

CYBERLUX CORP  
Form 10-Q  
November 14, 2008

**U.S. SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10QSB**

(Mark One)

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2008.

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934

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

For the Period Ended September 30, 2008

Commission file number 000-33415

**CYBERLUX CORPORATION**  
(Name of Small Business Issuer in Its Charter)

Nevada  
(State of Incorporation)

91-2048978  
(IRS Employer Identification No.)

4625 Creekstone Drive  
Suite 130  
Research Triangle Park  
Durham, NC 27703

(Address of Principal Executive Offices)

(919) 474-9700  
Issuer's Telephone Number

Indicate by check mark whether the issuer (1) 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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated Filer  accelerated filer  non-accelerated filer  Smaller reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Number of shares outstanding of the issuer's Common Stock as of November 14, 2008: 766,426,120

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CYBERLUX CORPORATION

Quarterly Report on Form 10-Q for the  
Quarterly Period Ending September 30, 2008

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**CYBERLUX CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	(unaudited) September 30, 2008	December 31, 2007
<b>ASSETS</b>		
Current assets:		
Cash & cash equivalents	\$ 290	\$ 626
Accounts receivable, net of allowance for doubtful accounts of \$1,803	53,927	77,815
Inventories, net of allowance of \$43,333	54,251	157,379
Other current assets	17,500	10,000
<b>Total current assets</b>	<b>125,968</b>	<b>245,820</b>
Property, plant and equipment, net of accumulated depreciation of \$189,338 and \$169,171, respectively	54,440	74,607
Other assets		
Deposits	24,400	24,400
Patents and development costs, net of accumulated amortization of \$1,214,056 and \$819,639, respectively	2,760,918	3,155,335
<b>Total other assets</b>	<b>2,785,318</b>	<b>3,179,735</b>
<b>Total Assets</b>	<b>\$ 2,965,726</b>	<b>\$ 3,500,162</b>
<b>LIABILITIES AND DEFICIENCY IN STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Cash overdraft	\$ 7,137	\$ 33,178
Accounts payable	1,050,295	733,538
Accrued liabilities	2,978,209	2,345,133
Short-term notes payable - related parties	418,823	397,064
Short-term notes payable	39,804	196,067
Short-term convertible notes payable	4,805,175	3,050,510
<b>Total current liabilities</b>	<b>9,299,443</b>	<b>6,755,490</b>
Long-term liabilities:		
Derivative liability relating to convertible debentures	23,899,079	17,334,621
Warrant liability relating to convertible debentures	977,938	4,509,538
<b>Total long-term liabilities</b>	<b>24,877,017</b>	<b>21,844,159</b>
<b>Total liabilities</b>	<b>34,176,460</b>	<b>28,599,649</b>
Commitments and Contingencies		

Redeemable Series A convertible preferred stock, \$0.001 par value; 200 shares designated, 26.9806 and 28.9806 issued and outstanding as of September 30, 2008 and December 31, 2007; liquidation preference of \$219,892 and \$231,845 as of September 30, 2008 and December 31, 2007, respectively	134,900	144,900
<b>DEFICIENCY IN STOCKHOLDERS' EQUITY</b>		
Class B convertible preferred stock, \$0.001 par value, 3,650,000 shares designated; 3,650,000 shares issued and outstanding for September 30, 2008 and December 31, 2007; liquidation preference of \$3,650,000 as of September 30, 2008 and December 31, 2007	3,650	3,650
Class C convertible preferred stock, \$0.001 par value, 700,000 shares designated; 150,000 shares issued and outstanding for September 30, 2008 and December 31, 2007, liquidation preference of \$3,910,490 and \$3,823,230, as of September 30, 2008 and December 31, 2007, respectively	150	150
Common stock, \$0.001 par value, 900,000,000 shares authorized; 717,713,999 and 552,342,881 shares issued and outstanding as of September 30, 2008 and December 31, 2007	717,714	552,343
Additional paid-in capital	17,162,032	15,286,709
Accumulated deficit	(49,229,180)	(41,087,239)
Deficiency in stockholders' equity	(31,345,634)	(25,244,387)
Total liabilities and (deficiency) in stockholders' equity	\$ 2,965,726	\$ 3,500,162

