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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

OR

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

For the transition period from _____ to _____

Commission file number 0-21617

ProPhase Labs, Inc.

(Exact name of registrant as specified in its charter)

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

(215) 345-0919

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or shorter period that the registration was required to submit such files). Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company (See definition of "large accelerated filer", "accelerated filer", "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 [X]
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 [X]

Securities Registered Pursuant to Section 12(b) of the Exchange Act:

Title of Each Class	Trading Symbol	Name of Each Exchange on Which Registered
Common Stock, par value $0.0005	PRPH	Nasdaq Capital Market

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 May 14, 2019
Common Stock, $0.0005 par value	11,560,256

ProPhase Labs, Inc. and Subsidiaries

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	March 31, 2019 (Unaudited)	December 31, 2018
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,450	$ 1,554
Marketable debt securities, available for sale	4,229	6,687
Escrow receivable	4,830	4,830
Accounts receivable, net	788	2,968
Inventory	1,611	1,903
Prepaid expenses and other current assets	218	296
Total current assets	14,126	18,238
Property, plant and equipment, net of accumulated depreciation of $5,955 and $5,854, respectively	2,446	2,499
TOTAL ASSETS	**$ 16,572**	**$ 20,737**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 258	$ 437
Accrued advertising and other allowances	101	101
Dividend payable	-	2,929
Other current liabilities	511	766
Total current liabilities	870	4,233
COMMITMENTS AND CONTINGENCIES	**-**	**-**
Stockholders' equity		
Preferred stock authorized 1,000,000, $.0005 par value, no shares issued	-	-
Common stock authorized 50,000,000, $.0005 par value, issued 28,208,707 and 28,201,541 shares, respectively	14	14
Additional paid-in capital	59,667	59,471
Retained earnings	3,520	4,533
Treasury stock, at cost, 16,652,022 and 16,652,022 shares, respectively	(47,490)	(47,490)
Accumulated comprehensive loss	(9)	(24)
Total stockholders' equity	15,702	16,504
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 16,572**	**$ 20,737**

See accompanying notes to condensed consolidated financial statements

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

	For the Three Months ended	
	March 31, 2019	**March 31, 2018**
Net sales	$ 2,318	$ 3,407
Cost of sales	1,798	1,982
Gross profit	520	1,425
Operating expenses:		
Sales and marketing	266	172
Administration	1,204	1,219
Research and development	94	87
Total operating expenses	1,564	1,478
Loss from operations	(1,044)	(53)
Interest income, net	31	96
Net income (loss)	**$ (1,013)**	**$ 43**
Other comprehensive income (loss):		
Unrealized gain (loss) on marketable debt securities	15	(43)
Total comprehensive loss	$ (998)	$ -
Basic earnings (loss) per share	$ (0.09)	$ -
Diluted earnings (loss) per share	$ (0.09)	$ -
Weighted average common shares outstanding:		
Basic	11,557	11,130
Diluted	11,557	11,413

See accompanying notes to condensed consolidated financial statements

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

	Common Stock Shares Outstanding, Net of Shares of Treasury Stock	Par Value	Additional Paid in Capital	Retained Earnings	Accumulated Comprehensive Loss	Treasury Stock	Total
Balance as of January 1, 2019	**11,549,519**	**$ 14**	**$ 59,471**	**$ 4,533**	**$ (24)**	**$ (47,490)**	**$ 16,504**
Unrealized gain on marketable debt securities, net realized losses of $4	-	-	-	-	15	-	15
Stock based compensation	7,166	-	196	-	-	-	196
Net loss	-	-	-	(1,013)	-	-	(1,013)
Balance as of March 31, 2019	**11,556,685**	**$ 14**	**$ 59,667**	**$ 3,520**	**$ (9)**	**$ (47,490)**	**$ 15,702**

