0.13)	\$ (0.20)
Income (loss) from discontinued operations	(0.02)	0.05	2.51	0.07
Net income (loss)	\$ (0.05)	\$ 0.01	\$ 2.38	\$ (0.13)
Weighted average common shares outstanding:				
Basic	15,967	17,081	16,661	17,081
Diluted	15,967	17,600	17,118	17,081

See accompanying notes to condensed consolidated financial statements

**ProPhase Labs, Inc. and Subsidiaries**  
**Condensed Consolidated Statement of Stockholders' Equity**  
**For the Nine Months Ended September 30, 2017**  
**(in thousands, except share data)**  
**(unaudited)**

	Common Stock Shares Outstanding, Net of Shares of Treasury Stock	Par Value	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Comprehensive Loss	Treasury Stock	Total
Balance at December 31, 2016	17,080,776	\$ 13	\$ 56,378	\$ (19,687)	\$ -	\$ (30,742)	\$ 5,962
Net income (as restated)	-	-	-	40,805	-	-	40,805
Unrealized loss	-	-	-	-	(35)	-	(35)
Proceeds from warrants exercised	51,000	-	69	-	-	-	69
Proceeds from options exercised	682,000	-	854	-	-	-	854
Treasury stock acquired	(5,385,315)	-	-	-	-	(11,802)	(11,802)
Share-based compensation expense	-	-	46	-	-	-	46
Tax benefits from exercise of warrants	-	-	179	-	-	-	179
Tax benefit allowance	-	-	(179)	-	-	-	(179)
<b>Balance at September 30, 2017 (as restated)</b>	<b>12,428,461</b>	<b>\$ 13</b>	<b>\$ 57,347</b>	<b>\$ 21,118</b>	<b>\$ (35)</b>	<b>\$ (42,544)</b>	<b>\$ 35,899</b>

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, 2017 (as restated)	September 30, 2016
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 40,805	\$ (2,296)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Gain on sale of assets, net of taxes	(42,389)	-
Change in valuation allowance, income tax	(1,322)	-
Depreciation	515	317
Amortization of loan origination and warrant expenses	10	18
Share-based compensation expense	46	1
Changes in operating assets and liabilities:		
Accounts receivable	4,657	167
Inventory	744	133
Prepaid and other assets	112	-
Accounts payable	(1,653)	978
Accrued advertising and other allowances	(1,517)	(210)
Due to Mylan, Inc. and affiliates	319	-
Other current liabilities	(1,417)	22
Assets held for sale	(22)	-
Net cash used in operating activities	<u>\$ (1,112)</u>	<u>\$ (870)</u>
<b>Cash flows from investing activities:</b>		
Net proceeds from the sale of asset	40,825	-
Purchase of marketable securities	(32,194)	-
Sale of marketable securities	8,518	-
Capital expenditures	(202)	(419)
Net cash provided by (used in) investing activities	<u>16,947</u>	<u>(419)</u>
<b>Cash flows from financing activities:</b>		
Payments to retire Notes	(1,500)	-
Payments to acquire treasury stock	(11,802)	-
Proceeds from exercise of warrants	69	-
Proceeds from exercise of stock options	854	-
Net cash used in financing activities	<u>(12,379)</u>	<u>-</u>
Net decrease in cash and cash equivalents	3,456	(1,289)
Cash and cash equivalents at beginning of period	<u>441</u>	<u>1,664</u>
Cash and cash equivalents at end of period	<u>\$ 3,897</u>	<u>\$ 375</u>
<b>Supplemental disclosures of cash flow information:</b>		
Interest paid	<u>\$ 54</u>	<u>\$ 95</u>
Income taxes paid	<u>\$ 1,350</u>	<u>\$ -</u>
<b>Non-cash investing activities:</b>		
Escrow receivable	<u>\$ 5,000</u>	<u>\$ -</u>
Net unrealized losses, investments in marketable securities	<u>\$ 35</u>	<u>\$ -</u>

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 health care and cold remedy products that are offered to the general public. We are also engaged in the research and development of potential over-the-counter (“OTC”) drug and natural base health products including supplements, personal care and cosmeceutical products. On August 23, 2017, the Company formed a new wholly-owned subsidiary, ProPhase Digital Media, Inc. (a Delaware corporation), which will be responsible for marketing the dietary TK Supplements<sup>®</sup> product line, but could also market other companies’ products as well.

**Discontinued Operations**

Prior to March 29, 2017, our flagship OTC drug brand was Cold-EEZE<sup>®</sup> and our principal product was Cold-EEZE<sup>®</sup> cold remedy zinc gluconate lozenges, proven in clinical studies to reduce the duration and severity of symptoms of the common cold. In addition to Cold-EEZE<sup>®</sup> cold remedy lozenges, we also marketed and distributed non-lozenge forms of our proprietary zinc gluconate formulation, (i) Cold-EEZE<sup>®</sup> cold remedy QuickMelts<sup>®</sup>, (ii) Cold-EEZE<sup>®</sup> Gummies and (iii) Cold-EEZE<sup>®</sup> cold remedy Oral Spray. Each of the Cold-EEZE<sup>®</sup> QuickMelts<sup>®</sup> and Gummies products are based on a 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.

On January 6, 2017, we signed an asset purchase agreement (as amended, the “Asset Purchase Agreement”), by and among the Company, Meda Consumer Healthcare Inc. (“MCH”) and Mylan Inc. (together with MCH, “Mylan”), for the sale of assets by us to Mylan (see Note 4). The sale of assets (i) was subject to stockholder approval and other customary closing conditions and (ii) consisted principally of the sale of our intellectual property rights and other assets relating to our Cold-EEZE<sup>®</sup> brand and product line (collectively, referred to herein as the “Cold-EEZE<sup>®</sup> Business”) to Mylan, including all current and pipeline over-the-counter allergy, cold, flu, multi-symptom relief and immune support treatments for adults and children to the extent each is, or is intended to be, branded “Cold-EEZE<sup>®</sup>”, and all private label versions thereof, including all formulations and derivatives thereof as set forth in the Asset Purchase Agreement.

A special meeting of our stockholders was held on March 29, 2017 (the “Special Meeting”). At the Special Meeting, our stockholders approved the sale of assets and the transactions contemplated by the Asset Purchase Agreement. Effective March 29, 2017, we completed the sale of the Cold-EEZE<sup>®</sup> Business to Mylan. As a consequence of the sale of the Cold-EEZE<sup>®</sup> Business, for the three and nine months ended September 30, 2017 and 2016, we have classified as discontinued operations (i) the gain from the sale of the Cold-EEZE<sup>®</sup> Business, (ii) all income and expenses attributable to the Cold-EEZE<sup>®</sup> Business and (iii) the income tax expense attributed to the sale of the Cold-EEZE<sup>®</sup> Business (see Notes 4 and 7). Excluded from the sale of the Cold-EEZE<sup>®</sup> Business were our accounts receivable and inventory, and we also retained all liabilities associated with our Cold-EEZE<sup>®</sup> Business operations arising prior to March 29, 2017.

**Continuing Operations**

We continue to own and operate our manufacturing facility and manufacturing business in Lebanon, Pennsylvania, and our headquarters in Doylestown, Pennsylvania. As part of the sale of the Cold-EEZE<sup>®</sup> Business, we entered into a manufacturing agreement (see Note 8) with Mylan and our wholly-owned subsidiary, Pharmedco Manufacturing, Inc. (“PMI”), to supply various Cold-EEZE<sup>®</sup> lozenge products to Mylan. In addition to the production services we provide to Mylan under the manufacturing agreement, we produce OTC drug and dietary supplement lozenges and other products for other third party customers in addition to performing operational tasks such as warehousing, customer order processing and shipping.

We are also pursuing a series of new product development and pre-commercialization initiatives in the OTC dietary supplement category. Initial OTC dietary supplement product development activities were completed in the fourth quarter of Fiscal 2015 under the brand name of TK Supplements<sup>®</sup>. The TK Supplements<sup>®</sup> product line comprises of three men’s health products: (i) Legendz XL<sup>®</sup> for sexual health, (ii) Triple Edge XL<sup>®</sup>, a daily energy booster plus testosterone support, and (iii) Super ProstaFlow Plus<sup>™</sup> for prostate and urinary health. In addition to developing direct-to-consumer (“Direct Response”) marketing strategies of Legendz XL<sup>®</sup>, we received initial product acceptance and shipped into a national chain drug retailer and to several regional retailers during the Fiscal 2017.

For the three and nine months ended September 30, 2017 and 2016, our revenues from continuing operations have come principally from our OTC health care products.

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

**Note 1 – Organization and Business – continued**

We use a December 31 year-end for financial reporting purposes. References herein to “Fiscal 2017” shall mean the fiscal year ended December 31, 2017 and references to other “Fiscal” years shall mean the year, which ended on December 31 of the year indicated. The term “we”, “us” or the “Company” as used herein also refer, where appropriate, to the Company, together with its subsidiaries unless the context otherwise requires.