The accompanying notes are an integral part of these condensed consolidated financial statements

**CYBERLUX CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
<b>REVENUE:</b>	\$ 69,256	\$ 298,459	\$ 401,162	\$ 521,814
Cost of goods sold	(47,295)	(227,932)	(267,815)	(402,608)
Gross margin (loss)	21,961	70,527	133,347	119,206
<b>OPERATING EXPENSES:</b>				
Depreciation	6,209	5,332	20,167	16,981
Research and development	—	42,466	1,386	121,951
General and administrative expenses	1,351,634	629,606	2,890,873	2,865,387
Total operating expenses	1,357,843	677,404	2,912,426	3,004,319
<b>NET LOSS FROM OPERATIONS</b>	<b>(1,335,882)</b>	<b>(606,877)</b>	<b>(2,779,079)</b>	<b>(2,885,113)</b>
Debt forgiveness	—	—	—	381,652
Unrealized gain (loss) relating to adjustment of derivative and warrant liability to fair value of underlying securities	2,754,714	(56,164,992)	(3,032,859)	(65,227,499)
Interest expense, net	(517,553)	(631,731)	(1,887,066)	(1,829,729)
Debt acquisition costs	9,289	(34,381)	(442,423)	(77,751)
Net Income (loss) before provision for income taxes	910,568	(57,437,981)	(8,141,427)	(69,638,440)
Income taxes (benefit)	—	—	515	—
<b>INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS</b>	<b>\$ 910,568</b>	<b>\$ (57,437,981)</b>	<b>\$ (8,141,942)</b>	<b>\$ (69,638,440)</b>
Weighted average number of common shares outstanding-basic	667,942,486	494,297,678	602,506,202	327,087,037
Weighted average number of common shares outstanding-fully diluted	Note A			
Income (loss) per share-basic	\$ 0.00	\$ (0.12)	\$ (0.01)	\$ (0.21)
Loss per share-fully diluted	Note A			
Preferred dividend	\$ 24,000	\$ 24,000	\$ 72,000	\$ 72,000

The accompanying notes are an integral part of these condensed consolidated financial statements

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**CYBERLUX CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW**  
**(unaudited)**

Nine months ended September 30,  
2008 2007

**CASH FLOWS FROM OPERATING  
ACTIVITIES:**

Net income (loss) available to common stockholders	\$ (8,141,942)	\$ (69,638,440)
Adjustments to reconcile net income (loss) to cash used in operating activities		
Depreciation	20,167	16,981
Amortization	394,417	394,417
Common stock issued in connection issuance of debt	385,108	—
Common stock issued in connection with services rendered	878,800	118,110
Preferred stock issued as compensation	—	370,500
Gain on repurchase and cancellation of warrants		(381,652)
Beneficial conversion feature relating to convertible debenture	184,736	—
Accretion of convertible notes payable	1,254,665	1,408,058
Unrealized (gain) loss on adjustment of derivative and warrant liability to fair value of underlying securities	3,032,858	65,227,499
(Increase) decrease in:		
Accounts receivable	23,888	85,272
Inventories	103,128	88,393
Prepaid expenses and other assets	(7,500)	12,543
Increase (decrease) in:		
Cash overdraft	(26,041)	68,350
Accounts payable	372,758	92,929
Accrued liabilities	633,076	343,689
Net cash (used in) operating activities	(891,882)	(1,793,351)

**CASH FLOWS FROM INVESTING  
ACTIVITIES:**

Net cash acquired in connection with acquisition of Hybrid Lighting Technologies, Inc	—	150,000
Acquisition of fixed assets	—	(11,314)
Net cash provided by (used in) investing activities:	—	138,686

**CASH FLOWS FROM FINANCING  
ACTIVITIES:**

Net proceeds from issuance of convertible debentures	500,000	1,000,000
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Proceeds from sale of common stock	526,050		
Proceeds from exercise of warrants	—		—
Proceeds from sale of warrants	—		158,723
Net proceeds (payments) from borrowing on long term basis	(156,263)		20,290
Net proceeds (payments) to notes payable, related parties	21,759		81,470
Net cash provided by (used in) financing activities:	891,546		1,260,483
Net increase (decrease) in cash and cash equivalents	(336)		(394,182)
Cash and cash equivalents at beginning of period	626		395,812
Cash and cash equivalents at end of period	\$ 290	\$	1,630
Supplemental disclosures:			
Interest Paid	\$ —	\$	—
Income Taxes Paid	—		—
NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Unrealized (gain) loss in adjustment of derivative and warrant liability to fair value of underlying securities	\$ 3,032,858	\$	65,227,499
Common stock issued for services rendered	\$ 878,800	\$	118,110
Preferred stock issued as compensation	\$ —	\$	370,500