	Common Stock Shares Outstanding, Net of Shares of Treasury Stock	Par Value	Additional Paid in Capital	Retained Earnings	Accumulated Comprehensive Loss	Treasury Stock	Total
Balance as of January 1, 2018	**11,129,892**	**$ 14**	**$ 58,034**	**$ 20,902**	**$ (78)**	**$ (47,025)**	**$ 31,847**
Unrealized loss on marketable debt securities, net realized gain of $15	-	-	-	-	(43)	-	(43)
Stock based compensation	-	-	31	-	-	-	31
Net income	-	-	-	43	-	-	43
Balance as of March 31, 2018	**11,129,892**	**$ 14**	**$ 58,065**	**$ 20,945**	**$ (121)**	**$ (47,025)**	**$ 31,878**

See accompanying notes to condensed consolidated financial statements

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

	For the Three Months ended	
	March 31, 2019	**March 31, 2018**
Cash flows from operating activities		
Net (loss) income	$ (1,013)	$ 43
Adjustments to reconcile net (loss) income to net cash provided by/(used in) operating activities:		
Realized gain on marketable debt securities	3	15
Depreciation and amortization	101	95
Stock-based compensation expense	196	31
Changes in operating assets and liabilities:		
Accounts receivable	2,180	161
Inventory	292	(479)
Prepaid and other assets	78	(80)
Accounts payable and accrued expenses	(179)	(18)
Other current liabilities	(255)	105
Acccrued sales allowance, discontinued operations	-	(61)
Assets held for sale	-	22
Net cash provided by (used in) operating activities	1,403	(166)
Cash flows from investing activities		
Purchase of marketable securities	-	(5,764)
Proceeds from maturities of marketable debt securities	-	5,695
Proceeds from sale of marketable debt securities	2,470	450
Capital expenditures	(48)	-
Net cash provided by investing activities	2,422	381
Cash flows from financing activities		
Payment of dividends	(2,929)	-
Net cash used in financing activities	(2,929)	-
Increase in cash and cash equivalents	896	215
Cash and cash equivalents, at the beginning of the period	1,554	3,173
Cash and cash equivalents, at the end of the period	**$ 2,450**	**$ 3,388**
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ -	$ -
Income taxes paid	$ -	$ -
Supplemental disclosure of non-cash investing and financing activities:		
Net unrealized gain (loss), investments in marketable debt securities	$ 15	$ (43)
Change in escrow receivable	$ -	$ 5,000

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 as a corporation in Nevada in July 1989. Effective June 18, 2015, we changed our state of incorporation from the State of Nevada to the State of Delaware. We are a vertically integrated and diversified branding, marketing and technology company engaged in the research, development, manufacture, distribution, marketing and sale of over-the-counter ("OTC") consumer healthcare products, dietary supplements and other remedies in the United States. This includes the development and marketing of dietary supplements under the TK Supplements® brand.

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

In August 2017, we formed ProPhase Digital Media, Inc. ("PDM"), a Delaware corporation and wholly-owned subsidiary. Our objective is for PDM to become an independent full-service direct marketing agency. PDM's first initiative will be to market the TK Supplements® product line. If successful, this may lead to the marketing of other companies' consumer products.

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

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

Note 2 – Summary of Significant Accounting Policies

For the three months ended March 31, 2019 and 2018, our revenues have come principally from OTC health care contract manufacturing and sales to retail customers of dietary supplement products.

Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial statements and within the rules of the Securities and Exchange Commission ("SEC") applicable to interim financial statements and therefore do not include all disclosures that might normally be required for financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The accompanying unaudited condensed consolidated financial statements have been prepared by management without audit and should be read in conjunction with our consolidated financial statements, including the notes thereto, appearing in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018. 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 months ended March 31, 2019 are not necessarily indicative of operating results that may be achieved over the course of the full year.

Product Innovation, Seasonality of the Business and Liquidity

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

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

As a consequence of the scope and timing of our TK Supplements® product market acceptance and the seasonality of our business, we realize variations in operating results and demand for working capital from quarter to quarter. As of March 31, 2019, we had working capital of approximately $13.3 million, including $4.2 million of marketable debt securities, which are available for sale. We believe our current working capital at March 31, 2019 is at an acceptable and adequate level to support our business for at least the next twelve months.