**Note 2 - Restatement of Previously Issued Financial Statements**

The Company determined that when calculating its income tax provision related to the gain on the sale of discontinued operations, it incorrectly utilized available net operating losses without considering the statutory limitations imposed by the state of Pennsylvania, and that it incorrectly allocated the amount of income tax benefit resulting from the reversal of certain valuation allowances to continuing operations, which resulted in an overstatement of income the tax benefit from continuing operations and an understatement of the gain on sale of discontinued operations, which is presented net of taxes. In the process of this determination, the Company determined that such information existed at September 30, 2017 which affected the income tax benefit/ provision from continuing and discontinued operations reported in the three and nine months ended September 30, 2017. The Company concluded that the impact of applying corrections for these errors and misstatements on the consolidated financial statements as of and for the three and nine months ended September 30, 2017 is material. As a result, the Company is restating its consolidated financial statements as of and for the three and nine months ended September 30, 2017. See below for a reconciliation of the previously reported amounts to the restated amounts.

The table below sets forth the condensed consolidated balance sheet, including the balances as originally reported, adjustments and the as restated balances (in thousands):

	As of September 30, 2017		
	As originally reported	Adjustments	As restated
Income taxes payable	\$ -	\$ 751	\$ 751
Total current liabilities	2,432	751	3,183
Retained earnings	21,869	(751)	21,118
Total stockholders' equity	36,650	(751)	35,899
Total liabilities and stockholders' equity	\$ 39,082	\$ -	\$ 39,082

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

The table below sets for the condensed consolidated statements of operations, including the balances as originally reported, adjustments, and the as restated amounts (in thousands):

	For the three months ended September 30, 2017		
	As originally reported	Adjustments	As restated
Income tax benefit from continuing operations	\$ -	\$ 305	\$ 305
Loss from continuing operations	(777)	305	(472)
Gain on sale of discontinued operations, net of taxes	\$ -	(305)	(305)
Loss from discontinued operations, net of tax	-	(305)	(305)
Net loss	<u>(777)</u>	<u>-</u>	<u>(777)</u>
Basic loss per share:			
Loss from continuing operations	\$ (0.05)	\$ 0.02	\$ (0.03)
Loss from discontinued operations	-	(0.02)	(0.02)
Net loss	<u>\$ (0.05)</u>	<u>\$ 0.00</u>	<u>\$ (0.05)</u>
Diluted loss per share:			
Loss from continuing operations	\$ (0.05)	\$ 0.02	\$ (0.03)
Loss from discontinued operations	-	(0.02)	(0.02)
Net loss	<u>\$ (0.05)</u>	<u>\$ 0.00</u>	<u>\$ (0.05)</u>
	For the nine months ended September 30, 2017		
	As originally reported	Adjustments	As restated
Income tax benefit from continuing operations	\$ 18,113	\$ (16,791)	\$ 1,322
Income (loss) from continuing operations	14,677	(16,791)	(2,114)
Gain on sale of discontinued operations, net of taxes	26,349	16,040	42,389
Income from discontinued operations	26,879	16,040	42,919
Net income	<u>41,556</u>	<u>(751)</u>	<u>40,805</u>
Basic earnings (loss) per share:			
Income (loss) from continuing operations	\$ 0.88	\$ (1.01)	\$ (0.13)
Income from discontinued operations	1.61	0.97	2.58
Net income	<u>\$ 2.49</u>	<u>\$ (0.04)</u>	<u>\$ 2.45</u>
Diluted earnings (loss) per share:			
Income (loss) from continuing operations	\$ 0.86	\$ (0.99)	\$ (0.13)
Income from discontinued operations	1.57	0.94	2.51
Net income	<u>\$ 2.43</u>	<u>\$ (0.05)</u>	<u>\$ 2.38</u>

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

The table below sets forth the condensed consolidated statements of cash flows from operating activities, including the balances as originally reported, adjustments and as the restated balances (in thousands):

	For the nine months ended September 30, 2017		
	As originally reported	Adjustments	As restated
Net income	\$ 41,556	\$ (751)	\$ 40,805
Gain on sale of assets, net of taxes	(26,339)	(16,050)	(42,389)
Change in valuation allowance, income tax	(19,473)	18,151	(1,322)
Other current liabilities	(67)	(1,350)	(1,417)
Net cash used in operating activities	<u>\$ (4,323)</u>	<u>\$ -</u>	<u>\$ (4,323)</u>

The restatement had no impact on cash flows from investing activities or financing activities or net increase in cash.

**Note 3 – 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 Fiscal 2016. 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, 2017 are not necessarily indicative of operating results that may be achieved over the course of the full year. Historical financial statements have been reclassified to conform to the current period presentation, principally reflecting the sale of Cold-EEZE<sup>®</sup> Business as discontinued operations.

***Discontinued Operations Carve Out and ProPhase Allocations***

For the three and nine months ended September 30, 2017 and 2016, results from operations for our Cold-EEZE<sup>®</sup> Business are classified as discontinued operations. The carve out of the discontinued operations (i) were prepared in accordance with the SEC’s carve out rules under Staff Accounting Bulletin (“SAB”) Topic 1B1 and (ii) are derived from identifying and carving out the specific assets, liabilities, net sales, cost of sales, operating expenses and interest expense associated with the Cold-EEZE<sup>®</sup> Business’s operations. General administrative and overhead expenses, including personnel expenses and bonuses, and research and development overhead expenses incurred by us (for which the discontinued operation benefits from such resources) are allocated to discontinued operations based upon the percentage of the Cold-EEZE<sup>®</sup> Business’s net sales to our consolidated net sales. For the three months ended September 30, 2017 and 2016, we allocated (i) zero and \$406,000, respectively, of administrative expenses and (ii) zero and \$77,000, respectively, of research and development expenses, to discontinued operations in the accompanying condensed statements of operations. For the nine months ended September 30, 2017 and 2016, we allocated (i) \$348,000 and \$1.1 million respectively, of administrative expenses and (ii) \$52,000 and \$172,000, respectively, of research and development expenses, to discontinued operations in the accompanying condensed statements of operations (see Note 4).

***Seasonality of the Business***

Our net sales are derived principally from our OTC health care and cold remedy products sold in the United States of America. 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. Revenues are generally at their lowest levels in the second quarter when customer demand generally declines.

For the three and nine months ended September 30, 2017 and 2016, our net sales were principally related to domestic markets.

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

**Note 3 – Summary of Significant Accounting Policies – continued**

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

***Cash and 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.

***Marketable Securities***

We have classified our investments in marketable securities as available-for-sale and as a current asset. Our investments in marketable securities are carried at fair value, with unrealized gains and losses included as a separate component of stockholders' equity. Realized gains and losses from our marketable securities recorded as other income (expense). We initiated short term investments in marketable securities, which carry maturity dates under one year from date of purchase with interest rates of 0.87% - 1.56%, during the third quarter of Fiscal 2017. For those three and nine months ended September 30, 2017, we reported an unrealized loss of \$35,000. Unrealized gains and losses are classified as other comprehensive income (loss) and the cost is determined on a specific identification basis. The following is a summary of the components of our marketable securities and the underlying fair value input level tier hierarchy (see long-lived assets below) (in thousands):

	As of September 30, 2017				Market Value
	Input Level	Amortized cost	Unrealized gain	Unrealized loss	
U.S. government obligations	Level 2	\$ 6,455	\$ -	\$ 1	\$ 6,454
Corporate obligations	Level 2	17,221	-	34	17,187
		<u>\$ 23,676</u>	<u>\$ -</u>	<u>\$ 35</u>	<u>\$ 23,641</u>

***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, 2017 and December 31, 2016, the financial statements include adjustments to reduce inventory for excess or obsolete inventory of \$1.5 million and \$1.6 million, respectively. The components of inventory are as follows (in thousands):

	September 30, 2017	December 31, 2016
Raw materials	\$ 1,493	\$ 1,404
Work in process	366	466
Finished goods	133	866
	<u>\$ 1,992</u>	<u>\$ 2,736</u>

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

**Note 3 – Summary of Significant Accounting Policies – continued**

***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.

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 products are subject to regulations by various federal, state and local agencies, including the Food and Drug Administration (“FDA”) and, as applicable, the Homeopathic Pharmacopoeia of the United States.

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

We maintain cash and cash equivalents with certain major financial institutions. As of September 30, 2017, our cash balance was \$3.9 million and our bank balance was \$3.6 million. Of the total bank balance, \$500,000 was covered by federal depository insurance and \$3.1 million was uninsured at September 30, 2017.

Trade accounts receivable potentially subject us to credit concentrations from time-to-time as a consequence of the timing, payment pattern and ultimate purchase volumes or shipping schedules with our customers. We extend credit to our customers based upon an evaluation of the customer’s financial condition and credit history and generally we do not require collateral. Our customers include consumer products companies and large national chain, regional, specialty and local retail stores. These credit concentrations may impact our overall exposure to credit risk, either positively or negatively, in that our customers may be similarly affected by changes in economic, regulatory or other conditions that may impact the timing and collectability of amounts due to us. As a consequence of an evaluation of our customer’s financial condition, payment patterns, balance due to us and other factors, we did not offset our account receivable with an allowance for bad debt at September 30, 2017 and December 31, 2016.