The accompanying notes are an integral part of these condensed consolidated financial statements

**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE A-SUMMARY OF ACCOUNTING POLICIES**

General

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Accordingly, the results from operations for the three and nine month periods ended September 30, 2008, are not necessarily indicative of the results that may be expected for the year ended December 31, 2008. The unaudited condensed financial statements should be read in conjunction with the December 31, 2007 financial statements and footnotes thereto included in the Company's Form 10-KSB for the year ended December 31, 2007.

Business and Basis of Presentation

Cyberlux Corporation (the "Company") is incorporated on May 17, 2000 under the laws of the State of Nevada. Until December 31, 2004, the Company was a development state enterprise as defined under Statement on Financial Accounting Standards No.7, Development Stage Enterprises ("SFAS No.7"). The Company develops, manufactures and markets long-term portable lighting products for commercial and industrial users. While the Company has generated revenues from its sale of products, the Company has incurred expenses, and sustained losses. Consequently, its operations are subject to all risks inherent in the establishment of a new business enterprise. As of September 30, 2008, the Company has accumulated losses of \$49,229,180.

The consolidated financial statements include the accounts of its wholly owned subsidiaries, SPE Technologies, Inc. and Hybrid Lighting Technologies, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

Revenue Recognition

Revenues are recognized in the period that products are provided. For revenue from product sales, the Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, REVENUE RECOGNITION ("SAB104"), which superseded Staff Accounting Bulletin No. 101, REVENUE RECOGNITION IN FINANCIAL STATEMENTS ("SAB101"). SAB 101 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the selling price is fixed and determinable; and (4) collectability is reasonably assured. Determination of criteria (3) and (4) are based on management's judgments regarding the fixed nature of the selling prices of the products delivered and the collectability of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments are provided for in the same period the related sales are recorded. The Company defers any revenue for which the product has not been delivered or is subject to refund until such time that the Company and the customer jointly determine that the product has been delivered or no refund will be required. At September 30, 2008 and December 31, 2007, the Company did not have any deferred revenue.

SAB 104 incorporates Emerging Issues Task Force 00-21 (“EITF 00-21”), MULTIPLE DELIVERABLE REVENUE ARRANGEMENTS. EITF 00-21 addresses accounting for arrangements that may involve the delivery or performance of multiple products, services and/or rights to use assets. The effect of implementing EITF 00-21 on the Company’s financial position and results of operations was not significant.

Reclassification

Certain reclassifications have been made in prior year’s financial statements to conform to classifications used in the current year.

Concentrations of Credit Risk

Financial instruments and related items which potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents and trade receivables. The Company places its cash and temporary cash investments with credit quality institutions. At times, such investments may be in excess of the FDIC insurance limit. The Company periodically reviews its trade receivables in determining its allowance for doubtful accounts. At September 30, 2008 and December 31, 2007, allowance for doubtful receivable was \$1,803 and \$8,646, respectively.

**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE A-SUMMARY OF ACCOUNTING POLICIES (continued)**

Stock based compensation

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123R (revised 2004), "Share-Based Payment" which is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation". Statement 123R supersedes APB opinion No. 25, "Accounting for Stock Issued to Employees", and amends FASB Statement No. 95, "Statement of Cash Flows". Generally, the approach in Statement 123R is similar to the approach described in Statement 123. However, Statement 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro-forma disclosure is no longer an alternative. This statement does not change the accounting guidance for share based payment transactions with parties other than employees provided in Statement of Financial Accounting Standards No. 123(R). This statement does not address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans." On April 14, 2005, the SEC amended the effective date of the provisions of this statement. The effect of this amendment by the SEC is that the Company had to comply with Statement 123R and use the Fair Value based method of accounting no later than the first quarter of 2006. The Company implemented SFAS No. 123(R) on January 1, 2006 using the modified prospective method. The fair value of each option grant issued after January 1, 2006 was determined as of grant date, utilizing the Black-Scholes option pricing model. The amortization of each option grant will be over the remainder of the vesting period of each option grant.