Use of Estimates

The preparation of financial statements and the accompanying notes thereto, in conformity with 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 Debt Securities

We have classified our investments in marketable debt securities as available-for-sale and as a current asset. Our investments in marketable debt 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 debt securities are recorded as interest income (expense). We initiated short term investments in marketable debt securities, which carry maturity dates between one and three years from date of purchase with interest rates of 1.23% - 3.25%, during the first quarter of Fiscal 2019. For the three months ended March 31, 2019, we reported an unrealized gain of $15,000 and an accumulated unrealized loss of $9,000. 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 debt securities and the underlying fair value input level tier hierarchy (see long-lived assets below) (in thousands):

	As of March 31, 2019		
	Amortized Cost	Unrealized Losses	Market Value
U.S treasuries	$ 430	$ (3)	$ 427
Corporate bonds	3,808	(6)	3,802
	$ 4,238	$ (9)	$ 4,229

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

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

Inventory

Inventory is valued at the lower of cost, determined on a first-in, first-out basis (FIFO), or net realizable value. Inventory items are analyzed to determine cost and the net realizable value and appropriate valuation adjustments are established. At March 31, 2019, after the 2019 write-off of certain inventory previously recorded, the financial statements include adjustments to reduce inventory for excess, obsolete or short-dated shelf-life inventory of $372,000, inclusive of adjustments of $267,000 for product samples of TK Supplements® products. At March 31, 2019, the inventory adjustment for excess, obsolete or short-dated shelf-life inventory included $128,000 in finished goods and $244,000 in raw material and work in process. At December 31, 2018, the financial statements include adjustments to reduce inventory for excess, obsolete or short-dated shelf-life inventory of $377,000, inclusive of an adjustment of $270,000 for product samples of TK Supplements® products. At December 31, 2018, the inventory adjustment for excess, obsolete or short-dated shelf-life inventory included $319,000 in finished goods and $58,000 in raw material and work in process. The components of inventory are as follows (in thousands):

	March 31, 2019	December 31, 2018
Raw materials	$ 1,096	$ 1,374
Work in process	243	371
Finished goods	272	158
	$ 1,611	$ 1,903

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. We use the straight-line method in computing depreciation for financial reporting purposes. Depreciation expense is computed in accordance with the following ranges of estimated asset lives: building and improvements –ten to thirty-nine years; machinery and equipment – three to seven years; computer equipment and software – three to five years; and furniture and fixtures – five years. We have reviewed our property, plant and equipment for the three months ended March 31, 2019 and 2018 and concluded there were no impairments or changes in useful lives.

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. The manufacturing and distribution of OTC healthcare and dietary supplement products are subject to regulations by various federal, state and local agencies, including the Food and Drug Administration ("FDA") and, as applicable, the Homeopathic Pharmacopoeia of the United States.

Financial instruments that potentially subject us to significant concentrations of credit risk consist principally of cash investments, marketable debt 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 March 31, 2019, our cash and cash equivalents balance was $2.5 million and our bank balance was $2.6 million. Of the total bank balance, $250,000 was covered by federal depository insurance and $2.3 million was uninsured at March 31, 2019.

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

Long-lived Assets

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

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

Fair Value of Financial Instruments

Cash and cash equivalents, marketable debt securities, accounts receivable, accounts payable, and accrued expenses are reflected in the Condensed Consolidated Financial Statements at carrying value which approximates fair value. We account for our marketable debt securities at fair value pursuant to GAAP, with the net unrealized gains or losses reported as a component of accumulated other comprehensive income or loss.

	As of March 31, 2019			
	Level 1	**Level 2**	**Level 3**	**Total**
Marketable debt securities				
U.S. government obligations	$ -	$ 427	$ -	$ 427
Corporate obligations	-	3,802	-	3,802
	$ -	$ 4,229	$ -	$ 4,229

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

There were no transfers of marketable debt securities between Levels 1, 2 or 3 for the three months ended March 31, 2019 and December 31, 2018.