***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.

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

**Note 3 – Summary of Significant Accounting Policies – continued**

***Fair Value of Financial Instruments***

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

	As of September 30, 2017			
	Level 1	Level 2	Level 3	Total
Marketable securities				
U.S. government obligations	\$ -	\$ 6,454	\$ -	\$ 6,454
Corporate obligations	-	17,187	-	17,187
	<u>\$ -</u>	<u>\$ 23,641</u>	<u>\$ -</u>	<u>\$ 23,641</u>

***Revenue Recognition***

We generate sales principally through two types of customers, contract manufacturing customers and retail customers. Sales from product shipments to contract manufacturing and retailer customer are recognized at the time ownership is transferred to the customer. Revenue from retailer customers is reduced for trade promotions, estimated sales returns, cash discounts and other allowances in the same period as the related sales are recorded. 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 for retailer customers accommodates returns for (i) discontinued products, (ii) store closings and (iii) products that have reached or exceeded their designated expiration date. We do not impose a period of time within which product may be returned. All requests for product returns must be submitted to us for pre-approval. The main components of our returns policy are: (i) we will accept returns that are due to damaged product that is un-saleable and such return request activity falls within an acceptable range, (ii) we will accept returns for products that have reached or exceeded designated expiration dates and (iii) we will accept returns in the event that we discontinue a product provided that the customer will have the right to return only such items that it purchased directly from us. We will not accept return requests pertaining to customer inventory “Overstocking” or “Resets”. We will 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.

Pursuant to the terms of the Asset Purchase Agreement, we are responsible for and continue to accept product returns of the Cold-EEZE<sup>®</sup> Business for product shipped prior to March 30, 2017. Additionally, pursuant to the terms of the Asset Purchase Agreement, we allocated and, in June 2017, issued a credit to Mylan in the aggregate amount of \$400,000 for future sales returns and allowances relating to certain product returns that were sold by us prior to March 30, 2017.

As of September 30, 2017 and December 31, 2016, we included a provision for sales allowances of zero and \$108,000, respectively. Additionally, accrued advertising and other allowances as of September 30, 2017 included (i) \$902,000 for estimated future sales returns and (ii) \$371,000 for cooperative incentive promotion costs. As of December 31, 2016, accrued advertising and other allowances included (i) \$1.2 million for estimated future sales returns and (ii) \$1.5 million for cooperative incentive promotion costs.

One of our customers accounted for 50.7% of our revenues in the nine months ended September 30, 2017, compared to one customer accounted for 68.3% of our revenues in Fiscal 2016.

***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 (i) from continuing operations for the three months ended September 30, 2017 and 2016 were \$22,000 and \$46,000, respectively, and (ii) attributed to and classified as discontinued operations were zero and \$1.1 million, respectively. Advertising and incentive promotion expenses incurred (i) from continuing operations for the nine months ended September 30, 2017 and 2016 were \$78,000 and \$385,000, respectively, and (ii) attributed to and classified as discontinued operations were \$2.8 million and \$4.5 million, respectively. Included in prepaid expenses and other current assets was \$10,000 and \$263,000 at September 30, 2017 and December 31, 2016, respectively, relating to prepaid advertising and promotion expenses.

***Shipping and Handling***

Product sales may 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.

**ProPhase Labs, Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**  
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**Note 3 – Summary of Significant Accounting Policies – continued**

***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.

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 6). 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, 2017 and 2016, we charged to operations \$28,000 and zero, 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, 2017 and 2016, we charged to operations \$46,000 and \$1,000, 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 incurred for the three months ended September 30, 2017 and 2016 (i) from continuing operations were \$60,000 and \$43,000, respectively, and (ii) attributed to and classified as discontinued operations of zero and \$77,000, respectively. Research and development costs incurred for the nine months ended September 30, 2017 and 2016 (i) from continuing operations were \$318,000 and \$202,000, respectively, and (ii) attributed to and classified as discontinued operations of \$52,000 and \$172,000, respectively. Research and development costs are principally related to personnel expenses and new product development initiatives and costs associated with our OTC health care 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 full valuation allowance equaling the total deferred tax asset is being provided (see Notes 4 and 7).

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. This ASU, as amended, is effective for fiscal years and interim periods within those years beginning after December 15, 2017. We plan to adopt the provisions of the new standard in the first quarter of 2018. The Company is utilizing a comprehensive approach to assess the impact of the guidance on our revenue. Additionally, the Company is evaluating the impact of the new guidance on disclosures, as well as the impact on controls to support the recognition. We do not believe that its adoption will not have a material impact on our consolidated financial statements.

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

**Note 3 – Summary of Significant Accounting Policies – continued**

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. We adopted the standard in January 2017 with no 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 adoption of this update will have 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 adoption of this update will have on our consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, “Income Taxes: Intra-Entity Transfers of Assets Other than Inventory”. The new standard requires entities should recognize the income tax consequences of an asset other than inventory when the asset transfer occurs. The new guidance will be effective for fiscal years beginning after December 15, 2017 and requires a modified retrospective adoption through a cumulative effect adjustment directly to retained earnings as of the beginning of the period of adoption. We are currently evaluating the impact adoption of this update will have on our consolidated financial statements.

**Note 4 – Discontinued Operations, Sale of the Cold-EEZE<sup>®</sup> Business**

At the Special Meeting held on March 29, 2017, our stockholders approved the sale of the Cold-EEZE<sup>®</sup> Business and the transactions contemplated by the Asset Purchase Agreement. Effective March 29, 2017, we completed the sale of the Cold-EEZE<sup>®</sup> Business to Mylan.

As a consequence of the sale of the Cold-EEZE<sup>®</sup> Business, for the three and nine months ended September 30, 2017 and 2016, we have classified as discontinued operations (i) the gain from the sale of the Cold-EEZE<sup>®</sup> Business, (ii) all gains and losses attributable to the Cold-EEZE<sup>®</sup> Business operations and (iii) the income tax expense attributed to the sale of the Cold-EEZE<sup>®</sup> Business (see Note 7). Excluded from the sale of the Cold-EEZE<sup>®</sup> Business were our accounts receivable and inventory, and we also retained all liabilities associated with our Cold-EEZE<sup>®</sup> Business operations arising prior to March 29, 2017.

Pursuant to the Asset Purchase Agreement, we also agreed to a one-time sale to Mylan of certain non-lozenge-based Cold-EEZE<sup>®</sup> inventory. At September 30, 2017, we have classified as assets held for sale approximately \$22,000 of such inventory, which approximates our cost. At December 31, 2016, the balance sheet impact of discontinued operations was deemed not material, as such, no reclassifications for discontinued operations have been presented.

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

**Note 4 – Discontinued Operations, Sale of the Cold-EEZE® Business – continued**

Pursuant to the Asset Purchase Agreement, we entered into a 90 day transition service arrangement with Mylan, for which we earned \$150,000 in transition service fees through September 30, 2017. Pursuant to this arrangement, we (i) received, processed, fulfilled, and shipped customer orders, and billed such customers for these shipments on behalf of Mylan from March 30, 2017 to June 30, 2017, (ii) processed certain sales allowances, returns and other customer promotional deductions, and (iii) paid certain Cold-EEZE® Business expenses which are to be reimbursed by Mylan. At September 30, 2017, we have a balance due to Mylan of \$319,000 which is comprised of (i) net billings to Mylan's customers for product shipments, less sales and other allowances, of \$1.0 million (ii) return allocation of \$400,000 for future sales returns and allowances (see Note 3), offset by (iii) \$1.5 million for product shipments and transition service fee due from Mylan and (iv) \$240,000 for the reimbursement of certain Cold-EEZE® Business expenses we paid on behalf of Mylan. For the nine months ended September 30, 2017, the \$150,000 transition service fees earned are recorded as a component of other income (expense).

The net proceeds received from the sale of the Cold-EEZE® Business were as follows (in thousands):

	Amount (as restated)
Gross consideration from the sale of the Cold-EEZE® Business	\$ 50,000
Closing and transaction costs	(4,175)
Net proceeds from sale of the Cold-EEZE® Business	45,825
Book value of assets sold	(13)
Gain on sale of the Cold-EEZE® Business before income taxes	45,812
Income tax expense	(3,423)
Gain on sale of the Cold-EEZE® Business after income taxes	\$ 42,389
<b>Net proceeds:</b>	
Cash paid at closing, net of closing and transaction costs	\$ 43,145
Proceeds due on sale of assets, cash held in escrow	5,000
	\$ 48,145

For the nine months ended September 30, 2017, we incurred \$4.2 million in closing and transaction costs associated with the sale of the Cold-EEZE® Business which were comprised of (i) transaction fees and related closing costs of \$1.9 million and (ii) performance bonuses, contract termination compensation and severance payments to certain employees associated with the sale of the Cold-EEZE® Business of \$2.3 million. The compensation committee of our board of directors approved these compensation arrangements. These compensation and termination payments were paid by us in April 2017.

The following table sets forth the condensed operating results of our discontinued operations for the three and nine months ended September 30, 2017 and 2016, respectively, (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net sales	-	\$ 3,787	\$ 4,687	\$ 9,966
Cost of sales	-	1,827	2,037	4,255
Sales and marketing	-	524	1,720	3,357
Administration	-	406	348	1,061
Research and development	-	77	52	172
Income from discontinued operations	\$ -	\$ 953	\$ 530	\$ 1,121

**ProPhase Labs, Inc. and Subsidiaries**  
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**Note 5 – 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, PMI and Quigley Pharma, Inc. (collectively, the “Obligors”), and funded on December 11, 2015. We incurred loan origination costs of \$22,000 which were recorded as a reduction of the Notes and the origination costs were charged to other income (expense) over the term of the loan. The Warrants had an exercise term equal to three years and were exercisable commencing on the date of issuance. The fair value of the Warrants at the date of grant was \$14,000 which was recorded as a reduction of the Notes and is charged to other income (expense) over the term of the loan.

The Notes bore interest at the rate of 12% per annum, payable semi-annually and the principal was due and payable on June 15, 2017. The Notes could be pre-paid at any time prior to maturity without penalty. The effective interest, inclusive of the Warrant and loan origination costs, was 14.3% per annum. For the nine months ended September 30, 2017 and 2016, we charged to other income (expense) \$54,000 and \$105,000, respectively, in connection with the Notes.

On March 29, 2017, in connection with the sale of the Cold-EEZE<sup>®</sup> Business, we paid in full the remaining principal and accrued interest, in the total amount of \$1,553,000, due under the Notes. Of the \$1,553,000 paid to the Investors, \$69,000 was netted against the aggregate exercise price of the Warrants, which were simultaneously exercised by the Investors.

In connection with the issuance of the Notes, the Company entered into a security agreement with John E. Ligums, Jr., as collateral agent for the Investors (the “Security Agreement”), to secure the timely payment and performance in full of the Company’s obligations under the Notes. Under the Security Agreement, we granted 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 our personal property, inventory, equipment, general intangibles, cash and cash equivalents, and proceeds. In connection with the payoff of the Notes, the Security Agreement was terminated.

**Note 6 – 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 stockholders approved the change to our state of incorporation from the State of Nevada to the State of Delaware pursuant to a plan of conversion (the “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, 2017, 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 of Preferred Stock and the number of shares constituting each such series and to fix by resolution, voting powers, preferences and relative, participating, optional and other special rights of each series of Preferred Stock, and the qualifications, limitations or restrictions thereof, if any. Subject to the limitation on the total number of shares of Preferred Stock that we have authority to issue under our certificate of incorporation, the board of directors is also authorized to increase or decrease the number of shares of any series, subsequent to the issue of that series, but not below the number of shares of such series then-outstanding. In case the number of shares of any series is so decreased, the shares constituting such decrease will resume the status that they had prior to the adoption of the resolution originally fixing the number of shares of such series. We may 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 to our capital structure or the terms of our capital stock.

**ProPhase Labs, Inc. and Subsidiaries**  
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**Note 6 – Transactions Affecting Stockholders' Equity – continued**

***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 our 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, (iii) June 18, 2014 and (iv) January 6, 2017. The Rights Agreement, as amended and restated, provides that each Right entitles the stockholder of record to purchase from the Company that number of 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.

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 Board of Directors determines 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 terms of 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.

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

**Note 6 – Transactions Affecting Stockholders' Equity – continued**

Pursuant to the terms of the 2015 Equity Line, we are obligated to file one or more registration 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.

At September 30, 2017, we have 2,450,000 shares of our Common Stock available for sale, at our discretion, under the terms of our 2015 Equity Line and covered pursuant to an effective registration statement.

***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 our stockholders on April 24, 2011, and further amended and approved by our stockholders on May 6, 2013 and 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.

For the nine months ended September 30, 2017, we granted to employees to acquire our Common Stock pursuant to the terms of 2010 Plan and aggregate of 625,000 options of which (i) 25,000 options are exercisable at \$2.15 per share that vest over three years and (ii) 600,000 options are exercisable at \$2.00 per share that vest over four years. The assumptions used in determining the fair value of the 25,000 stock options granted in the third quarter of Fiscal 2017 were (i) expected option life of 4.5 years, (ii) weighted average risk rate of 1.62%, (iii) dividend yield of 0% and (iv) expected volatility of 38.59%. The assumptions used in determining the fair value of the 600,000 stock options granted in the second quarter of Fiscal 2017 were (i) expected option life of 4.75 years, (ii) weighted average risk rate of 1.81%, (iii) dividend yield of 0% and (iv) expected volatility of 44.51%. No options were granted for the three months and nine months ended September 30, 2016.

For the three months and nine months ended September 30, 2017, stock options of 592,000 and 682,000, respectively, were exercised pursuant to the 2010 Plan and we derived net proceeds of \$752,000 and \$854,000, respectively. For the nine months ended September 30, 2016, there were no stock options exercised. At September 30, 2017, there were 1,642,000 options outstanding under the 2010 Plan and 108,659 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, 2017 and 2016, no shares were granted to our directors. At September 30, 2017, there were 147,808 shares of Common Stock that may be issued pursuant to the terms of the 2010 Directors' Equity Compensation Plan.

***Treasury Stock***

***Stock Purchase Agreements***

On June 12, 2017 we entered into a Stock Purchase Agreement with each of Mark S. Leventhal, a former director of the Company, and certain other persons and entities associated and/or affiliated with Mr. Leventhal (the "Leventhal Holders"), pursuant to which we purchased all 1,061,980 shares of our Common Stock then held by the Leventhal Holders, representing an approximate 6.2% aggregate ownership interest (based on 17.2 million shares of common stock outstanding as of June 12, 2017). Upon consummation of the transactions, the Leventhal Holders ceased to hold any direct or indirect ownership interest in the Company.

Pursuant to the terms of the Stock Purchase Agreements, the total consideration paid by us to the Leventhal Holders for their shares was \$1,858,465, which amount was equal to the product of (i) \$1.75 multiplied by (ii) the number of shares purchased.

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

**Note 6 – Transactions Affecting Stockholders' Equity – continued**

Tender Offer

On August 25, 2017, we announced a tender offer to purchase up to 4.0 million shares of our Common Stock at a price of \$2.30 per share (the "Tender Offer"). The number of shares proposed to be purchased in the tender offer represented approximately 24.7% of the approximately 16.2 million shares of our Common Stock issued and outstanding as of August 21, 2017. The last reported sale price of our Common Stock on August 15, 2017, the last full trading day before we announced the Tender Offer, was \$2.13 per share.

The Tender Offer expired on September 25, 2017. Subject to the terms of the Tender Offer, we accepted for purchase 4,323,335 shares of our Common Stock, including all "odd lots" validly tendered, at a purchase price of \$2.30 per share, for an aggregate purchase price of approximately \$9.9 million. Based on the final tabulation by American Stock Transfer & Trust Company, the Depository for the Tender Offer, 5,910,327 shares of our Common Stock were properly tendered and not withdrawn. We were informed by the Depository that, after giving effect to the priority for an aggregate amount of approximately 9,338 "odd lot" shares, the final proration factor for the remaining tendered shares is approximately 73%. Prior to the Tender Offer, an investor, BML Investment Partners, L.P. ("BLM"), owned 2,322,627 shares, or 13.6%, of our outstanding Common Stock. Pursuant to the terms of the Tender Offer, BML tendered and sold 1,695,305 shares of our Common Stock. In addition, Ted Karkus, our Chairman of the Board and Chief Executive Officer, Robert V. Cuddihy, Jr., our then Chief Operating Officer and Chief Financial Officer, and one of our directors tendered and sold 364,954, 358,621 and 4,379 shares of Common Stock, respectively.

**Note 7 – Income Taxes**

At December 31, 2016, there were \$47.1 million in net operating loss carryforwards, subject to applicable limitations, available to us for federal purposes which will expire beginning for the year ended December 31, 2020 through 2036. Additionally, there were \$22.1 million in net operating loss carryforwards, subject to limitations, available to us for state purposes which will expire beginning for the year ended December 31, 2020 through 2036.

We believe that a significant portion of our income tax liability arising from our taxable gain for federal and state income tax purposes from the sale of the Cold-EEZE<sup>®</sup> Business will be offset to the extent of our current year losses from operations, the write-off for tax purposes of the tax-basis of the Cold-EEZE<sup>®</sup> Business and the available net operating loss carryforwards at the federal and state levels. However, for state income tax purposes, based upon the available state net operating loss carryforwards and corresponding limitations, we estimate a net income tax expense arising from the sale of the Cold-EEZE<sup>®</sup> Business of \$2.1 million.

Utilization of net operating loss carryforwards may be subject to limitations as set forth in Section 382 of the Internal Revenue Code ("Section 382"). Based on our preliminary Section 382 analysis, we do not believe that our current net operating loss carryforwards are subject to these limitations as of September 30, 2017. However, until we complete a final Section 382 analysis upon filing of our 2017 income tax return, there can be no assurances that our preliminary analysis is accurate or complete. Should we identify any limitations upon the completion of our final Section 382 analysis, the impact could be material to our consolidated financial statements and that we could incur additional income tax expense arising from the sale of the Cold-EEZE<sup>®</sup> Business.

For the nine months ended September 30, 2017, we charged to discontinued operations \$3.4 million for estimated federal and state income taxes arising from the sale of the Cold-EEZE<sup>®</sup> Business and we have realized an income tax benefit from continuing operations of \$1.3 million as a consequence of the utilization of the federal and state net operating losses.

Subsequent to the income tax effects arising from the sale of the Cold-EEZE<sup>®</sup> Business, we will continue to have net operating loss carry-forwards for federal income tax purposes. 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.

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

**Note 8– Commitments and Contingencies**

Escrow Receivable

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

Pursuant to the terms of the Asset Purchase Agreement, we, Mylan, and an escrow agent entered into an Escrow Agreement at closing, pursuant to which Mylan deposited \$5 million of the aggregate purchase price for the Cold-EEZE<sup>®</sup> Business into an escrow account established with the Escrow Agent in order to satisfy, in whole or in part, certain of our indemnity obligations under the Asset Purchase Agreement. If, on the 18<sup>th</sup> month anniversary of the closing date, there are funds remaining in the escrow account, then the escrow account will be reduced by the difference, if a positive number, of (i) \$2.5 million minus (ii) the aggregate amount of all escrow claims asserted by Mylan prior to this date that have either been paid out of the escrow account or are pending as of such date, and, within two business days of such date, the Escrow Agent will disburse such difference, if a positive number, to us. Within two business days of the second anniversary of the closing date, the Escrow Agent will release any funds remaining in the escrow account to us minus any amounts being reserved for escrow claims asserted by Mylan prior to such date. Upon the resolution of any pending escrow claims, the Escrow Agent will, within two business days of receipt of joint instructions or a final order from a court (as described in the Escrow Agreement) disburse such reserved amount to the parties entitled to such funds.

Management does not believe that we will be subject to indemnity claims contemplated by the Asset Purchase Agreement. However, in the event that such a claim is made, and if successful, we would be required to pay Mylan pursuant to the indemnification provisions of the Asset Purchase Agreement which may reduce the amount we ultimately collect from escrow or could even require us to return a portion of the net proceeds received from the sale of the Cold-EEZE<sup>®</sup> Division.

Manufacturing Agreement

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

Transition Services Agreement

In connection with the Asset Purchase Agreement, we entered into a transition services agreement with Mylan to provide litigation support, insurance coverage, supply chain, customer support, finance, accounting, commercial advertising and packaging services, quality control, IT and research and development services to Mylan for time periods ranging from two to nine months from the closing date. We will continue to incur certain operating costs during the transition period to support Mylan.

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

**Note 8 – Commitments and Contingencies – continued**

Future Obligations:

We have estimated future minimum obligations over the next five years, including the remainder of Fiscal 2017, as follows (in thousands):

Fiscal Year	Employment Contracts
2017	169
2018	675
2019	169
2020	-
2021	-
Total	<u>\$ 1,013</u>

Other Commitments:

On September 27, 2017, we entered into an Employment Agreement Termination and Release Agreement with Robert V. Cuddihy, Jr., our former Chief Financial Officer (the “Termination Agreement”). The Termination Agreement provides that Mr. Cuddihy’s employment agreement will terminate effective September 30, 2017, and that on the expiration of the seven day revocation period from the date Mr. Cuddihy signs the Termination Agreement, and subject to his not having revoked the Termination Agreement prior to that time, we would pay Mr. Cuddihy a one-time lump sum payment of \$55,000 by October 15, 2017. The Termination Agreement contains a general release of claims in favor of us and other customary provisions. The one-time payment to Mr. Cuddihy was paid on October 20, 2017.

**Note 9 – Earnings (Loss) Per Share**

Basic earnings (loss) per share for continuing and discontinued operations are computed by dividing respective 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, 2017 and 2016 were 1,642,000 and 1,706,500, respectively.

For the three months ended September 30, 2017 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 three months ended September 30, 2017 there were 504,170 Common Stock Equivalents which were in the money, that were excluded from the loss per share computation as a consequence of their anti-dilutive effect. For the nine months ended September 30, 2017, for continuing operations diluted loss per share is the same as basic loss per share due to the inclusion of Common Stock Equivalents, would have an anti-dilutive effect on the loss per share from continuing operations. For the nine months ended September 30, 2017 there were 456,728 Common Stock Equivalents which were in the money, that were included in the fully diluted earnings per share from discontinued operations computation.

For the three months ended September 30, 2016 there were 519,162 Common Stock Equivalents which were in the money, that were included in the fully diluted earnings per share computation. For the nine months ended September 30, 2016, for continuing operations dilutive earnings (loss) per share is the same as basic earnings per share due to (i) the inclusion of 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, there were 342,248, Common Stock Equivalents which were in the money, that were excluded from the earnings (loss) per share computation as a consequence of their anti-dilutive effect.

**Note 10 – Subsequent Event**

On November 10, 2017, we announced our intention to commence a tender offer to purchase up to 1,700,000 shares of our Common Stock at a price per share of \$2.30 per share. We anticipate that the tender offer will be launched on or before November 20, 2017 and will remain open for at least 20 business days from initiation. If the maximum number of shares to be purchased in the tender offer were in fact tendered, the number of shares that would then be purchased in the tender offer represents approximately 13.7% of our currently issued and outstanding common shares. If stockholders tender more than 1,700,000 shares, the maximum sought in the tender offer, ProPhase will purchase shares from all stockholders who properly tender shares, on a pro rata basis, based on the aggregate number of shares tendered. The NASDAQ Official Closing Price of our Common Stock on November 9, 2017 was \$2.11 per share. As of November 10, 2017, we have approximately \$27.7 million in cash and cash equivalents and marketable securities, a portion of which will be used to fund the tender offer.

**ProPhase Labs, Inc. and Subsidiaries**  
**Management's Discussion and Analysis of**  
**Financial Condition and Results of Operations**

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

*The following discussion and analysis should be read in conjunction with our interim unaudited condensed financial statements and related notes included in this Quarterly Report on Form 10-Q/A ("Quarterly Report") which has been restated as discussed in Note 2 in the condensed consolidated financial statements and the audited financial statements and notes thereto as of and for the year ended December 31, 2016 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on February 24, 2017 (the "2016 Annual Report"). As used in this Quarterly Report, unless the context suggests otherwise, "we," "us," "our," or "ProPhase" refer to ProPhase Labs, Inc. and its subsidiaries and consolidated variable interest entities, unless the context otherwise requires.*

**Restatement and revision of the consolidated financial**

As discussed in the Explanatory Note, this Amendment to Form 10-Q/A (this Amendment), amends and restates the Company's consolidated financial statements and related disclosures in Part I, Item 2. "Financial Statements" as of and for the three months ended March 31, 2017 to reflect the correction of certain errors discussed in Note 2 *Restatement of Previously Issued Financial Statements*. Accordingly, the Management's Discussion and Analysis of Financial Condition and Results of Operations set forth below reflects the effects of these restatements and revisions.

**General**

ProPhase 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 health care products and cold remedy products that are offered to the general public. We are also engaged in the research and development of potential over-the-counter ("OTC") drug and natural base health products including supplements, personal care and cosmeceutical products.

On September 26, 2017, the Company appointed Monica Brady as the Company's Chief Accounting Officer, effective October 2, 2017. In this capacity, Ms. Brady will serve as the Company's principal financial officer and principal accounting officer.

**Discontinued Operations**

Prior to March 29, 2017, our flagship OTC drug brand was Cold-EEZE<sup>®</sup> and our principal product was Cold-EEZE<sup>®</sup> cold remedy zinc gluconate lozenges and various non-lozenge forms of our proprietary zinc gluconate formulation. On January 6, 2017, we signed an asset purchase agreement (as amended, the "Asset Purchase Agreement"), by and among the Company, Meda Consumer Healthcare Inc. ("MCH") and Mylan Inc. (together with MCH, "Mylan"), for the sale of assets by us to Mylan. The sale of assets (i) was subject to stockholder approval and other customary closing conditions and (ii) consisted principally of the sale of our intellectual property rights and other assets relating to our Cold-EEZE<sup>®</sup> brand and product line (collectively, referred to herein as the "Cold-EEZE<sup>®</sup> Business") to Mylan, including all current and pipeline over-the-counter allergy, cold, flu, multi-symptom relief and immune support treatments for adults and children to the extent each is, or is intended to be, branded "Cold-EEZE<sup>®</sup>", and all private label versions thereof, including all formulations and derivatives thereof as set forth in the Asset Purchase Agreement.

A special meeting of our stockholders was held on March 29, 2017 (the "Special Meeting"). At the Special Meeting, our stockholders approved the sale of assets and the transactions contemplated by the Asset Purchase Agreement. Effective March 29, 2017, we completed the sale of the Cold-EEZE<sup>®</sup> Business to Mylan. As a consequence of the sale of the Cold-EEZE<sup>®</sup> Business, for the three and nine months ended September 30, 2017 and 2016, we have classified as discontinued operations (i) the gain from the sale of the Cold-EEZE<sup>®</sup> Business, (ii) all income and expenses attributable to the Cold-EEZE<sup>®</sup> Business and (iii) the income tax expense attributed to the sale of the Cold-EEZE<sup>®</sup> Business. Excluded from the sale of the Cold-EEZE<sup>®</sup> Business were our accounts receivable and inventory, and we also retained all liabilities associated with our Cold-EEZE<sup>®</sup> Business operations arising prior to March 29, 2017.

**Continuing Operations and Product Development**

We continue to own and operate our manufacturing facility and manufacturing business in Lebanon, Pennsylvania, and our headquarters in Doylestown, Pennsylvania. As part of the sale of the Cold-EEZE<sup>®</sup> Business, we entered into a manufacturing agreement with Mylan and our wholly-owned subsidiary, Pharnaloz Manufacturing, Inc. ("PMI"), to supply various Cold-EEZE<sup>®</sup> lozenge products to Mylan. In addition to the production service we provide to Mylan under the manufacturing agreement, we produce OTC drug and dietary supplement lozenges and other products for other third party customers in addition to performing operational tasks such as warehousing, customer order processing and shipping. We will seek to expand our contract manufacturing operations through developing new products and creating new contract manufacturing opportunities.

**ProPhase Labs, Inc. and Subsidiaries**  
**Management's Discussion and Analysis of**  
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We are also pursuing a series of new product development and pre-commercialization initiatives in the OTC 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<sup>®</sup>. The TK Supplements<sup>®</sup> product line comprises of three men's health products: (i) Legendz XL<sup>®</sup> for sexual health, (ii) Triple Edge XL<sup>®</sup>, a daily energy booster plus testosterone support, and (iii) Super ProstaFlow Plus<sup>™</sup> for prostate and urinary health. 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. In addition to developing direct-to-consumer ("Direct Response") marketing strategies of Legendz XL<sup>®</sup>, we received initial product acceptance and shipped into a national chain drug retailer and to several regional retailers during the Fiscal 2017.

If we are successful in achieving retail distribution, we intend to ramp up the media spend for our Direct Response TV spots to support this retail launch with the added benefit that it should also generate additional direct to consumer sales. As with any new product launch, we anticipate losses from our TK Supplements<sup>®</sup> initiatives as we optimize our retail and direct response strategy. 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, new contract manufacturing applications and other new product opportunities consistent with our Company and brand image, and our standard of proven consumer benefit and efficacy.

On November 10, 2017, we announced our intention to commence a tender offer to purchase up to 1,700,000 shares of our Common Stock at a price per share of \$2.30 per share. We anticipate that the tender offer will be launched on or before November 20, 2017 and will remain open for at least 20 business days from initiation. If the maximum number of shares to be purchased in the tender offer were in fact tendered, the number of shares that would then be purchased in the tender offer represents approximately 13.7% of our currently issued and outstanding common shares. If stockholders tender more than 1,700,000 shares, the maximum sought in the tender offer, ProPhase will purchase shares from all stockholders who properly tender shares, on a pro rata basis, based on the aggregate number of shares tendered. The NASDAQ Official Closing Price of our Common Stock on November 9, 2017 was \$2.11 per share. As of November 10, 2017, we have approximately \$27.7 million in cash and cash equivalents and marketable securities, a portion of which will be used to fund the tender offer.

#### **Seasonality of the Business**

Our net sales are derived principally from our OTC health care and cold remedy products sold in the United States of America. 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. Revenues are generally at their lowest levels in the second quarter when customer demand generally declines.

#### **Financial Condition and Results of Operations**

##### **Results from Continuing Operations for the Three Months Ended September 30, 2017 (as restated) as Compared to the Three Months Ended September 30, 2016**

For the three months ended September 30, 2017, net sales were \$3.0 million as compared to \$1.4 million for the three months ended September 30, 2016. The increase in net sales from period to period is due principally to an increase in the timing of shipments of lozenge-based products including shipments to Mylan under the terms of the Manufacturing and Supply Agreement dated March 29, 2017.

Cost of sales for the three months ended September 30, 2017 were \$2.6 million as compared to \$1.2 million for the three months ended September 30, 2016. The increase in the cost of sales for the three months ended September 30, 2017 as compared to the three months ended September 30, 2016 is due to increased shipments during the period. Gross margins are generally influenced by fluctuations in quarter-to-quarter production volume, fixed production costs and related overhead absorption, raw ingredient costs, inventory mark to market write-downs, if any, 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, 2017 was \$150,000 as compared to \$153,000 for the three months ended September 30, 2016. The decrease of \$3,000 in sales and marketing expense for the three months ended September 30, 2017 as compared to the three months ended September 30, 2016 was principally due to a decrease in other sales costs.

General and administration ("G&A") expenses for the three months ended September 30, 2017 was \$1.1 million as compared to \$734,000 for the three months ended September 30, 2016. The increase of \$390,000 in G&A expense for the three months ended September 30, 2017 as compared to the three months ended September 30, 2016 was principally due to an increase in professional services, including the costs associated with consummating the Tender Offer (defined below), and personnel expenses.

Research and development costs during the three months ended September 30, 2017 were \$60,000, as compared to \$43,000 for the three months ended September 30, 2016. The increase in research and development costs was due principally to an increase in the amount and timing of our product development expenditures.

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Other income (expense) for the three months ended September 30, 2017 and 2016 was income of \$125,000 compared to an expense of \$53,000, respectively. The income for the three month ended September 30, 2017 was principally the result of the \$125,000 of interest income earned on investments in marketable securities and money markets. Other expense for the three months ended September 30, 2016 was principally comprised of the interest expense, inclusive of the warrant and loan origination costs, incurred pursuant to the terms of the secured promissory notes which were repaid on March 29, 2017.

For the three months ended September 30, 2016, results from operations for our Cold-EEZE<sup>®</sup> Business are classified as discontinued operations. The carve out of the discontinued operations are derived from identifying and carving out the specific assets, liabilities, net sales, cost of sales, operating expenses and interest expense associated with the Cold-EEZE<sup>®</sup> Business's operations. In addition, G&A, including personnel expenses, and bonuses, and research and development overhead costs incurred by us (for which the discontinued operation benefits from such resources) are allocated to discontinued operations based upon the percentage of the Cold-EEZE<sup>®</sup> Business's net sales to our consolidated net sales. For the three months ended September 30, 2016, (i) we allocated \$406,000 to G&A and (ii) \$77,000 to research and development expenses, in the accompanying condensed statements of operations. For the three months ended September 30, 2017, there was no costs incurred related to discontinued operations.

As a consequence of the effects of the above, the net loss from continuing operations for the three months ended September 30, 2017 was \$472,000, or (\$0.03) per share, as compared to a net loss of \$786,000, or (\$0.05) per share, for the three months ended September 30, 2016. Net loss from discontinued operations for the three months ended September 30, 2017 was \$305,000, or (\$0.02) per share, as compared to a net loss of \$953,000, or (\$0.06) per share, for the three months ended September 2016. Net loss for the three months ended September 30, 2017 was \$777,000, or (\$0.05) per share, as compared to a net income of \$167,000, or \$0.01 per share, for the three months ended September 30, 2016.

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**Results from Continuing Operations for the Nine Months Ended September 30, 2017 (as restated)  
as Compared to the Nine Months Ended September 30, 2016**

For the nine months ended September 30, 2017, net sales were \$5.7 million as compared to \$3.4 million for the nine months ended September 30, 2016. The increase in net sales from period to period is due principally to an increase in the timing of shipments of lozenge-based products including shipments to Mylan under the terms of the Manufacturing and Supply Agreement dated March 29, 2017.

Cost of sales for the nine months ended September 30, 2017 were \$5.1 million as compared to \$2.9 million for the nine months ended September 30, 2016. The increase in the cost of sales for the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 is due to increased shipments during the period. Gross margins are generally influenced by fluctuations in quarter-to-quarter production volume, fixed production costs and related overhead absorption, raw ingredient costs, inventory mark to market write-downs, if any, 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, 2017 was \$486,000 as compared to \$686,000 for the nine months ended September 30, 2016. The decrease of \$200,000 in sales and marketing expense for the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 was principally due to a decrease in advertising costs.

G&A expenses for the nine months ended September 30, 2017 were \$3.5 million as compared to \$2.9 million for the nine months ended September 30, 2016. The increase of \$629,000 in G&A expense for the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 was principally due to the net effect of (i) a one-time charge for certain obsolete equipment, offset by (ii) a decrease in professional and legal fees.

Research and development costs during the nine months ended September 30, 2017 was \$318,000 as compared to \$202,000 for the nine months ended September 30, 2016. The increase in research and development costs for the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 was due principally to an increase in the amount and timing of our product development expenditures.

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Other income (expense) for the nine months ended September 30, 2017 and 2016 was income of \$222,000 compared to an expense of \$158,000, respectively. Other income (expense) for the nine month ended September 30, 2017 was principally the result of the net effects of (i) \$150,000 of Mylan transition service fees earned by us and (ii) interest income of \$125,000 offset by (iii) interest expense, inclusive of the warrant and loan origination costs, of \$54,000 incurred pursuant to the terms of the secured promissory notes. Other income (expense) for the nine months ended September 30, 2016 was principally comprise of the interest expense, inclusive of the warrant and loan origination costs, incurred pursuant to the terms of the secured promissory notes which were repaid on March 29, 2017.

For the nine months ended September 30, 2017, we charged to discontinued operations \$3.4 million for estimated federal and state income taxes arising from the sale of the Cold-EEZE<sup>®</sup> Business and we have realized an income tax benefit from continuing operations of \$1.3 million as a consequence of the utilization of the federal and state net operating losses.

For the nine months ended September 30, 2017 and 2016, results from operations for our Cold-EEZE<sup>®</sup> Business are classified as discontinued operations. The carve out of the discontinued operations are derived from identifying and carving out the specific assets, liabilities, net sales, cost of sales, operating expenses and interest expense associated with the Cold-EEZE<sup>®</sup> Business's operations. In addition, G&A, including personnel expenses and bonuses, and research and development overhead expenses incurred by us (for which the discontinued operation benefits from such resources) are allocated to discontinued operations based upon the percentage of the Cold-EEZE<sup>®</sup> Business's net sales to our consolidated net sales. For the nine months ended September 30, 2017 and 2016, we allocated (i) \$348,000 and \$1.1 million, respectively, to G&A expenses and (ii) \$52,000 and \$172,000, respectively, to research and development expenses, in the accompanying statements of operations.

As a consequence of the sale of the Cold-EEZE<sup>®</sup> Business, we recorded a gain on the sale of the assets of \$42.4 million, net of \$3.4 million of income tax.

As a result of the effects of the above, the net loss from continuing operations for the nine months ended September 30, 2017 was \$2.1 million, or (\$0.13) per share, as compared to a net loss of \$3.4 million, or (\$0.20) per share, for the nine months ended September 30, 2016. Net income from discontinued operations for the nine months ended September 30, 2017 was \$42.9 million, or \$2.58 per share, as compared to net income of \$1.1 million, or \$0.07 per share, for the nine months ended September 30, 2016. Net income for the nine months ended September 30, 2017 was \$40.8 million, or \$2.45 per share, as compared to a net loss of \$2.3 million, or (\$0.13) per share, for the nine months ended September 30, 2016.

#### **Liquidity and Capital Resources**

Our aggregate cash, cash equivalents and marketable securities as of September 30, 2017 were \$27.5 million compared to \$441,000 at December 31, 2016. The increase of \$27.1 million in our cash balance for the nine months ended September 30, 2017 was principally due to the net effect of (i) the net proceeds of \$40.8 million, excluding the \$5.0 million escrow receivable, derived from the sale of the Cold-EEZE<sup>®</sup> Business, (ii) proceeds from the exercise of stock options and warrants of \$923,000, offset by (iii) payments of \$1.5 million to retire the secured promissory notes, (iv) payments of \$11.8 million for the repurchase our Common Stock pursuant to the terms of the Tender Offer and certain other stock purchase agreements and (v) capital expenditures of \$202,000.

#### **Tender Offer**

On August 25, 2017, we announced a tender offer to purchase up to 4.0 million shares of our Common Stock at a price of \$2.30 per share (the "Tender Offer"). The number of shares proposed to be purchased in the tender offer represented approximately 24.7% of the approximately 16.2 million shares of our Common Stock issued and outstanding as of August 21, 2017. The last reported sale price of our Common Stock on August 15, 2017, the last full trading day before we announced the Tender Offer, was \$2.13 per share.

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The Tender Offer expired on September 25, 2017. Subject to the terms of the Tender Offer, we accepted for purchase 4,323,335 shares of our Common Stock, including all "odd lots" validly tendered, at a purchase price of \$2.30 per share, for an aggregate purchase price of approximately \$9.9 million. Based on the final tabulation by American Stock Transfer & Trust Company, the Depository for the Tender Offer, 5,910,327 shares of our Common Stock were properly tendered and not withdrawn. We were informed by the Depository that, after giving effect to the priority for an aggregate amount of approximately 9,338 "odd lot" shares, the final proration factor for the remaining tendered shares is approximately 73%. Prior to the Tender Offer, an investor, BML Investment Partners, L.P. ("BLM"), owned 2,322,627 shares, or 13.6%, of our outstanding Common Stock. Pursuant to the terms of the Tender Offer, BML tendered and sold 1,695,305 shares of our Common Stock. In addition, Ted Karkus, our Chairman of the Board and Chief Executive Officer, Robert V. Cuddihy, Jr., our then Chief Operating Officer and Chief Financial Officer, and one of our directors tendered and sold 364,954, 358,621 and 4,379 shares of Common Stock, respectively.

Stock Purchase Agreements

On June 12, 2017 we entered into a Stock Purchase Agreement with each of Mark S. Leventhal, a former director of the Company, and certain other persons and entities associated and/or affiliated with Mr. Leventhal (the "Leventhal Holders"), pursuant to which we purchased all 1,061,980 shares of our Common Stock then held by the Leventhal Holders, representing an approximate 6.2% aggregate ownership interest (based on 17.2 million shares of common stock outstanding as of June 12, 2017). Upon consummation of the transactions, the Leventhal Holders ceased to hold any direct or indirect ownership interest in the Company.

Pursuant to the terms of the Stock Purchase Agreements, the total consideration paid by us to the Leventhal Holders for their shares was \$1,858,465, which amount was equal to the product of (i) \$1.75 multiplied by (ii) the number of shares purchased.

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 (the "Exchange Act"). 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.

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At September 30, 2017, 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 an effective registration statement.

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, 2017, we had working capital of approximately \$30.6 million and 2,450,000 shares of Common Stock available for sale under the 2015 Equity line. We believe our current working capital, cash required to fund 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.

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

Pursuant to the terms of the Asset Purchase Agreement, we, Mylan, and an escrow agent entered into an Escrow Agreement at closing, pursuant to which Mylan deposited \$5 million of the aggregate purchase price for the Cold-EEZE<sup>®</sup> Business into an escrow account established with the Escrow Agent in order to satisfy, in whole or in part, certain of our indemnity obligations under the Asset Purchase Agreement. If, on the 18<sup>th</sup> month anniversary of the closing date, there are funds remaining in the escrow account, then the escrow account will be reduced by the difference, if a positive number, of (i) \$2.5 million minus (ii) the aggregate amount of all escrow claims asserted by Mylan prior to this date that have either been paid out of the escrow account or are pending as of such date, and, within two business days of such date, the Escrow Agent will disburse such difference, if a positive number, to us. Within two business days of the second anniversary of the closing date, the Escrow Agent will release any funds remaining in the escrow account to us minus any amounts being reserved for escrow claims asserted by Mylan prior to such date. Upon the resolution of any pending escrow claims, the Escrow Agent will, within two business days of receipt of joint instructions or a final order from a court (as described in the Escrow Agreement) disburse such reserved amount to the parties entitled to such funds.

Our current cash position supports our (i) operations, (ii) reorganization costs associated with the sale of the Cold-EEZE<sup>®</sup> Business, (iii) current research and development expenditures and (iv) initial operating losses related to new products, including the launch of Legendz XL<sup>®</sup>. Additionally, we are active in exploring new product technologies, applications, product line extensions, new contract manufacturing applications and other new business opportunities consistent with our Company and brand image, and our standard of proven consumer benefit and efficacy.

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, our cash balances will decline. We may also use our cash to explore and/or acquire new product technologies, applications, product line extensions, new contract manufacturing applications and other new business opportunities. In the event that our available cash is insufficient to support such initiatives, we may need to incur indebtedness or issue Common Stock to finance plans for growth. Volatility in the credit markets and the liquidity of major financial institutions may have an adverse effect on our ability to fund our business strategy through borrowings, under either existing or newly created instruments in the public or private markets on terms that we believe to be reasonable, if at all.

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**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.

**Critical Accounting Policies and Estimates**

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 3 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.

Pursuant to the terms of the Asset Purchase Agreement, we are responsible for and continue to accept product returns of the Cold-EEZE<sup>®</sup> Business for product shipped prior to March 30, 2017. Additionally, pursuant to the terms of the Asset Purchase Agreement, we allocated and, in June 2017, issued a credit to Mylan in an aggregate of \$400,000 for future sales returns and allowances arising from certain product returns that were sold by us prior to March 30, 2017.

As of September 30, 2017 and December 31, 2016, we included a provision for sales allowances of zero and \$108,000, respectively. Additionally, accrued advertising and other allowances as of September 30, 2017 included (i) \$902,000 for estimated future sales returns and (ii) \$371,000 for cooperative incentive promotion costs. As of December 31, 2016, accrued advertising and other allowances included (i) \$1.2 million for estimated future sales returns and (ii) \$1.5 million for cooperative incentive promotion costs.

Income Taxes

As of December 31, 2016, we have net operating loss carry-forwards of approximately \$47.1 million for federal purposes that will expire beginning in Fiscal 2020 through 2036. Additionally, there are net operating loss carry-forwards of \$22.1 million for state purposes that will expire beginning in Fiscal 2020 through 2036.

We believe that a significant portion of our income tax liability arising from our taxable gain for federal and state income tax purposes from the sale of the Cold-EEZE<sup>®</sup> Business will be offset to the extent of our current year losses from operations, the write-off for tax purposes of the tax-basis of the Cold-EEZE<sup>®</sup> Business and the available net operating loss carryforwards at the federal and state levels. However, for state income tax purposes, based upon the available state net operating loss carryforwards and corresponding limitations, we estimate a net income tax expense arising from the sale of the Cold-EEZE<sup>®</sup> Business of \$2.1 million.

Utilization of net operating loss carryforwards may be subject to limitations as set forth in Section 382 of the Internal Revenue Code ("Section 382"). Based on our preliminary Section 382 analysis, we do not believe that our current net operating loss carryforwards are subject to these limitations as of September 30, 2017. However, until we complete a final Section 382 analysis upon filing of our 2017 income tax return, there can be no assurances that our preliminary analysis is accurate or complete. Should we identify any limitations upon the completion of our final Section 382 analysis, the impact could be material to our consolidated financial statements and that we could incur additional income tax expense arising from the sale of the Cold-EEZE<sup>®</sup> Business.

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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. This ASU, as amended, is effective for fiscal years and interim periods within those years beginning after December 15, 2017. We plan to adopt the provisions of the new standard in the first quarter of 2018. The Company is utilizing a comprehensive approach to assess the impact of the guidance on revenue. Additionally, the Company is evaluating the impact of the new guidance on disclosures, as well as the impact on controls to support the recognition. We do not believe that its adoption will not 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. We adopted the standard in January 2017 with no 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 adoption of this update will have 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 adoption of this update will have on our consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, "Income Taxes: Intra-Entity Transfers of Assets Other than Inventory". The new standard requires entities should recognize the income tax consequences of an asset other than inventory when the asset transfer occurs. The new guidance will be effective for fiscal years beginning after December 15, 2017 and requires a modified retrospective adoption through a cumulative effect adjustment directly to retained earnings as of the beginning of the period of adoption. We are currently evaluating the impact adoption of this update will have on our consolidated financial statements.

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**Forward-Looking Statements**

This Quarterly Report contains "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the 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 Quarterly 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 Quarterly 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 ability to grow our manufacturing business and operate it profitably;
- Our ability to successfully develop and commercialize our existing products and new products without leveraging the Cold-EEZE<sup>®</sup> brand name;
- 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 homeopathic and health care 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 the United States economy, 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;
- Other risks identified in this Quarterly Report.

You should also consider carefully the statements under other sections of this Quarterly Report and our 2016 Annual Report, 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 Quarterly 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 Principal Accounting 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, 2017. Based on this evaluation, our Chief Executive Officer and Principal Accounting Officer have concluded that, as of that date and due to the material weakness described below, the Company’s disclosure controls and procedures were not 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 Principal Accounting Officer, as appropriate, to allow timely decisions regarding required disclosure. During the quarter ended September 30, 2017, 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. In addition, management has begun implementation of some of the remediation measures in August 2018 to address the material weakness identified as a result of the Restatement.

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.

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

Our management conducted an evaluation of our effectiveness of the system of internal control over financial reporting based on the framework in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework).

Following the filing of our original 2017 Form 10-K and during the financial statement close process for the quarter ended June 30, 2018, in connection with the preparation of our 2017 Federal and State income tax returns, management identified a material weakness that existed as of September 30, 2017 and at December 31, 2017, primarily related to our lack of adequate controls over the accounting for recording of income tax expense and the allocation of income tax expense/ benefit between continuing and discontinued operations.

#### Plan for Material Weakness in Internal Control over Financial Reporting

Starting in August 2018, the Company's management has begun to design and implement certain remediation measures to address the above-described material weakness and enhance the Company's internal control over financial reporting. We will take the following actions to improve the design and operating effectiveness of our internal control in order to remediate this material weakness:

As part of our remediation measure, the Company has identified and will implement plans to enhance the Company's process and controls including ensuring adequate, resources, use of tax accounting experts and management oversight with respect to the review of income tax reporting and disclosures.

## Part II. Other Information

### Item 1. Legal Proceedings.

The Company is not currently involved in any legal proceeding arising in the normal course of business. From time to time, the Company could become involved in disputes and various litigation matters that arise in the normal course of business. These may include disputes and lawsuits related to intellectual property, licensing, contract law and employee relations matters.

### Item 1A. Risk Factors.

There have been no material changes to the risks described in Item 1A. Risk Factors of our Quarterly Reports on Form 10-Q filed with the SEC on May 15, 2017, except as follows:

*We have identified a material weakness in our internal control over financial reporting which, if not timely remediated, may adversely affect the accuracy and reliability of our financial statements, and our reputation, business and the price of our common stock, as well as lead to a loss of investor confidence in us.*

In completing our Federal and State tax preparation review procedures during the second quarter of 2018, the Company identified errors in the treatment of the Net Operating Loss (NOL) limitations and our treatment of the amount of tax benefit allocated to continuing operations. We did not perform an effective risk assessment related to our internal controls over the accounting for income taxes. As a result, we identified a deficiency in the design of our internal control over financial reporting related to our accounting for income taxes, which affected the recording of income tax accounts by us in our interim and annual consolidated financial statements during 2017, including audit adjustments to the income tax accounts. As described under “Item 4. Controls and Procedures” above, our management has concluded that this deficiency constitutes a material weakness in our internal control over financial reporting and, accordingly, internal control over financial reporting and our disclosure controls and procedures were not effective as of December 31, 2017.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim consolidated financial statements will not be prevented or detected on a timely basis.

While we have developed and are in the process of implementing a remediation plan to remediate this material weakness, there can be no assurance that this will occur in 2018. We may identify additional material weaknesses in our internal control over financial reporting in the future. If we are unable to remediate this material weakness or we identify additional material weaknesses in our internal control over financial reporting in the future, our ability to analyze, record and report financial information accurately, to prepare our financial statements within the time periods specified by the rules and forms of the SEC and to otherwise comply with our reporting obligations under the federal securities laws and our long-term debt and credit agreements will likely be adversely affected. The occurrence of, or failure to remediate, this material weakness and any future material weaknesses in our internal control over financial reporting may adversely affect the accuracy and reliability of our financial statements, and our reputation, business and the price of our Common Stock or any other securities we may issue, as well as lead to a loss of investor confidence in us.

### 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**

<b>Exhibit No.</b>	<b>Description</b>
10.1	<a href="#"><u>Employment Agreement Termination and Release Agreement, dated September 27, 2017, by and between ProPhase Labs, Inc. and Robert V. Cuddihy, Jr. (incorporated by reference to Exhibit 10.1 to the Form 8-K (File No. 002-21617) filed on October 2, 2017).</u></a>
31.1	<a href="#"><u>Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u></a>
31.2	<a href="#"><u>Certification by the Chief Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u></a>
32.1	<a href="#"><u>Certification by the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u></a>
32.2	<a href="#"><u>Certification by the Chief Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u></a>
101.INS#	XBRL Instance Document
101.SCH#	XBRL Taxonomy Extension Schema Document
101.CAL#	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF#	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB#	XBRL Taxonomy Extension Label Linkbase Document
101.PRE#	XBRL Taxonomy Extension Presentation Linkbase Document

**SIGNATURES**

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

**ProPhase Labs, Inc.**

By: /s/ Ted Karkus

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

Date: August 20, 2018

By: /s/ Monica Brady

Monica Brady  
Chief Accounting Officer  
(Principal Accounting Officer)

Date: August 20, 2018



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

Date: August 20, 2018

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

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

I, Monica Brady., certify that:

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

Date: August 20, 2018

By: /s/ Monica Brady

Monica Brady  
Chief Accounting Officer  
(Principal Accounting and Financial Officer)

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**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/A for the period ended September 30, 2017, 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*

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Ted Karkus  
Chairman of the Board and Chief Executive Officer  
(Principal Executive Officer)  
August 20, 2018

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

I, Monica Brady, Chief Accounting Officer of ProPhase Labs, Inc., a Delaware corporation (the "Registrant"), in connection with the Registrant's Quarterly Report on Form 10-Q/A for the period ended September 30, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), do hereby represent, warrant and certify, in compliance with Rule 13a-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

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

*/s/ Monica Brady*

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Monica Brady  
Chief Accounting Officer  
(Principal Accounting and Financial Officer)  
August 20, 2018

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