As more fully described in Note G, the Company granted stock options over the years to employees of the Company under a non-qualified employee stock option plan. As of September 30, 2008, 52,432,307 stock options were outstanding and exercisable.

In prior years, the Company applied the intrinsic-value method prescribed in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," to account for the issuance of stock options to employees and accordingly compensation expense related to employees' stock options were recognized in the prior year financial statements to the extent options granted under stock incentive plans had an exercise price less than the market value of the underlying common stock on the date of grant.

Net Income (loss) Per Common Share

The Company computes earnings per share under Statement of Financial Accounting Standards No. 128, "Earnings Per Share" ("SFAS 128"). Net earnings (losses) per common share is computed by dividing net income (loss) by the weighted average number of shares of common stock and dilutive common stock equivalents outstanding during the period. Dilutive common stock equivalents consist of shares issuable upon conversion of convertible preferred shares and the exercise of the Company's stock options and warrants (calculated using the treasury stock method). During the three and nine months ended September 30, 2008 and 2007, common stock equivalents are not considered in the calculation of the weighted average number of common shares outstanding because they would be anti-dilutive, thereby decreasing the net loss per common share.

The following reconciliation of net income and share amounts used in the computation of income (loss) per share for the three months ended September 30, 2008:

	Three Months Ended September 30, 2008
Net income used in computing basic net income per share	\$ 910,568
Impact of assumed assumptions:	
Accretion of convertible debenture charged to interest expense	374,575
Impact of equity classified as liability:	
Gain on warrant liability marked to fair value	(2,754,714)
Net loss in computing diluted net loss per share:	\$ (1,469,571)

The weighted average shares outstanding used in the basic net income per share computations for the three months ended September 30, 2008 was 667,942,486. In determining the number of shares used in computing diluted loss per share, the Company did not add approximately 5,340,576,417 potentially dilutive securities for the three months ended September 30, 2008 because the effect would be anti-dilutive. The potentially dilutive securities added were mostly attributable to the warrants, options and convertible debentures outstanding. As a result, the diluted loss per share for the three months ended September 30, 2008 was \$0.00.

**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE A-SUMMARY OF ACCOUNTING POLICIES (continued)**Patents

The Company acquired in December 2006, for \$2,270,000, and January 2007, for \$1,387,000, patents in conjunction with the acquisitions of SPE Technologies, Inc and Hybrid Lighting Technologies, Inc, respectively. The patents have an estimated useful life of 7 years. Accordingly, the Company recorded an amortization charge to current period earnings of \$394,417 for the nine months ended September 30, 2008 and 2007. Patents are comprised of the following:

Description	Cost	Accumulated amortization and impairments	Net carrying value at September 30, 2008
Development costs	\$ 293,750	\$ 293,750	\$ -0-
Patents	2,294,224	573,556	1,720,668
Patents	1,387,000	346,750	1,040,250
Total	\$ 3,974,974	\$ 1,214,056	\$ 2,760,918

Derivative Financial Instruments

The Company's derivative financial instruments consist of embedded derivatives related to the 10% Secured Convertible Debentures (see Note D). These embedded derivatives include certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company record the derivatives and related warrants at their fair values as of the inception date of the Note Agreement and at fair value as of each subsequent balance sheet date. In addition, under the provisions of EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," as a result of entering into the Notes, the Company is required to classify all other non-employee stock options and warrants as derivative liabilities and mark them to market at each reporting date. Any change in fair value inclusive of modifications of terms will be recorded as non-operating, non-cash income or expense at each reporting date. If the fair value of the derivatives is higher at the subsequent balance sheet date, the Company will record a non-operating, non-cash charge. If the fair value of the derivatives is lower at the subsequent balance sheet date, the Company will record non-operating, non-cash income. Conversion-related derivatives were valued using the intrinsic method and the warrants using the Black Scholes Option Pricing Model with the following assumptions: dividend yield of 0%; annual volatility of 591%; and risk free interest rate from 0.98% to 2.98%. The derivatives are classified as long-term liabilities.