Revenue Recognition

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

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

Performance Obligations

We generate sales principally through two types of customers, contract manufacturing and retail customers. Sales from product shipments to contract manufacturing and retailer customers are recognized at the time ownership is transferred to the customer. Net sales from contract manufacturing and retail customers was $2.1 million and $0.2 million, respectively, for the three months ended March 31, 2019 and $3.3 million and $77,000, respectively, for the three months ended March 31, 2018. Revenue from retailer customers is reduced for trade promotions, estimated sales returns, cash discounts and other allowances in the same period as the related sales are recorded. No such allowance is applicable to our contract manufacturing customers. We make estimates of potential future product returns and other allowances related to current period revenue. We analyze historical returns, current trends, and changes in customer and consumer demand when evaluating the adequacy of the sales returns and other allowances.

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

Transaction Price

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

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

Recognize Revenue When the Company Satisfies a Performance Obligation

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

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

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

As of March 31, 2019 and December 31, 2018, we included a provision for sales allowances from operations of $4,000 and $1,000, respectively, which are reported as a reduction to account receivables. Additionally, accrued advertising and other allowances from discontinued operations as of March 31, 2019 included (i) $154,000 for estimated returns, which is reported as a reduction to account receivables, and (ii) $78,000 for cooperative incentive promotion costs, which is reported as accrued advertising and other allowances under current liabilities. As of December 31, 2018, accrued advertising and other allowances from discontinued operations included (i) $181,000 for estimated future sales returns, which is reported as a reduction to account receivables, and (ii) $88,000 for cooperative incentive promotion costs, which is reported as accrued advertising and other allowances under current liabilities.

As of March 31, 2019, we have deferred revenue of $119,000 in relation to Research and Development ("R&D") stability and release testing programs. Deferred revenues primarily consist of amounts that have been billed to or received from customers in advance of revenue recognition and prepayments received from customers in advance for implementation, maintenance and other services, as well as initial subscription fees. We recognize deferred revenues as revenues when the services are performed and the corresponding revenue recognition criteria are met. Customer prepayments are generally applied against invoices issued to customers when services are performed and billed.

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

Recognition Period	Deferred Revenue
0-12 Months	$ 97,123
13-24 Months	22,220
Total	$ 119,343

Disaggregation of Revenue

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

The following table disaggregates the Company's revenue by revenue source for the three months ended March 31, 2019 and 2018 (in thousands):

	For the Three Months ended	
Revenue by Customer Type	March 31, 2019	March 31, 2018
Contract manufacturing	$ 2,124	$ 3,330
Retail and others	194	77
Total revenue	$ 2,318	$ 3,407

Sales Tax Exclusion from the Transaction Price

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

Shipping and Handling Activities

We account for shipping and handling activities we perform after a customer obtains control of the good as activities to fulfill the promise to transfer the good.

Advertising and Incentive Promotions

Advertising and incentive promotion costs are expensed within the period in which they are utilized. Advertising and incentive promotion expense is comprised of (i) media advertising, presented as part of sales and marketing expense, (ii) cooperative incentive promotions and coupon program expenses, which are accounted for as part of net sales, and (iii) free product, which is accounted for as part of cost of sales. Advertising and incentive promotion expenses incurred for the three months ended March 31, 2019 and 2018 were $27,000 and $5,000, respectively.

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. We account for forfeitures as they occur.

Stock and stock options for the purchase of our common stock, $0.0005 par value ("Common Stock"), have been granted to both employees and non-employees pursuant to the terms of certain agreements and stock option plans (see Note 4). Stock options are exercisable during a period determined by us, but in no event later than seven years from the date granted.

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 March 31, 2019 and 2018 were $94,000 and $87,000, 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, dietary supplements and other remedies.

Income Taxes

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

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

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

Recently Adopted Accounting Standards

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

In August 2018, the SEC adopted SEC Final Rule Release No. 33-10532, Disclosure Update and Simplification, which amended certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements regarding stockholders' equity for interim financial statements. Under the amendments, a description of the changes in each caption of stockholders' equity presented in the balance sheet must be provided in a note or separate statement. The description must include a reconciliation of the beginning balance to the ending balance of each period for which a statement of comprehensive income is required to be filed. The condensed consolidated financial statements included in this Quarterly Report include a reconciliation of the beginning balance to the ending balance of stockholders' equity for each period in which a statement of operations and comprehensive income (loss) is provided.

Recently Issued Accounting Standards, Not Yet Adopted

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 potential impact of the adoption of this update on our consolidated financial statements.

Note 3 – Property, Plant and Equipment

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

	March 31, 2019	December 31, 2018	Estimated Useful Life
Land	$ 504	$ 504	
Building improvements	3,107	3,059	10-39 years
Machinery	4,126	4,126	3-7 years
Computer equipment	457	457	3-5 years
Furniture and fixtures	207	207	5 years
	8,401	8,353	
Less: accumulated depreciation	(5,955)	(5,854)	
Total property, plant and equipment, net	$ 2,446	$ 2,499	

Depreciation expense incurred for the three months ended March 31, 2019 and 2018 was $101,000 and $95,000, respectively.

Note 4 – Transactions Affecting Stockholders' Equity

Our authorized capital stock consists of 50 million shares of Common Stock, $0.0005 par value ("Common Stock") and 1 million shares of preferred stock, $0.0005 par value ("Preferred Stock").

Preferred Stock

The Preferred Stock authorized under our certificate of incorporation may be issued from time to time in one or more series. As of March 31, 2019, 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.

Common Stock Dividend

On December 24, 2018, the Board declared a special cash dividend of $0.25 per share on the Company's Common Stock resulting in $2.9 million payable on January 24, 2019 to holders of record of the Company's Common Stock on January 10, 2019. On January 24, 2019, we made cash payment of $2.9 million.

The 2010 Directors' Equity Compensation Plan

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

During the three months ended March 31, 2019, 7,166 shares of Common Stock were granted to our directors under the 2010 Directors' Plan. We recorded $23,000 of director fees during the three months ended March 31, 2019 in connection with these grants, which represented the fair value of the shares calculated based on the average closing price of the Company's shares of Common Stock for the first five trading days of the quarter in which the Board fee was earned. No shares were granted during the three months ended March 31, 2018.

As of March 31, 2019, there were 375,694 shares of Common Stock that may be issued pursuant to the terms of the 2010 Directors' Plan.

The 2010 Equity Compensation Plan

On May 5, 2010, our stockholders approved the 2010 Equity Compensation Plan, which has been subsequently amended and restated by our stockholders (the "2010 Plan"). The 2010 Plan provides that the total number of shares of Common Stock that may be issued under the 2010 Plan is 3.9 million shares. No options were granted under the 2010 Plan for the three months ended March 31, 2019 or 2018. In addition, no stock options were exercised during the three months ended March 31, 2019 or 2018. As of March 31, 2019, there were 649,500 options outstanding and 661,159 options available to be issued pursuant to the terms of the 2010 Plan. We will recognize approximately $440,372 over that 2.5 years.

The 2018 Stock Incentive Plan

On April 12, 2018, our stockholders approved the 2018 Stock Incentive Plan (the "2018 Stock Plan"). The 2018 Stock Plan provides for the grant of incentive stock options to eligible employees of the Company, and for the grant of nonstatutory stock options to eligible employees, directors and consultants. The purpose of the 2018 Stock Plan is to advance the interests of the Company and its stockholders by providing an incentive to attract, retain, and reward persons performing services for the Company and by motivating such persons to contribute to the growth and profitability of the Company. The 2018 Stock Plan provides that the total number of shares that may be issued pursuant to the 2018 Stock Plan is 2.3 million shares. As of September 30, 2018, all 2.3 million shares have been granted in the form of stock options to Ted Karkus (the "CEO Option"), our Chief Executive Officer and no stock options have been exercised under the 2018 Stock Plan. We use the Black-Scholes option pricing model to determine the fair value of the stock options at the date of grant. Based upon our limited historical experience, we determined the expected term of the stock option grants to be 4.5 years, calculated using the "simplified" method in accordance with the SEC Staff Accounting Bulletin 110. We use the "simplified" method since our historical data does not provide a reasonable basis upon which to estimate expected term. We will recognize approximately $965,481 over that 1.9 years.