Registration rights

In with raising capital through the issuance of Convertible Notes, the Company has issued convertible debentures and warrants in that have registration rights with liquidated damages for the underlying shares. As the contract must be settled by the delivery of registered shares and the delivery of the registered shares is not controlled by the Company, pursuant to EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the net value of the of the underlying embedded derivative and warrants at the date of issuance was recorded as liabilities on the balance sheet. Liquidated damages are estimated and accrued as a liability at each

reporting date. The Company has accrued an estimated \$816,586 in liquidation damages.

Recent accounting pronouncements

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115*" ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendment to SFAS No. 115 "*Accounting for Certain Investments in Debt and Equity Securities*" applies to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provision of SFAS No. 157, "*Fair Value Measurements*". The adoption of SFAS No. 159 is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE A-SUMMARY OF ACCOUNTING POLICIES (continued)**

Recent accounting pronouncements (continued)

In December 2007, the FASB issued SFAS No. 141(R), "*Business Combinations*" ("SFAS No. 141(R)"), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. SFAS No. 141R is effective as of the beginning of the first fiscal year beginning on or after December 15, 2008. Earlier adoption is prohibited and the Company is currently evaluating the effect, if any that the adoption will have on its consolidated financial position results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, "*Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51*" ("SFAS No. 160"), which will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity within the consolidated balance sheets. SFAS No. 160 is effective as of the beginning of the first fiscal year beginning on or after December 15, 2008. Earlier adoption is prohibited and the Company is currently evaluating the effect, if any that the adoption will have on its consolidated financial position results of operations or cash flows.

In June 2007, the Accounting Standards Executive Committee issued Statement of Position 07-1, "Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies" ("SOP 07-1"). SOP 07-1 provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide Investment Companies (the "Audit Guide"). SOP 07-1 was originally determined to be effective for fiscal years beginning on or after December 15, 2007, however, on February 6, 2008, FASB issued a final Staff Position indefinitely deferring the effective date and prohibiting early adoption of SOP 07-1 while addressing implementation issues.

In June 2007, the FASB ratified the consensus in EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services to be Used in Future Research and Development Activities" (EITF 07-3), which requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development (R&D) activities be deferred and amortized over the period that the goods are delivered or the related services are performed, subject to an assessment of recoverability. EITF 07-3 will be effective for fiscal years beginning after December 15, 2007. The Company does not expect that the adoption of EITF 07-3 will have a material impact on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB ratified the consensus in EITF Issue No. 07-1, "Accounting for Collaborative Arrangements" (EITF 07-1). EITF 07-1 defines collaborative arrangements and requires collaborators to present the result of activities for which they act as the principal on a gross basis and report any payments received from (made to) the other collaborators based on other applicable authoritative accounting literature, and in the absence of other applicable authoritative literature, on a reasonable, rational and consistent accounting policy is to be elected. EITF 07-1 also provides for disclosures regarding the nature and purpose of the arrangement, the entity's rights and obligations, the accounting policy for the arrangement and the income statement classification and amounts arising from the agreement. EITF 07-1 will be effective for fiscal years beginning after December 15, 2008, which will be the Company's fiscal year 2009, and will be applied as a change in accounting principle retrospectively for all collaborative arrangements existing as of the effective date. The Company has not yet evaluated the potential impact

of adopting EITF 07-1 on our consolidated financial position, results of operations or cash flows.

In March 2008, the FASB” issued SFAS No. 161, “*Disclosures about Derivative Instruments and Hedging Activities - an amendment to FASB Statement No. 133*” (“SFAS No. 161”). SFAS No. 161 is intended to improve financial standards for derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. Entities are required to provide enhanced disclosures about: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years beginning after November 15, 2008, with early adoption encouraged. We are currently evaluating the impact of SFAS No. 161, if any, will have on our consolidated financial position, results of operations or cash flows.

**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE A-SUMMARY OF ACCOUNTING POLICIES (continued)**Recent accounting pronouncements (continued)

In April 2008, the FASB issued FSP No. FAS 142-3, "*Determination of the Useful Life of Intangible Assets*". This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "*Goodwill and Other Intangible Assets*". We are required to adopt FSP 142-3 on September 1, 2009, earlier adoption is prohibited. The guidance in FSP 142-3 for determining the useful life of a recognized intangible asset shall be applied prospectively to intangible assets acquired after adoption, and the disclosure requirements shall be applied prospectively to all intangible assets recognized as of, and subsequent to, adoption. We are currently evaluating the impact of FSP 142-3 on our consolidated financial position, results of operations or cash flows.

In May 2008, the FASB issued SFAS No. 162, "*The Hierarchy of Generally Accepted Accounting Principles*" ("SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). SFAS No. 162 will become effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." We do not expect the adoption of SFAS No. 162 will have a material effect on our consolidated financial position, results of operations or cash flows.

In May 2008, the FASB issued FSP Accounting Principles Board ("APB") 14-1 "*Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*" ("FSP APB 14-1"). FSP APB 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer's non-convertible debt borrowing rate. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008 on a retroactive basis. We are currently evaluating the potential impact, if any, of the adoption of FSP APB 14-1 on our consolidated financial position, results of operations or cash flows.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not, or are not believed by management to, have a material impact on the Company's present or future consolidated financial statements.

**NOTE B-CONVERTIBLE DEBENTURES**

Notes payable at September 30, 2008 and December 31, 2007:

	September 30, 2008			December 31, 2007		
	Gross Principal Amount	Less: Unamortized Discount	Net	Gross Principal Amount	Less: Unamortized Discount	Net
10% convertible note payable, unsecured and	\$ 2,500	—\$	2,500	\$ 2,500	—\$	2,500

due September, 2003;  
 accrued and unpaid  
 interest due at maturity;  
 Note holder has the  
 option to convert note  
 principal together with  
 accrued and unpaid  
 interest to the Company's  
 common stock at a rate  
 of \$0.50 per share. The  
 Company is in violation  
 of the loan covenants

10% convertible  
 debenture, due three  
 years from date of the  
 note with interest payable  
 quarterly during the life  
 of the note. The note is  
 convertible into the  
 Company's common  
 stock at the lower of a)  
 \$0.03 or b) 25% of the  
 average of the three  
 lowest intraday trading  
 prices for the common  
 stock on a principal  
 market for twenty days  
 before, but not including,  
 conversion date. The  
 Company granted the  
 note holder a security  
 interest in substantially  
 all of the Company's  
 assets and intellectual  
 property and registration  
 rights. The Company is  
 in violation of the loan  
 covenants (see below)

	\$ 1,094,091		—\$ 1,094,091		\$ 1,094,091		\$ 158,665		\$ 935,426
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**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

	September 30, 2008			December 31, 2007		
	Gross Principal Amount	Less: Unamortized Discount	Net	Gross Principal Amount	Less: Unamortized Discount	Net
10% convertible debenture, due three years from date of the note with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a) \$0.6 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. The Company is in violation of the loan covenants (see below)	\$ 800,000	\$ 16,804	\$ 783,196	\$ 800,000	\$ 216,986	\$ 583,014
8% convertible debenture, due three years from date of the note with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading	700,000	56,256	643,744	700,000	231,416	468,584

prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights (see below)

8% convertible debenture, due March 2009 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)

500,000	80,822	419,178	500,000	205,936	294,064
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6% convertible debenture, due July 2009 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days

500,000	136,986	363,014	500,000	262,100	237,900
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before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)

6% convertible debenture, due September 2009 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)

	\$	280,000	\$	92,055	\$	187,945	\$	280,000	\$	162,119	\$	117,881
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**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

	September 30, 2008			December 31, 2007		
	Gross Principal Amount	Less: Unamortized Discount	Net	Gross Principal Amount	Less: Unamortized Discount	Net
6% convertible debenture, due December 2009 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)	\$ 600,000	\$ 243,836	\$ 356,164	\$ 600,000	\$ 393,973	\$ 206,027
8% convertible debenture, due April 2010 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days	400,000	206,027	193,973	400,000	306,119	93,881

before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)

8% convertible debenture, due May 2010 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)

150,000	79,041	70,959	150,000	116,575	33,425
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8% convertible debenture, due June 2010 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the