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

The following table summarizes stock options activities during the three months ended March 31, 2019 for both the 2010 Plan and 2018 Stock Plan (in thousands, except per share data):

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Total Intrinsic Value
Outstanding as of January 1, 2019	2,980	$ 1.82	4.8	$ 3,235
Forfeited	(30)	2.35	-	-
Outstanding as of March 31, 2019	2,950	$ 1.87	4.2	$ 3,396
Options vested and exercisable	858	$ 1.88	3.9	$ 1,079

Note 5 – Defined Contribution Plans

We maintain the ProPhase Labs, Inc. 401(k) Savings and Retirement Plan, a defined contribution plan for our employees. Our contributions to the plan are based on the amount of the employee plan contributions and compensation. Our contributions to the plan in during the three months ended March 31, 2019 and 2018 were $21,000 and $22,000, respectively.

Note 6 – Other Accrued Liabilities

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

	March 31, 2019	December 31, 2018
Accrued expenses	$ 108	$ 167
Accrued benefits	58	24
Accrued payroll	56	195
Accrued vacation	62	66
Sales tax payable	105	3
Income taxes payable	3	106
Deferred revenue	119	206
Total other current liabilities	$ 511	$ 766

Note 7– Commitments and Contingencies

Escrow Receivable

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

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

The terms of the Escrow Agreement provide that if, as of September 29, 2018, 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. In addition, within two business days of March 29, 2019, the Escrow Agent will release any funds remaining in the escrow account to us minus any amounts being reserved for escrow claims asserted by Mylan prior to such date. Upon the resolution of any pending escrow claims, the Escrow Agent 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. As described below, in August 2018, Mylan asserted an indemnification claim against us, for a yet to be determined amount. Accordingly, the distributions was not released to us on September 29, 2018 or March 29, 2019.

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

On August 2, 2018, we received notice of an indemnification claim from Mylan in relation to certain product advertising claims brought against Mylan related to certain Cold-EEZE® products. Pursuant to the terms of the asset purchase agreement, we have elected to assume the defense of these claims on behalf of Mylan. We dispute these product advertising claims and intend to vigorously contest such claims. While we believe these claims are without merit, in the event that these or any other indemnity claims are successful, we may be required to pay Mylan such amounts out of the escrow fund, 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® Business if the escrow funds are insufficient to cover the losses. Management expects to collect the full remaining escrow balance within the next twelve months, net of an immaterial reserve representative of our best estimate of the cost to adjudicate this matter.

Manufacturing Agreement

In connection with the asset purchase agreement, the Company and its wholly-owned subsidiary, PMI, entered into a manufacturing agreement (the "Manufacturing Agreement") with Mylan. Pursuant to the terms of the Manufacturing Agreement, Mylan (or an affiliate or designee) purchased the inventory of the Company's Cold-EEZE® 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.

Future Obligations:

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

	Employment Contracts
2019	$ 94
2020	125
2021	595
2022	675
2023	675
Total	$ 2,164

Note 8 – Earnings (Loss) Per Share

Basic earnings (loss) per share for continuing operations are computed by dividing the 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 outstanding to acquire shares of our Common Stock at March 31, 2019 and December 31, 2018 were 2,950,000 and 2,980,000, respectively.

For the three months ended March 31, 2019, dilutive earnings (loss) per share were the same as basic earnings per share due to the exclusion of Common Stock in the form of stock options ("Common Stock Equivalents"), which in a net loss position would have an anti-dilutive effect on loss per share. For the three months ended March 31, 2019, there were 2,950,000 potential dilutive Common Stock Equivalents that were excluded from the earnings (loss) per share computation as a consequence of their anti-dilutive effect. For the three months ended March 31, 2018, there were 282,867 Common Stock Equivalents that were in the money that were included in the fully diluted earnings per share computation and 2,300,000 options was excluded from the calculation.

Note 9 – Significant Customers

Revenue for the three months ended March 31, 2019 and 2018 was $2.3 million and $3.4 million, respectively. Three third-party contract manufacturing customers accounted for 45.7%, 23.9% and 12.3%, respectively, of our revenue for the three months ended March 31, 2019. Two third-party contract manufacturing customers accounted for 48.2% and 33.2%, respectively, of our revenues for the three months ended March 31, 2018. The loss of sales to either of these large third-party contract manufacturing customers could have a material adverse effect on our business operations and financial condition.