150,000	83,288	66,712	150,000	120,822	29,178
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note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)

8% convertible debenture, due June 2010 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)

\$	150,000	\$	87,260	\$	62,740	\$	150,000	\$	124,795	\$	25,205
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**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
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**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

	September 30, 2008			December 31, 2007		
	Gross Principal Amount	Less: Unamortized Discount	Net	Gross Principal Amount	Less: Unamortized Discount	Net
<p>8% convertible debenture, due July 2010 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)</p>	\$ 150,000	\$ 89,041	\$ 60,959	\$ 150,000	\$ 126,575	\$ 23,425
<p>6% convertible debenture (warrant), maturing March 2015 with interest accruing until conversion. The warrant is exercisable at the greater of a) \$0.012 or b) 75% of the average of three lowest intraday trading prices for the common stock on a principal market for</p>	\$ 500,000	—	500,000	\$ —	\$ —	—

twenty days before, but including, conversion date. The Company issued 6,763,300 shares of its common stock as security.

Total	5,976,591	(1,171,416)	4,805,175	5,476,591	(2,426,081)	3,050,510
Less: current maturities:	5,976,591	(1,171,416)	4,805,175	5,476,591	(2,426,081)	3,050,510
Long term portion	\$ -0-	\$ -0-	\$ 0-	\$ -0-	\$ -0-	\$ -0-

The Company entered into a Securities Purchase Agreement with four accredited investors on April 23, 2005 for the issuance of an aggregate of \$1,500,000 of convertible notes (“Convertible Notes”) and attached to the Convertible Notes was warrants to purchase 25,000,000 shares of the Company’s common stock. The Convertible Notes accrue interest at 10% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company’s common stock at a rate of the lower of a) \$0.03 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 270.43% per annum.

As of September 30, 2008, the Company issued to investors of the Convertible Notes a total amount of \$1,500,000 in exchange for total proceeds of \$1,352,067. The proceeds that the Company received were net of prepaid interest of \$72,933 representing the first eight month’s interest and related fees and costs of \$75,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on April 23, 2005. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$945,313 and \$554,687 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

- Requirement to pay principal and interest when due
- Provide shares of the Company’s common stock to the Holder(s) upon exercise by the Holder(s)
- Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness
- Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement
- Change of control
- Trading market limitations

**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
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**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2008 and December 31, 2007, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine months ended September 30, 2008 and 2007, the Company amortized the debt discount and charged to interest expense \$158,665 and \$75,669, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on October 24, 2005 for the issuance of \$800,000 of convertible notes ("Convertible Notes") and attached to the Convertible Notes was warrants to purchase 800,000 shares of the Company's common stock. The Convertible Note accrues interest at 10% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.06 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not

including, conversion date. The effective interest rate at the date of inception was 142.28% per annum.

As of September 30, 2008, the Company issued to investors of the Convertible Notes a total amount of \$800,000 in exchange for total proceeds of \$775,000. The proceeds that the Company received were net of related fees and costs of \$25,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on October 24, 2005. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$743,770 and \$56,230 to the embedded derivatives and related warrants, respectively.

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**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Securities Purchase Agreement contains the following covenants:

- Requirement to pay principal and interest when due
- Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)
- Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness
- Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement
- Change of control
- Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2008 and December 31, 2007, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable,

together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine months ended September 30, 2008 and 2007, the Company amortized the debt discount and charged to interest expense \$200,183 and \$200,183, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on December 28, 2005 for the issuance of \$700,000 of convertible notes ("Convertible Notes") and attached to the Convertible Notes were warrants to purchase 700,000 shares of the Company's common stock. The Convertible Note accrues interest at 8% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 158.81% per annum.

As of September 30, 2008, the Company issued to investors of the Convertible Notes a total amount of \$700,000 in exchange for total proceeds of \$675,000. The proceeds that the Company received were net of related fees and costs of \$25,000.

**CYBERLUX CORPORATION**  
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**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on December 28, 2005. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$655,921 and \$44,079 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

- Requirement to pay principal and interest when due
- Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)
- Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness
- Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement
- Change of control
- Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2008 and December 31, 2007, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall

collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine month period ended September 30, 2008 and 2007, the Company amortized the debt discount and charged to interest expense \$175,160 and \$174,521, respectively.