We are subject to account receivable credit concentrations from time-to-time as a consequence of the timing, payment pattern and ultimate purchase volumes or shipping schedules with our customers. These concentrations may impact our overall exposure to credit risk, either positively or negatively, in that our customers may be similarly affected by changes in economic, regulatory or other conditions that may impact the timing and collectability of amounts due to us. Two customers represented 35% and 23% of our total trade receivable balances at March 31, 2019 and 82% of our total trade receivable balances at December 31, 2018, respectively.

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 ("Quarterly Report") and the audited financial statements and notes thereto as of and for the year ended December 31, 2018 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 March 26, 2019 (the "2018 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.

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 Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements. Many of these factors are beyond our ability to predict. Given the risks and uncertainties surrounding forward-looking statements, you should not place undue reliance on these statements. Forward-looking statements typically are identified by use of terms such as "anticipate", "believe", "plan", "expect", "intend", "may", "will", "should", "estimate", "predict", "potential", "continue" and similar words although some forward-looking statements are expressed differently. This Quarterly Report may contain forward-looking statements attributable 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 that there are many important risks, uncertainties and other factors that could cause our actual results, levels of activity, performance, achievements and prospects, as well as those of the markets we serve, to differ materially from the forward-looking statements contained in this 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 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 fund our operations including the cost and availability of capital and credit;
- Our ability to grow our manufacturing business and operate it profitably;
- Potential disruptions in our ability to manufacture our products and those of others or our access to raw materials;
- Our ability to successfully develop and commercialize our existing products and new 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 those we manufacture for others, 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;
- Seasonal fluctuations in demand for the products we manufacture at our manufacturing facility; and
- Our ability to attract, retain and motivate our key employees.

You should also consider carefully the statements we make under other sections of this Quarterly Report and in our 2018 Annual Report, as well as in other documents we file from time to time with the SEC, that 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, except as required by law.

General

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

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

In August 2017, we formed ProPhase Digital Media Inc. ("PDM"), a Delaware corporation and wholly-owned subsidiary. Our objective is for PDM to become an independent full-service direct marketing agency. PDM's first initiative will be to market the TK Supplements® product line. If successful, this may lead to the marketing of other companies' consumer products.

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

Financial Condition and Results of Operations
Results from Operations for the Three Months Ended March 31, 2019
as Compared to the Three Months Ended March 31, 2018

For the three months ended March 31, 2019, net sales were $2.3 million as compared to $3.4 million for the three months ended March 31, 2018. The decrease in net sales from period to period was principally due to a decrease in contract manufacturing net sales.

Cost of sales for the three months ended March 31, 2019 were $1.8 million as compared to $2.0 million for the three months ended March 31, 2018. For the three months ended March 31, 2019 and 2018, we realized a gross margin of 22.4% and 41.8%, respectively. The decrease of 19.4% in gross margin from the prior period is principally due to (i) a decrease in the absorption of fixed production costs and (ii) fluctuations in our product mix shipped from period to period. Gross margins are generally influenced by fluctuations in quarter-to-quarter production volume, fixed production costs and related overhead absorption, raw ingredient costs, inventory mark to market write-downs, if any and timing of shipments to customers.

Sales and marketing expense for the three months ended March 31, 2019 was $266,000 as compared to $172,000 for the three months ended March 31, 2018. The increase of $94,000 in sales and marketing expense for the three months ended March 31, 2019 as compared to the three months ended March 31, 2018 was principally due to the development costs associated with launching TK Supplements product lines during the current period.

Administration expenses for the three months ended March 31, 2019 were $1.2 million as compared to $1.2 million for the three months ended March 31, 2018. Administrative expenses for the three months ended March 31, 2019 were consistent with administrative expenses for the three months ended March 31, 2018.

Research and development costs during the three months ended March 31, 2019 were $94,000, as compared to $87,000 for the three months ended March 31, 2018. The increase of $7,000 in research and development costs for the three months ended March 31, 2019 as compared to the three months ended March 31, 2018 was principally due to the timing of product research expenses in the current period.

Interest income for the three months ended March 31, 2019 and 2018 was $31,000 and $96,000, respectively. The decrease in interest income for the three months ended March 31, 2019 as compared to March 31, 2018 was principally due a lower balance in our investment account available to earn interest.

As a consequence of the effects of the above, the net loss for the three months ended March 31, 2019 was approximately $1.0 million, or ($0.09) per share as compared to net income of $43,000, or $0.00 per share for the three months ended March 31, 2018.

Liquidity and Capital Resources

Our aggregate cash and cash equivalents and marketable debt securities as of March 31, 2019 were $6.7 million as compared to $8.2 million at December 31, 2018. Our working capital was $13.3 million and $14.0 million as of March 31, 2019 and December 31, 2018, respectively. The decrease of $1.5 million in our cash and cash equivalents and marketable securities balance for the three months ended March 31, 2019 was principally due to the $2.9 million payment of a $0.25 special cash dividend in January 2019 offset by, (i) higher cash balance in our investment account and (ii) cash provided by operating activities.

General

We believe our current working capital is an acceptable and adequate level of working capital to support our business for at least the next twelve months.

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 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 product opportunities. In the event that our available cash is insufficient to support such initiatives, we may need to incur indebtedness or issue Common Stock to finance plans for growth. Volatility in the credit markets and the liquidity of major financial institutions may have an adverse effect on our ability to fund our business strategy through borrowings, under either existing or newly created instruments in the public or private markets on terms that we believe to be reasonable, if at all.

Off-Balance Sheet Arrangements

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

Impact of Inflation

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

Critical Accounting Policies and Estimates

The condensed consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"), which require the use of estimates, judgments and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of expenses in the periods presented. We believe that the accounting estimates employed are appropriate and resulting balances are reasonable; however, due to inherent uncertainties in making estimates, actual results could differ from the original estimates, requiring adjustments to these balances in future periods. The critical accounting estimates that affect the consolidated financial statements and the judgments and assumptions used are consistent with those described under Part II, Item 7 of the 2018 Annual Report.

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 excessive exposure to market risks associated with interest rates. The impact on our results of one percentage point change in short-term interest rates would not have a material impact on our future earnings, fair value, or cash flows related to investments in cash equivalents or interest-earning marketable securities.

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

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that material information required to be disclosed by us in the reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms, and that the information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. We performed an evaluation, under the supervision and with the participation of our management, including our principal executive officer (our Chief Executive Officer) and our principal financial officer (our Chief Financial Officer), of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on this review, our Chief Executive Officer and Chief Financial Officer concluded that due to the material weakness described in the 2018 Annual Report, the Company's disclosure controls and procedures were not effective at the reasonable assurance level as of the end of the period covered by this Quarterly Report.

Changes in Internal Control Over Financial Reporting

As part of our plan to remediate the deficiency in internal controls described in the 2018 Annual Report, management continued to take steps to improve our income tax controls during the three months ended March 31, 2019, including consulting with our third-party tax consultant throughout the period while formalizing our review procedures. In addition, we implemented a new tax provision software during the three months ended March 31, 2019 to strengthen the transparency in the overall tax process. We will continue to assess and enhance our internal control processes and retrain personnel in the accounting department.

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 the 2018 Annual Report.

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

Exhibit No.	Description
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification by the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification by the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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: May 14, 2019

By: */s/ Monica Brady*
Monica Brady
Chief Financial Officer
(Principal Financial Officer)

Date: May 14, 2019

EXHIBIT 31.1

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

I, Ted Karkus, certify that:

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

2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Quarterly Report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f) for the registrant and have:

   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;

   (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2019

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

EXHIBIT 31.2

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

I, Monica Brady, certify that:

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

2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Quarterly Report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f) for the registrant and have:

   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;

   (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2019

By: */s/ Monica Brady*
Monica Brady
Chief Financial Officer
(Principal Financial Officer)

EXHIBIT 32.1

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

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

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ Ted Karkus

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

May 14, 2019

EXHIBIT 32.2

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

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

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ Monica Brady
Monica Brady
Chief Financial Officer
(Principal Financial Officer)

May 14, 2019