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**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company entered into a Securities Purchase Agreement with four accredited investors on March 31, 2006 for the issuance of \$500,000 of convertible notes ("Convertible Notes") and attached to the Convertible Notes was warrants to purchase 19,000,000 shares of the Company's common stock. The Convertible Note accrues interest at 8% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 11.01% per annum.

As of September 30, 2008, the Company issued to investors of the Convertible Notes a total amount of \$500,000 in exchange for total proceeds of \$460,000. The proceeds that the Company received were net of related fees and costs of \$40,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on March 31, 2006. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$136,612 and \$363,388 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

- Requirement to pay principal and interest when due
- Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)
- Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness
- Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement
- Change of control
- Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable

Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2008 and December 31, 2007, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

For the nine month period ended September 30, 2008 and 2007, the Company amortized the debt discount and charged to interest expense \$125,114 and \$124,657, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on July 28, 2006 for the issuance of \$500,000 of convertible notes (“Convertible Notes”) and attached to the Convertible Notes was warrants to purchase 15,000,000 shares of the Company’s common stock. The Convertible Note accrues interest at 6% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company’s common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 10.00% per annum.

As of September 30, 2008, the Company issued to investors of the Convertible Notes a total amount of \$500,000 in exchange for total proceeds of \$490,000. The proceeds that the Company received were net of related fees and costs of \$10,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on July 28, 2006. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$200,000 and \$300,000 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

- Requirement to pay principal and interest when due
- Provide shares of the Company’s common stock to the Holder(s) upon exercise by the Holder(s)
- Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness
- Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement
- Change of control
- Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase

Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

As of September 30, 2008 and December 31, 2007, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine month period ended September 30, 2008 and 2007, the Company amortized the debt discount and charged to interest expense \$125,114 and \$124,657, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on September 26, 2006 for the issuance of \$280,000 of convertible notes ("Convertible Notes") and attached to the Convertible Notes was warrants to purchase 10,000,000 shares of the Company's common stock. The Convertible Note accrues interest at 6% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 9.36% per annum.

As of September 30, 2008, the Company issued to investors of the Convertible Notes a total amount of \$280,000 in exchange for total proceeds of \$259,858. The proceeds that the Company received were net of related fees and costs of \$20,142.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on September 26, 2006. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the

Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$100,513 and \$179,487 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

- Requirement to pay principal and interest when due
- Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)
- Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness
- Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement
- Change of control
- Trading market limitations

**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2008 and December 31, 2007, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM" or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine months period ended September 30, 2008 and 2007, the Company amortized the debt discount and charged to interest expense \$70,064 and \$69,808, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on December 20, 2006 for the issuance of \$600,000 of convertible notes ("Convertible Notes") and attached to the Convertible Notes was warrants to purchase 20,000,000 shares of the Company's common stock. The Convertible Note accrues interest at 6% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before,

but not including, conversion date. The effective interest rate at the date of inception was 15.00% per annum.

As of September 30, 2008, the Company issued to investors of the Convertible Notes a total amount of \$600,000 in exchange for total proceeds of \$590,000. The proceeds that the Company received were net of related fees and costs of \$10,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on December 20, 2006. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$360,000 and \$240,000 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

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**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

- Requirement to pay principal and interest when due
- Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)
- Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness
- Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement
- Change of control
- Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2008 and December 31, 2007, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the

right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine months ended September 30, 2008 and 2007, the Company amortized the debt discount and charged to interest expense \$150,137 and \$149,589, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on April 18, 2007 for the issuance of \$400,000 of convertible notes ("Convertible Notes") and attached to the Convertible Notes was warrants to purchase 10,000,000 shares of the Company's common stock. The Convertible Note accrues interest at 8% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 235.00% per annum.

As of September 30, 2008, the Company issued to investors of the Convertible Notes a total amount of \$400,000 in exchange for total proceeds of \$360,000. The proceeds that the Company received were net of related fees and costs of \$40,000.

**CYBERLUX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2008**  
**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on April 18, 2007. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$386,378 and \$13,622 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

- Requirement to pay principal and interest when due
- Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)
- Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness
- Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement
- Change of control
- Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase