

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

FORM 10-Q

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

For the quarterly period ended **September 30, 2013**

OR

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

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

Commission file number: 000-22563

**SG BLOCKS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**95-4463937**

(I.R.S. Employer  
Identification No.)

**3 Columbus Circle, 16<sup>th</sup> Floor New York, NY**

(Address of principal executive offices)

**10019**

(Zip Code)

**(646) 747-2423**

(Registrant's telephone number, including area code)

400 Madison Avenue, Suite 16C New York, NY

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

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

As of November 10, 2013, there were 42,198,093 shares of the registrant's common stock, \$0.01 par value, outstanding.

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**SG BLOCKS, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2013**

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**PART I. FINANCIAL INFORMATION**

**Item Financial Statements**

**1.**

**SG BLOCKS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS**

	<i>September 30, 2013 (Unaudited)</i>	<i>December 31, 2012</i>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 524,580	\$ 868,067
Short-term investment	39,364	39,249
Accounts receivable, net	674,694	284,395
Costs and estimated earnings in excess of billings on uncompleted contracts	324,370	36,476
Inventory	212,925	48,011
Prepaid expenses and other current assets	9,493	1,405
Total current assets	1,785,426	1,277,603
Equipment, net	12,718	6,064
Security deposit	12,000	-
Debt issuance costs, net	67,245	103,632
Totals	\$ 1,877,389	\$ 1,387,299
<b>Liabilities and Stockholders' Deficiency</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 945,403	\$ 343,080
Accrued interest, related party	26,570	20,439
Accrued interest	51,530	-
Related party accounts payable and accrued expenses	208,370	102,856
Related party notes payable	73,500	73,500
Convertible debentures, net	1,455,804	-
Billings in excess of costs and estimated earnings on uncompleted contracts	26,999	69,789
Deferred revenue	438,859	201,117
Conversion option liabilities	14,152	69,502
Warrant liabilities	271,459	337,055
Total current liabilities	3,512,646	1,217,338
Convertible debentures, net	229,086	685,692
Total liabilities	3,741,732	1,903,030
Commitments		
Stockholders' deficiency:		
Preferred stock, \$0.01 par value, 5,000,000 shares authorized; 0 issued and outstanding at September 30, 2013 and December 31, 2012	-	-
Common stock, \$0.01 par value, 100,000,000 shares authorized; 42,198,093 issued and outstanding at September 30, 2013 and December 31, 2012	421,981	421,981
Additional paid-in capital	6,408,010	6,099,635
Accumulated deficiency	(8,689,394)	(7,036,776)
Accumulated other comprehensive loss	(4,940)	(571)
Total stockholders' deficiency	(1,864,343)	(515,731)
Totals	\$ 1,877,389	\$ 1,387,299

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

**SG BLOCKS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**AND COMPREHENSIVE LOSS**

	<i>For the Three Months Ended</i>		<i>For the Nine Months Ended</i>	
	<i>September 30,</i>		<i>September 30,</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>(Unaudited)</i>	<i>(Unaudited)</i>	<i>(Unaudited)</i>	<i>(Unaudited)</i>
<b>Revenue:</b>				
SG Block sales	\$ 911,760	\$ 314,185	\$ 1,867,584	\$ 1,219,028
Engineering services	-	23,965	20,095	618,719
Project management	820,441	35,100	2,422,310	142,573
	<u>1,732,201</u>	<u>373,250</u>	<u>4,309,989</u>	<u>1,980,320</u>
<b>Cost of revenue:</b>				
SG Block sales	788,628	236,483	1,534,496	923,252
Engineering services	-	37,659	15,275	541,309
Project management	726,533	31,527	2,533,672	128,986
	<u>1,515,161</u>	<u>305,669</u>	<u>4,083,443</u>	<u>1,593,547</u>
<b>Gross profit</b>	217,040	67,581	226,546	386,773
<b>Operating expenses:</b>				
Payroll and related expenses	332,878	358,918	1,009,971	1,073,808
General and administrative expenses	151,460	211,580	528,721	731,689
Marketing and business development expense	33,982	12,443	89,412	65,502
Pre-project expenses	2,476	9,627	36,770	32,020
Total	<u>520,796</u>	<u>592,568</u>	<u>1,664,874</u>	<u>1,903,019</u>
<b>Operating loss</b>	(303,756)	(524,987)	(1,438,328)	(1,516,246)
<b>Other income (expense):</b>				
Interest expense	(184,277)	(2,067)	(505,378)	(6,154)
Interest income	35	37	115	105
Change in fair value of financial instruments	22,616	1,160	290,973	34,224
Cancellation of trade liabilities and unpaid interest	-	-	-	31,447
Total	<u>(161,626)</u>	<u>(870)</u>	<u>(214,290)</u>	<u>59,622</u>
<b>Net loss</b>	\$ (465,382)	\$ (525,857)	\$ (1,652,618)	\$ (1,456,624)
<b>Comprehensive loss</b>				
Foreign currency translation adjustment	(639)	-	(4,369)	(634)
<b>Total comprehensive loss</b>	<u>\$ (466,021)</u>	<u>\$ (525,857)</u>	<u>\$ (1,656,987)</u>	<u>\$ (1,457,258)</u>
Net loss per share - basic and diluted:				
Basic and diluted	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>	<u>\$ (0.04)</u>	<u>\$ (0.04)</u>
Weighted average shares outstanding:				
Basic and diluted	<u>42,198,093</u>	<u>41,985,950</u>	<u>42,198,093</u>	<u>41,137,769</u>

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

**SG BLOCKS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES**  
**IN STOCKHOLDERS' DEFICIENCY**

*For the Nine Months Ended September 30, 2013 (Unaudited)*

	<u>\$0.01 Par Value Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Accumulated Deficiency</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
<b>Balance - December 31, 2012</b>	42,198,093	\$ 421,981	\$ 6,099,635	\$ (7,036,776)	\$ (571)	\$ (515,731)
Stock-based compensation	-	-	305,517	-	-	305,517
Fair value of warrants issued	-	-	2,858	-	-	2,858
Foreign currency translation adjustment	-	-	-	-	(4,369)	(4,369)
Net loss	-	-	-	(1,652,618)	-	(1,652,618)
<b>Balance - September 30, 2013</b>	<u>42,198,093</u>	<u>\$ 421,981</u>	<u>\$ 6,408,010</u>	<u>\$ (8,689,394)</u>	<u>\$ (4,940)</u>	<u>\$ (1,864,343)</u>

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

**SG BLOCKS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the Nine Months Ended September 30,

	<u>2013</u>	<u>2012</u>
	<i>(Unaudited)</i>	<i>(Unaudited)</i>
<b>Cash flows from operating expenses:</b>		
	\$ (1,652,618)	\$ (1,456,624)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	2,131	1,927
Amortization of debt issuance costs	67,245	-
Amortization of discount on convertible debentures	319,225	-
Interest income on short-term investment	(115)	(105)
Change in fair value of financial instruments	(290,973)	(34,224)
Stock-based compensation	305,517	416,219
Bad debts expense	-	53,111
Cancellation of trade liabilities and unpaid interest	-	(31,447)
Changes in operating assets and liabilities:		
Accounts receivable	(390,299)	(244,908)
Costs and estimated earnings in excess of billings on uncompleted contracts	(287,894)	58,347
Inventory	(164,914)	(9,820)
Prepaid expenses and other current assets	(8,088)	(1,405)
Security deposit	(12,000)	
Accounts payable and accrued expenses	602,323	55,561
Accrued interest, related party	6,131	6,154
Accrued interest	51,530	-
Related party accounts payable and accrued expenses	105,514	50,731
Billings in excess of costs and estimated earnings on uncompleted contracts	(42,790)	81,117
Deferred revenue	237,742	120,900
Net cash used in operating activities	<u>(1,152,333)</u>	<u>(934,466)</u>
<b>Cash flows used in investing activities</b>		
Purchase of equipment	(8,785)	(549)
Net cash used in investing activities	<u>(8,785)</u>	<u>(549)</u>
<b>Cash flows from financing activities:</b>		
Expenditures on debt issuance costs	(28,000)	-
Proceeds from common stock to be issued	-	14,000
Proceeds from issuance of common stock and warrants in private offering	-	642,183
Proceeds from issuance of convertible debentures and warrants	850,000	-
Net cash provided by financing activities	822,000	656,183
<b>Effect of exchange rate changes on cash</b>	(4,369)	(634)
<b>Net decrease in cash</b>	(343,487)	(279,466)
<b>Cash and cash equivalents - beginning of period</b>	868,067	561,759
<b>Cash and cash equivalents - end of period</b>	<u>\$ 524,580</u>	<u>\$ 282,293</u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the period for:		
Interest	<u>\$ -</u>	<u>\$ -</u>
<b>Supplemental disclosure of non-cash financing activities:</b>		
In connection with the 2012 private offering, \$80,000 was paid for a prior liability which was included in accounts payable and accrued expenses.		
Issuance of common stock for settlement of debt	<u>\$ -</u>	<u>\$ 67,782</u>
Forgiveness of related party accrued compensation	<u>\$ -</u>	<u>\$ 73,888</u>

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

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

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For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

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### 1. Description of Business

SG Blocks, Inc. (the "Company") was previously known as CDSI Holdings, Inc. (a Delaware corporation incorporated on December 29, 1993). On November 4, 2011, the Company's wholly-owned subsidiary was merged with and into SG Building Blocks, Inc. ("SG Building", formerly SG Blocks Inc.) (the "Merger"), with SG Building surviving the Merger and becoming a wholly-owned subsidiary of the Company. The Merger was a reverse merger that was accounted for as a recapitalization of SG Building as SG Building was the accounting acquirer. Accordingly, the historical financial statements presented are the financial statements of SG Building.

During 2012, the Company formed SG Blocks Sistema De Constucao Brasileiro LTDA. ("SG Brazil"), a wholly owned subsidiary of the Company. As of September 30, 2013, SG Brazil is inactive.

The Company is a provider of code engineered cargo shipping containers modified for use in "green" construction. The Company also provides engineering and project management services related to the use of modified containers in construction.

### 2. Liquidity and Financial Condition

Through September 30, 2013, the Company has incurred an accumulated deficiency since inception of \$8,689,394. At September 30, 2013, the Company had a cash balance of \$524,580. At November 13, 2013, the Company had a cash balance of approximately \$441,000.

Since the Company's inception, it has generated revenues from SG Block sales, engineering services, and project management.

The Company expects that through the next 10 to 16 months, the capital requirements to fund the Company's growth will consume all of the cash flows that it expects to generate from its operations, as well as from the proceeds of intended issuances of debt and equity securities. The Company further believes that during this period, while the Company is focusing on the growth and expansion of its business, the gross profit that it expects to generate from operations will not generate sufficient funds to cover anticipated operating costs. Accordingly, the Company requires external funding to sustain operations and to follow through on the execution of its business plan. However, there can be no assurance that the Company's plans will materialize and/or that the Company will be successful in funding estimated cash shortfalls through additional debt or equity capital and through the cash generated by the Company's operations. Given these conditions, the Company's ability to continue as a going concern is contingent upon it being able to secure an adequate amount of debt or equity capital to enable it to meet its cash requirements. In addition, the Company's ability to continue as a going concern must be considered in light of the problems, expenses and complications frequently encountered by entrants into established markets, the competitive environment in which the Company operates and the current capital raising environment.

Since inception, the Company's operations have primarily been funded through proceeds from equity and debt financings and sales activity. Although management believes that the Company has access to capital resources, there are currently no commitments in place for new financing at this time, and there is no assurance that the Company will be able to obtain funds on commercially acceptable terms, if at all.

During the nine months ended September 30, 2013, the Company raised \$850,000 in net new funds through the issuance of convertible debentures (See Note 7). The proceeds from these issuances were used to fund the Company's operations and working capital needs.

The Company intends to raise additional funds in 2014 through a private placement of its common stock as well as additional issuances of convertible debentures. The additional capital would be used to fund the Company's operations, including the costs that it expects to incur as a public company. The current level of cash and operating margins is not enough to cover the existing fixed and variable obligations of the Company, so increased revenue performance and the addition of capital through issuances of securities are critical to the Company's success. Should the Company not be able to raise additional capital through a private placement or some other financing source, the Company would take one or more of the following actions to conserve cash: reduction in employee headcount, reduction in base salaries to senior executives and employees, and other cost reduction measures. Assuming that the Company is successful in its growth plans and development efforts, the Company believes that it will be able to raise additional funds through sales of its stock. There is no guarantee that the Company will be able to raise such additional funds on acceptable terms, if at all.

These factors, among others, raise substantial doubt about the Company's ability to continue as a going concern.

The Company's financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should it be unable to continue as a going concern.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

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For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

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### 3. Summary of Significant Accounting Policies

**Interim financial information** – The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments, consisting of normal accruals, considered necessary for a fair presentation of the interim financial statements have been included. Results for the nine months ended September 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013.

The condensed consolidated financial statements and notes should be read in conjunction with the financial statements and notes for the year ended December 31, 2012 included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2013.

**Reclassification** – Certain prior period amounts have been reclassified to conform to the current period presentation.

**Basis of consolidation** – The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, SG Building and SG Brazil. All intercompany balances and transactions have been eliminated.

**Accounting estimates** – The preparation of condensed consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Significant areas which require the Company to make estimates include revenue recognition, stock-based compensation, warrant liabilities and allowance for doubtful accounts. Actual results could differ from those estimates.

**Operating cycle** – The length of the Company’s contracts varies, but is typically between six to twelve months. Assets and liabilities relating to long-term contracts are included in current assets and current liabilities in the accompanying balance sheets as they will be liquidated in the normal course of contract completion, which at times could exceed one year.

**Revenue recognition** – The Company accounts for its long-term contracts associated with the design, engineering, manufacture and project management of building projects and related services, using the percentage-of-completion accounting method. Under this method, revenue is recognized based on the extent of progress towards completion of the long-term contract. The Company uses the cost to cost basis because management considers it to be the best available measure of progress on these contracts.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

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For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

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### 3. Summary of Significant Accounting Policies *(continued)*

Contract costs include all direct material and labor costs and those indirect costs related to contract performance. General and administrative costs, marketing and business development expenses and pre-project expenses are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. An amount equal to contract costs attributable to claims is included in revenue when realization is probable and the amount can be reliably estimated.

The asset, "Costs and estimated earnings in excess of billing on uncompleted contracts," represents revenue recognized in excess of amounts billed. The liability, "Billings in excess of costs and estimated earnings on uncompleted contracts," represents billing in excess of revenue recognized.

The Company offers a one-year warranty on completed contracts. The Company has not incurred any claim obligations to date and does not anticipate that any claims are likely to occur for warranties that are currently outstanding. Accordingly, no warranty reserve is considered necessary for any of the periods presented.

The Company also supplies repurposed containers to its customers. In these cases, the Company serves as a supplier to its customers for standard and made to order products that it sells at fixed prices. Revenue from these contracts is generally recognized when the products have been delivered to the customer, accepted by the customer and collection is reasonably assured. Revenue is recognized upon completion of the following: an order for product is received from a customer; written approval for the payment schedule is received from the customer and the corresponding required deposit or payments are received; a common carrier signs documentation accepting responsibility for the unit as agent for the customer; and the unit is delivered to the customer's shipping point.

Amounts billed to customers in a sales transaction for shipping and handling are classified as revenue. Products sold are generally paid for based on schedules provided for in each individual customer contract including upfront deposits and progress payments as products are being manufactured.

Funds received in advance of meeting the criteria for revenue recognition are deferred and are recorded as revenue when they are earned.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

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For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

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### 3. Summary of Significant Accounting Policies (continued)

**Cash and cash equivalents** – The Company considers cash and cash equivalents to include all short-term, highly liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less upon acquisition.

**Accounts receivable** – Accounts receivable are receivables generated from sales to customers and progress billings on performance type contracts. Amounts included in accounts receivable are deemed to be collectible within the Company's operating cycle. Management provides an allowance for doubtful accounts based on the Company's historical losses, specific customer circumstances, and general economic conditions. Periodically, management reviews accounts receivable and adjusts the allowance based on current circumstances and charges off uncollectible receivables when all attempts to collect have been exhausted and the prospects for recovery are remote.

The Company has a factoring agreement which provides for the Company to receive an advance of 75% of any accounts receivable that it factors. On August 13, 2012, the factoring agreement was increased for up to \$1,000,000 for credit worthy retail clients. The factoring agreement also provides for discount fees ranging from 2.5% to 7.5% of the face value of any accounts receivable factored. The factoring agreement is with recourse except in an instance which the customer is insolvent. The agreement originally expired January 2013 and was automatically extended for a one year period. The agreement will continue to automatically extend for successive periods of one year unless either party formally cancels. For the nine months ended September 30, 2013 and 2012, there has been no activity with regard to this agreement. Under the convertible debentures agreement as described in Note 7, the Company is precluded from any borrowing under this factoring agreement.

**Inventory** – Raw construction materials (primarily shipping containers) are valued at the lower of costs (first-in, first-out method) or market. Finished goods and work-in-process inventories are valued at the lower of costs or market, using the specific identification method. As of September 30, 2013 and December 31, 2012, work-in-process inventory amounted to \$212,925 and \$48,011, respectively.

**Debt issuance costs** – All debt issuances are stated at cost, net of amortization. Amortization is computed over the estimated useful life of the related assets on a straight-line method. As of September 30, 2013, all debt issuance costs are amortized over 18 months.

**Convertible instruments** – The Company bifurcates conversion options from their host instruments and accounts for them as free standing derivative financial instruments according to certain criteria. The criteria include circumstances in which (a) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument.

The Company has determined that the embedded conversion options should be bifurcated from their host instruments and a portion of the proceeds received upon the issuance of the hybrid contract have been allocated to the fair value of the derivative. The derivative is subsequently marked to market at each reporting date based on current fair value, with the changes in fair value reported in results of operations.

**Common stock purchase warrants and other derivative financial instruments** – The Company classifies as equity any contracts that (i) require physical settlement or net-share settlement or (ii) provides a choice of net-cash settlement or settlement in the Company's own shares (physical settlement or net-share settlement) providing that such contracts are indexed to the Company's own stock. The Company classifies as assets or liabilities any contracts that (i) require net-cash settlement (including a requirement to net cash settle the contract if any event occurs and if that event is outside the Company's control) or (ii) gives the counterparty a choice of net-cash settlement of settlement shares (physical settlement or net-cash settlement). The Company assesses classification of common stock purchase warrants and other free standing derivatives at each reporting date to determine whether a change in classification between assets and liabilities or equity is required.

The Company's free standing derivatives consist of warrants to purchase common stock that were issued to a placement agent involved with the private offering memorandum as well as issuances of convertible debentures as described in Note 9. The Company evaluated the common stock purchase warrants to assess their proper classification in the consolidated balance sheet and determined that the common stock purchase warrants feature a characteristic permitting cash settlement at the option of the holder. Accordingly, these instruments have been classified as warrant liabilities in the accompanying condensed consolidated balance sheets as of September 30, 2013 and December 31, 2012.

**Fair value measurements** – Financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities are carried at cost, which the Company believes approximates fair value due to the short-term nature of these instruments.

The Company measures the fair value of financial assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company maximized the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.



# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

### 3. Summary of Significant Accounting Policies (continued)

The Company uses three levels of inputs that may be used to measure fair value:

- Level 1 Quoted prices in active markets for identical assets or liabilities
- Level 2 Quoted prices for similar assets and liabilities in active markets or inputs that are observable.
- Level 3 Inputs that are unobservable (for example, cash flow modeling inputs based on assumptions).

Financial liabilities measured at fair value on a recurring basis are summarized below:

	September 30, 2013	Quoted prices in active market for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Warrant Liabilities	\$ 271,459	\$ -	\$ -	\$ 271,459
Conversion Option Liabilities	\$ 14,152	\$ -	\$ -	\$ 14,152

	December 31, 2012	Quoted prices in active market for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Warrant Liabilities	\$ 337,055	\$ -	\$ -	\$ 337,055
Conversion Option Liabilities	\$ 69,502	\$ -	\$ -	\$ 69,502

Warrant and conversion option liabilities are measured at fair value using the lattice pricing model and are classified within Level 3 of the valuation hierarchy. For fair value measurements categorized within Level 3 of the fair value hierarchy, the Company's Chief Financial Officer, who reports to the Chief Executive Officer, determines its valuation policies and procedures. The development and determination of the unobservable inputs for Level 3 fair value measurements and fair value calculations are the responsibility of the Company's Chief Financial Officer and are approved by the Chief Executive Officer.

The following table sets forth a summary of the changes in the fair value of the Company's Level 3 financial liabilities that are measured at fair value on a recurring basis:

	For the nine months ended September 30, 2013	For the nine months ended September 30, 2012
Beginning balance	\$ 406,557	\$ 198,471
Aggregate fair value of conversion option liabilities and warrants issued	170,027	19,130
Change in fair value of conversion option liabilities and warrants	(290,973)	(34,224)
Ending balance	<u>\$ 285,611</u>	<u>\$ 183,377</u>

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

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For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

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### 3. Summary of Significant Accounting Policies *(continued)*

The significant assumptions and valuation methods that the Company used to determine fair value and the change in fair value of the Company's derivative financial instruments are discussed in Notes 7 and 9.

The Company presented warrant and conversion option liabilities at fair value on its condensed consolidated balance sheets, with the corresponding changes in fair value recorded in the Company's condensed consolidated statements of operations for the applicable reporting periods. As disclosed in Notes 7 and 9, the Company computed the fair value of the warrant and conversion option liability at the date of issuance and the reporting dates of September 30, 2013 and December 31, 2012 using the lattice pricing method.

The calculation of the lattice pricing model involves the use of the fair value of the Company's common stock, estimated term, volatility, risk-free interest rates, the size of the time step and dividend yield (if applicable). The Company developed the assumptions that were used as follows: The fair value of the Company's common stock was obtained from publically quoted prices as well as valuation models developed by the Company. The results of the valuation were assessed for reasonableness by comparing such amount to sales of other equity and equity linked securities to unrelated parties for cash and intervening events affected in the price of the Company's stock. The term represents the remaining contractual term of the derivative; the volatility rate was developed based on analysis of the Company's historical stock price volatility and the historical volatility rates of several other similarly situated companies (using a number of observations that was at least equal to or exceeded the number of observations in the life of the derivative financial instrument at issue); the risk free interest rates were obtained from publicly available US Treasury yield curve rates; the dividend yield is zero because the Company has not paid dividends and does not expect to pay dividends in the foreseeable future. The size of the time step is used to determine the up ratio and down ratio probabilities applied in the lattice model and are proportional to the remaining term of the derivative instrument.

**Share-based payments** – The Company measures the cost of services received in exchange for an award of equity instruments based on the fair value of the award. For employees and directors, the fair value of the award is measured on the grant date and for non-employees, the fair value of the award is generally re-measured on interim financial reporting dates and vesting dates until the service period is complete. The fair value amount is then recognized over the period services are required to be provided in exchange for the award, usually the vesting period. The Company recognizes stock-based compensation expense on a graded-vesting basis over the requisite service period for each separately vesting tranche of each award. Stock-based compensation expense is reflected within operating expenses in the condensed consolidated statements of operations.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

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For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

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### 3. Summary of Significant Accounting Policies (continued)

**Foreign currency translation** – The Company’s international subsidiary considers its local currency to be its functional currency. Assets and liabilities of the Company’s subsidiary operating in a foreign country are translated into U.S. dollars using both the exchange rate in effect at the balance sheet date or historical date, as applicable. Results of operations are translated using the average exchange rates prevailing throughout the period. The effects of exchange rate fluctuations on translating foreign currency assets and liabilities into U.S. dollars are included in stockholders’ deficiency as a component of accumulated other comprehensive loss, while gains and losses resulting from foreign currency translations are included in operations.

**Income taxes** – The Company accounts for income taxes utilizing the asset and liability approach. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes generally represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from the differences between the financial and tax bases of the Company’s assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted.

The calculation of tax liabilities involves dealing with uncertainties in the application of complex tax regulations. The Company recognizes liabilities for anticipated tax audit issues based on the Company’s estimate of whether, and the extent to which, additional taxes will be due. If payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when the liabilities are no longer determined to be necessary. If the estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result.

The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the consolidated financial statements or tax returns. Deferred tax liabilities and assets are determined based on the difference between the financial statement basis and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The Company estimates the degree to which tax assets and credit carryforwards will result in a benefit based on expected profitability by tax jurisdiction. A valuation allowance for such tax assets and loss carryforwards is provided when it is determined to be more likely than not that the benefit of such deferred tax asset will not be realized in future periods. If it becomes more likely than not that a tax asset will be used, the related valuation allowance on such assets would be reduced.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

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For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

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### 3. Summary of Significant Accounting Policies *(continued)*

**Concentrations of credit risk** – Financial instruments that potentially subject the Company to concentration of credit risk, consist principally of cash and cash equivalents. The Company places its cash with high credit quality institutions. At times, such amounts may be in excess of the FDIC insurance limits. The Company has not experienced any losses in such account and believes that it is not exposed to any significant credit risk on the account.

With respect to receivables, concentrations of credit risk are limited to a few customers in the construction industry. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers other than normal lien rights. At September 30, 2013 and December 31, 2012, 79% and 59%, respectively, of the Company's accounts receivable were due from four and three customers, respectively.

Revenue relating to three and one customers, respectively, represented approximately 92% and 86% of the Company's total revenue for the three months ended September 30, 2013 and 2012, respectively. Revenue relating to three and two customers, respectively, represented approximately 77% and 76% of the Company's total revenue for the nine months ended September 30, 2013 and 2012, respectively. During the nine months ended September 30, 2012 24% of the Company's total revenue was recognized by SG Brazil.

Costs of revenue relating to one vendor, who is a related party and disclosed in Note 12, represented approximately 22% and 76% of the Company's total cost of revenue for the three months ended September 30, 2013 and 2012. Cost of revenue relating to two unrelated vendor represented approximately 56% of the Company's total cost of revenue for the three months ended September 30, 2013. Costs of revenue relating to one vendor, who is a related party and disclosed in Note 12, represented approximately 30% and 50% of the Company's total cost of revenue for the nine months ended September 30, 2013 and 2012. Cost of revenue relating to one unrelated vendor represented approximately 34% of the Company's total cost of revenue for the nine months ended September 30, 2013. The Company believes it would be able to use other vendors at reasonable comparable terms if needed.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

### 4. Accounts Receivable

At September 30, 2013 and December 31, 2012, the Company's accounts receivable consisted of the following:

	<u>2013</u>	<u>2012</u>
Billed:		
SG Block sales	\$ 472,728	\$ 207,390
Engineering services	147,764	216,535
Project management	228,632	34,900
Total gross receivables	849,124	458,825
Less: allowance for doubtful accounts	(174,430)	(174,430)
Total net receivables	<u>\$ 674,694</u>	<u>\$ 284,395</u>

### 5. Costs and Estimated Earnings on Uncompleted Contracts

Costs and estimated earnings on uncompleted contracts consist of the following at September 30, 2013 and December 31, 2012:

	<u>2013</u>	<u>2012</u>
Costs incurred on uncompleted contracts	\$ 735,025	\$ 177,529
Provision for loss on uncompleted contracts	10,177	6,680
Estimated income (loss)	(25,249)	6,156
	719,953	190,365
Less: billings to date	(422,582)	(223,678)
	<u>\$ 297,371</u>	<u>\$ (33,313)</u>

The above amounts are included in the accompanying condensed consolidated balance sheets under the following captions at September 30, 2013 and December 31, 2012.

	<u>2013</u>	<u>2012</u>
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 324,370	\$ 36,476
Billings in excess of cost and estimated earnings on uncompleted contracts	(26,999)	(69,789)
	<u>\$ 297,371</u>	<u>\$ (33,313)</u>

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

### 5. Costs and Estimated Earnings on Uncompleted Contracts (continued)

Although management believes it has established adequate procedures for estimating costs to complete on open contracts, it is at least reasonably possible that additional significant costs could occur on contracts prior to completion. The Company periodically evaluates and revises its estimates and makes adjustments when they are considered necessary.

As of September 30, 2013 and December 31, 2012, the Company has accrued anticipated losses on uncompleted contracts in the amount of \$10,177 and \$6,680, respectively. This amount is included in cost of revenue on the accompanying condensed consolidated statements of operations and comprehensive loss and is included in accounts payable and accrued expenses on the accompanying condensed consolidated balance sheets.

### 6. Debt Issuance Costs

Debt issuance costs consisted of the following at September 30, 2013 and December 31, 2012:

	2013	2012
Financial advisor fee	\$ 108,000	\$ 80,000
Legal fees	15,466	15,466
Fair value of warrants issued (as disclosed in Note 10 )	11,024	8,166
	<u>134,490</u>	<u>103,632</u>
Less: accumulated amortization	67,245	-
	<u>\$ 67,245</u>	<u>\$ 103,632</u>

Amortization expense of debt issuance costs for the three months and nine months ended September 30, 2013 amounted to \$22,415 and \$67,245, respectively, and is included in interest expense on the accompanying condensed consolidated statements of operations.

### 7. Convertible Debentures

On December 27, 2012, the Company entered a Securities Purchase Agreement (“Securities Purchase Agreement”) with Hillair Capital Investments L.P. (“Hillair”), whereby the Company issued and sold to Hillair: (i) \$1,120,000 in 8% Original Discount Senior Secured Convertible Debentures due July 1, 2014, for \$1,000,000 (“Debenture”), and (ii) a Common Stock purchase warrant to purchase up to 2,604,651 shares of the Company’s Common Stock with a fair value of \$199,806 at issuance, which has been recorded as a discount to the debenture. (As disclosed in Note 9) The Company recorded a discount of \$120,000, which will be amortized over the term of the debenture, using the effective interest method. At any time after December 28, 2012, until the Debenture is no longer outstanding, the Debenture shall be convertible, in whole or in part, into shares of Common Stock at the option of Hillair, subject to certain conversion limitations set forth in the Debenture. The initial conversion price for the Debenture is \$0.43 per share, subject to adjustments upon certain events, as set forth in the Debenture. The Company shall pay interest on the aggregate unconverted and then outstanding principal amount of the Debenture at 8% per annum, payable quarterly on January 1, April 1, July 1 and October 1, beginning on July 1, 2013. Interest is payable in cash or at the Company’s option in shares of Common Stock, provided certain conditions are met, based on a share value equal to the lesser of (a) \$0.43 per share, subject to adjustments upon certain events, and (b) 90% of the average of the volume weighted average price for 20 consecutive trading days prior to the applicable interest payment date, provided that the price shall be equal to at least a \$0.01 discount to the volume weighted average price for the trading day that is immediately prior to the applicable interest payment date. Merriman Capital, Inc. (“Merriman”) acted as financial advisor to the Company in connection with the transaction and received a fee consisting of \$80,000 and warrants to purchase up to 104,186 shares of the Company’s Common Stock. (As disclosed in Note 9) In connection with the issuance of the Debenture, the Company also paid Hillair \$45,000 for due diligence which has been recorded as a discount to the debenture, and will be amortized over the term of the debenture, using the effective interest method. In addition, the Company incurred \$15,466 in legal fees which are included in debt issuance costs in the accompanying condensed consolidated balance sheet at September 30, 2013 and December 31, 2012.

On January 8, 2013 and January 9, 2013, the Company issued and sold to Next View Capital LP (“Next View”) and another investor (“Another Investor”) an aggregate of (i) \$392,000 in 8% Original Discount Senior Secured Convertible Debentures due July 1, 2014, for \$350,000 (“January 2013 Debentures”), and (ii) Common Stock purchase warrants to purchase up to 911,628 shares of the Company’s Common Stock with a fair value of \$69,933 at issuance, which has been recorded as a discount to the January 2013 Debentures. (As disclosed in Note 9). The Company recorded a discount of \$42,000, which will be amortized over the term of the debenture, using the effective interest method. Except for the date of issuance, these debentures and warrants have the same terms and conditions as the debenture and warrant issued to Hillair as described above. Merriman acted as financial advisor to the Company in connection with this transaction and received a fee consisting of \$28,000 and warrants to purchase up to 36,466 shares of the Company’s Common Stock. (As disclosed in Note 9)

On each of April 1, 2014 and July 1, 2014, the Company is obligated to redeem a total amount equal to \$756,000 in connection with the Hillair, Next View and Another Investor debentures. In lieu of a cash redemption and subject to the Company meeting certain equity conditions described in the Debenture, the Company may elect to pay the Periodic Redemption Amount in shares based on a conversion

price equal to the lesser of (a) \$0.43 per share, subject to adjustments upon certain events, and (b) 90% of the average of the volume weighted average price for the 20 consecutive trading days prior to the applicable redemption date, provided that the conversion price shall be equal to at least a \$0.01 discount to the volume weighted average price for the 20 consecutive days that is immediately prior to the applicable redemption date.

In April 2013, the Company issued and sold to Frank Casano (“Casano”) and Scott Masterson (“Masterson”) an aggregate of (i) \$560,000 in 8% Original Discount Senior Secured Convertible Debentures due October 15, 2014, for \$500,000 (“April 2013 Debentures”), and (ii) Common Stock purchase warrants to purchase up to 1,302,326 shares of the Company’s Common Stock with a fair value of \$60,801 at issuance, which has been recorded as a discount to the April 2013 Debentures. (As disclosed in Note 9). The Company recorded a discount of \$60,000, which will be amortized over the term of the debenture, using the effective interest method. Except for the date of issuance, these debentures and warrants have the same terms and conditions as the debenture and warrant issued to Hillair as described above.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

### 7. Convertible Debentures (continued)

On each of July 15, 2014 and October 15, 2014, the Company is obligated to redeem a total amount equal to \$280,000 in connection with the Casano and Masterson debentures. In lieu of a cash redemption and subject to the Company meeting certain equity conditions described in the Debenture, the Company may elect to pay the Periodic Redemption Amount in shares based on a conversion price equal to the lesser of (a) \$0.43 per share, subject to adjustments upon certain events, and (b) 90% of the average of the volume weighted average price for the 20 consecutive trading days prior to the applicable redemption date, provided that the conversion price shall be equal to at least a \$0.01 discount to the volume weighted average price for the 20 consecutive days that is immediately prior to the applicable redemption date.

A summary of the Company's convertible debentures as of September 30, 2013 is as follows:

Hillair Debentures, net of \$217,154 discount	\$ 902,847
January 2013 Debentures, net of \$68,128 discount	323,872
April 2013 Debentures, net of \$101,829 discount	<u>458,171</u>
<b>Total debt</b>	<b>1,684,890</b>
<b>Less current portion</b>	<b><u>1,455,804</u></b>
<b>Long-term debt</b>	<b><u>\$ 229,086</u></b>

For the three months and nine months ended September 30, 2013, interest expense on the convertible debentures amounted to \$42,073 and \$112,777, respectively, and is included on the accompanying condensed consolidated statements of operations. For the three months and nine months ended September 30, 2013, total amortization relating to the discount amounted to \$117,723 and \$319,225, respectively, and is included in interest expense on the accompanying condensed consolidated statements of operations.

The Company bifurcated the conversion option from its debt host. The fair value of the conversion option liabilities were determined to be \$108,795 at the date of issuance, utilizing the lattice method. Consequently, the Company recorded a discount of \$108,795 on the debentures, which will be amortized over the term of the debenture, using the effective interest method. The fair value of the conversion option liabilities as of September 30, 2013 was \$14,152. The significant assumptions which the Company used to measure the fair value at the date of issuance and September 30, 2013 of the conversion option liability are as follows:

	Date of Issuance	September 30, 2013
Stock price	\$ 0.24-0.30	\$ 0.23
Term	1.25 to 1.5 years	0.5 to 1.04 years
Volatility	50%	50%
Risk-free interest rate	0.14-0.21%	0.10%
Exercise price	\$ 0.43	\$ 0.43
Delta	0.02-0.03	0.01-0.02
Up Ratio	1.072-1.079	1.046-1.066
Down Ratio	0.921-0.928	0.934-0.954
Up transition probability	0.500	0.500

In connection with the Securities Purchase Agreement, the Company is required to maintain compliance with a variety of contractual provisions which include certain affirmative and negative covenants. The requirements principally consist of a requirement to maintain timely filings with the SEC, reserve sufficient authorized shares to issue upon the exercise of the underlying conversion option, and permit the note holders to participate in future financing transactions. The Company is also restricted, among other things, from incurring new indebtedness, permitting additional liens, making material changes to its charter documents, repay or repurchase more than a de minimis number of shares of its common stock or common stock equivalents, repay or repurchase any indebtedness, pay cash dividends, enter into transactions with affiliates or use the proceeds of the convertible notes to provide funding to its Brazilian subsidiary. The underlying securities purchase and debenture agreements also provide for the Company to pay liquidated damages in the event of its failure to (i) deliver shares upon the conversion of the notes, in which case the liquidated damages would amount to a cash payment of \$10 per trading day (increasing to \$15 per trading day on the fifth trading day) for each \$1,000 of principal amount being converted until such certificates are delivered (ii) maintain timely required filings with the SEC, in which case the liquidated damages would amount to a cash payment of two percent (2.0%) of the aggregate subscription amount of such purchasers securities on the day of the failure to maintain timely filings with the SEC and on every thirtieth (30th) day thereafter until the required documents are filed with the SEC or is no longer required for the purchaser to transfer the underlying shares pursuant to Rule 144 and (iii) to compensate the Holder for a Buy-in of securities previously sold by the Holder, as defined in the agreements, on a failure to timely deliver certificates upon conversion by the Holder. If the holder is subject to a Buy-in, then Company shall (A) pay in cash to the Holder (in addition to any other remedies available to or elected by the

Holder) the amount, if any, by which (x) the Holder's total purchase price (including any brokerage commissions) for the Common Stock so purchased exceeds (y) the product of (1) the aggregate number of shares of Common Stock that the Holder was entitled to receive from the conversion at issue multiplied by (2) the actual sale price at which the sell order giving rise to such purchase obligation was executed (including any brokerage commissions) and (B) at the option of the Holder, either reissue (if surrendered) this Debenture in a principal amount equal to the principal amount of the attempted conversion (in which case such conversion shall be deemed rescinded) or deliver to the Holder the number of shares of Common Stock that would have been issued if the Company had timely complied with its delivery requirements.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

### 8. Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of the common shares issuable upon the exercise of stock options and warrants. Potentially dilutive common shares are excluded from the calculation if their effect is antidilutive. At September 30, 2013, there were options and warrants to purchase 10,320,001 and 6,119,864 shares of common stock, respectively, outstanding which could potentially dilute future net income (loss) per share. At September 30, 2013 the Company also had outstanding convertible debt which is initially convertible into 4,818,605 shares of Common Stock, which could potentially increase under certain circumstances related to the market price of the Company's Common Stock at the time of conversion. At September 30, 2012, there were options and warrants to purchase 9,287,501 and 1,160,607 shares of common stock, respectively, outstanding which could potentially dilute future net income (loss) per share.

Basic and diluted net loss per share was calculated as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
Net loss	\$ (465,382)	\$ (525,857)	\$ (1,652,618)	\$ (1,456,624)
Weighted average shares outstanding - basic	42,198,093	41,985,950	42,198,093	41,137,769
Dilutive effect of stock options and warrants	-	-	-	-
Weighted average shares outstanding - diluted	42,198,093	41,985,950	42,198,093	41,137,769
Net loss per share - basic and diluted	\$ (0.01)	\$ (0.01)	\$ (0.04)	\$ (0.03)

### 9. Warrants

In conjunction with a private placement in October 2010 (the "2010 Private Placement"), the Company issued warrants to Ladenburg, the placement agent for the 2010 Private Placement. The warrants entitle Ladenburg to purchase up to a total of 1,044,584 shares of common stock for \$0.25 per share. The warrants expire October 28, 2015. The warrants are exercisable, at the option of the holder, at any time prior to their expiration. The fair value of warrants issued to placement agents was calculated utilizing the lattice method. The warrants issued to Ladenburg contain provisions that make them redeemable for cash by the holder of the warrant under certain circumstances that are not within the control of the Company. Accordingly, the fair market value of the warrants as of the date of issuance has been classified as liabilities. The fair value of the 2010 Private Placement warrants as of September 30, 2013 was \$54,728.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

### 9. Warrants (continued)

In conjunction with a private placement in 2012 (the "2012 Private Placement"), the Company issued warrants to Ladenburg in March 2012. The warrants entitle Ladenburg to purchase up to a total of 86,323 shares of common stock for \$0.35 per share and expire March 27, 2017. The Company also issued warrants to Ladenburg in May 2012 in connection with the additional 702,872 shares of common stock issued in the 2012 Private Placement. These warrants entitle Ladenburg to purchase 29,700 shares of common stock at \$0.35 per share and expire May 22, 2017. The warrants are exercisable, at the option of the holder, at any time prior to their expiration. The fair value of warrants issued to placement agents was calculated utilizing the lattice method. The warrants issued to Ladenburg contain provisions that make them redeemable for cash by the holder of the warrant under certain circumstances that are not within the control of the Company. Accordingly, the fair market value of the warrants as of the date of issuance has been classified as liabilities. The fair value of the 2012 Private Placement warrants as of September 30, 2013 was \$5,275.

As part of the issuance of convertible debentures to Hillair as disclosed in Note 7, the Company issued warrants to Hillair. The warrants entitle Hillair to purchase up to 2,604,651 shares of Common Stock for \$0.4488 per share, subject to adjustments upon certain events. The warrants may be exercised at any time on or after June 27, 2013 and expire on June 27, 2018. The fair value of warrants issued to Hillair was calculated utilizing the lattice method. The warrants issued to Hillair contain provisions that make them redeemable for cash by the holder of the warrant under certain circumstances that are not within the control of the Company. Accordingly, the fair market value of the warrants as of the date of issuance has been classified as liabilities and has been included as a debt discount of the convertible debentures described in Note 7. The fair value of the Hillair warrants as of September 30, 2013 was \$112,730.

In connection, with the issuance of convertible debentures to Hillair, the Company issued warrants to Merriman. The warrants entitle Merriman to purchase up to 52,093 shares of Common Stock for \$0.4488 per share and 52,093 shares of Common Stock at \$0.43 per share. The fair market value of the warrants as of the date of issuance has been classified as equity and is recorded in deferred loan costs on the accompanying consolidated balance sheets. The fair value of the Merriman warrants as of the date of issuance was \$8,166.

As part of the issuance of convertible debentures to Next View and Another Investor as disclosed in Note 7, the Company issued warrants to Next View and Another Investor. The warrants entitle Next View and Another Investor to purchase up to 651,163 and 260,465, respectively, shares of Common Stock for \$0.4488 per share, subject to adjustments upon certain events. The warrants issued to Next View and Another Investor contain substantially all of the same terms as the warrants issued to Hillair. The fair market value of the warrants as of the date of issuance has been classified as liabilities and has been included as a debt discount of the convertible debentures described in Note 7. The fair value of the Next View and Another Investor warrants as of September 30, 2013 was \$39,455.

In connection, with the issuance of convertible debentures to Next View and Another Investor, the Company issued warrants to Merriman. The warrants entitle Merriman to purchase up to 18,233 shares of Common Stock for \$0.4488 per share and 18,233 shares of Common Stock at \$0.43 per share. The fair market value of the warrants as of the date of issuance has been classified as equity and is recorded in deferred loan costs on the accompanying consolidated balance sheets. The fair value of the Merriman warrants as of the date of issuance was \$2,858.

As part of the issuance of convertible debentures to Casano and Masterson as disclosed in Note 7, the Company issued warrants to Casano and Masterson. The warrants entitle Casano and Masterson to purchase up to 1,041,861 and 260,465, respectively, shares of Common Stock for \$0.4488 per share, subject to adjustments upon certain events. The warrants issued to Casano and Masterson contain substantially all of the same terms as the warrants issued to Hillair. The fair market value of the warrants as of the date of issuance has been classified as liabilities and has been included as a debt discount of the convertible debentures described in Note 7. The fair value of the Next View and Another Investor warrants as of September 30, 2013 was \$59,271.

The change in fair value of the warrants of \$10,069 and \$1,160 is included in the accompanying condensed consolidated statements of operations for the three months ended September 30, 2013 and 2012, respectively. The change in fair value of the warrants of \$196,330 and \$34,224 is included in the accompanying condensed consolidated statements of operations for the nine months ended September 30, 2013 and 2012, respectively.

The significant assumptions which the Company used to measure the fair value of warrants at September 30, 2013 and December 31, 2012 is as follows:

	2013	2012
Stock price	\$ 0.23	\$ 0.35
	2.33 -	
Term	5 Years	2.84 -5 Years
Volatility	50%	50%
Risk-free interest rate	0.33-1.39%	0.36 - 0.72%
Exercise prices	\$ 0.25-0.4488	\$ 0.25-0.4488
Dividend yield	0.00%	0.00%
Delta	0.03 - 0.08	0.08
	1.093 -	

Up ratio	1.145	1.144
Down ratio	0.858 -	0.857
Up transition probability	0.500	0.500

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

### 10. Stock Options and Grants

**2011 Plan** – On July 27, 2011, in connection with the Merger, the Company obtained the written consent of holders of a majority of its outstanding common stock approving the 2011 Incentive Stock Plan (the “2011 Plan”). The 2011 Plan covers up to 8,000,000 shares of common stock, and all officers, directors, employees, consultants and advisors are eligible to be granted awards under the 2011 Plan. An incentive stock option may be granted under the 2011 Plan only to a person who, at the time of the grant, is an employee of the Company or its subsidiaries. The 2011 Plan expires on July 26, 2021, and is administered by the Company’s board of directors. As of September 30, 2013, there were 3,928 shares of common stock available for issuance under the 2011 Plan.

During 2012, the Company’s board of directors approved the issuance of up to an additional 2,000,000 shares of the Company’s common stock in the form of restricted stock or options. These options generally have the same terms and conditions as those provided under the 2011 Plan, however, the authorization of these options is not subject to shareholder approval. The issuance of these options will be approved by the Company’s board of directors on a case-by-case basis. As of September 30, 2013, there were 76,071 shares of common stock available for issuance under this approval.

A summary of stock option activity as of September 30, 2013 and changes during the nine months then ended are presented below:

	Shares	Weighted Average Fair Value Per Share	Weighted Average Exercise Price Per Share	Weighted Average Remaining Terms (in years)	Aggregate Intrinsic Value
<b>Outstanding – December 31, 2012</b>	9,317,501	\$ 0.11	\$ 0.36	9.03	539,650
Granted	602,500	0.09	0.40		
Exercised	-	-	-		
Cancelled	-	-	-		
<b>Outstanding – September 30, 2013</b>	<u>9,920,001</u>	<u>\$ 0.11</u>	<u>\$ 0.36</u>	<u>8.35</u>	<u>\$ 162,925</u>
<b>Exercisable – December 31, 2012</b>	4,973,333	\$ 0.11	\$ 0.30	8.97	\$ 359,600
<b>Exercisable – September 30, 2013</b>	<u>6,467,500</u>	<u>\$ 0.11</u>	<u>\$ 0.36</u>	<u>8.32</u>	<u>\$ 107,683</u>

For the three months and nine months ended September 30, 2013, the Company recognized stock-based compensation expense of \$96,209 and \$305,517, respectively, which is included in payroll and related expenses in the accompanying condensed consolidated statements of operations.

As of September 30, 2013, there was \$134,020 of total unrecognized compensation costs related to non-vested stock options, which will be expensed over a weighted average period of 0.41 years. The intrinsic value is calculated as the difference between the fair value as of the balance sheet date and the exercise price of each of the outstanding stock options. The fair value at September 30, 2013 and December 31, 2012 was \$0.23 and \$0.30 per share, respectively, as determined by using a weighted value between the income approach method and the weighted average bulletin board price.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

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*For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)*

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### **10. Stock Options and Grants (continued)**

During 2011, the Company executed a two year consulting agreement with a consultant, to act as a Senior Advisor of the Company. In consideration for the services to be performed under the agreement, the Company shall on the last business day of each month during the term, grant the consultant an option to purchase 10,000 shares of the Company's Common Stock with an exercise price equal to fair market value. One-third of the options vest upon the grant date, the second third vests on the first anniversary date of the grant date, and the remaining third vests on the second anniversary of the grant date. During the nine months ending September 30, 2013, the consultant was granted options to purchase 90,000 shares of the Company's Common Stock with exercise prices ranging from \$0.16 to \$0.32 per share. These options were not granted under the 2011 Plan. The fair value of these options upon issuance amounted to \$13,828.

On March 14, 2013, under the 2011 Plan, three employees and directors of the Company were granted options to purchase 150,000 shares of the Company's Common Stock with an exercise price of \$0.43 per share. One-third of the options vest upon the grant date, the second third vests on the first anniversary date of the grant date, and the remaining third vests on the second anniversary of the grant date. The fair value of these options upon issuance amounted to \$11,310.

On March 14, 2013, seven employees and directors of the Company were granted options to purchase 362,500 shares of the Company's Common Stock with an exercise price of \$0.43 per share. These options were granted separate and apart from the 2011 Plan and were not granted from the shares available under the Company's 2011 Plan. One-third of the options vest upon the grant date, the second third vests on the first anniversary date of the grant date, and the remaining third vests on the second anniversary of the grant date. The fair value of these options upon issuance amounted to \$27,333.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

### 10. Stock Options and Grants (continued)

The fair value of the stock-based option awards granted during the nine months ended September 30, 2013 were estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

Stock price	\$ 0.23-0.24
Expected dividend yield	0.00%
Expected stock volatility	50%
Risk-free interest rate	0.88-2.78%
Expected life	5.5 - 10 years

Because the Company does not have significant historical data on employee exercise behavior, the Company uses the "Simplified Method" to calculate the expected life of the stock-based option awards. The simplified method is calculated by averaging the vesting period and contractual term of the options.

### 11. Commitments

**Operating lease** – The Company leases office space in New York City to conduct its business. The Company's previous lease began in October 2011 and was terminated as of September 30, 2013. \$24,742 and 83,334 shares of the company's common stock will be issued to the former lessor in lieu of the balance due of \$49,742 as of September 30, 2013. Non-contingent rent increases were being amortized over the life of the lease on a straight line basis. As of September 30, 2013 the reversal of the accrued rent increases resulted in a decrease of rent expense. The Company's current lease began on October 1, 2013 and expires December 31, 2014. The rental expense charged to operations for the three months ended September 30, 2013 and 2012 amounted to \$3,898 (net of \$23,773 in reversal of accrued rent upon termination of lease) and \$28,217, respectively. The rental expense charged to operations for the nine months ended September 30, 2013 and 2012 amounted to \$57,672 and \$84,651, respectively. Future minimum rental payments on this lease are as follows for the year ending December 31,:

2014	\$ 71,999
	<u>\$ 71,999</u>

### 12. Related Party Transactions

ConGlobal Industries, Inc. is a minority stockholder of the Company and provides containers and labor on domestic projects. The Company recognized Cost of Goods Sold of \$338,656 and \$238,578, for services ConGlobal Industries, Inc. rendered during the three months ended September 30, 2013 and 2012, respectively. The Company recognized Cost of Goods Sold of \$1,215,710 and \$803,149, for services ConGlobal Industries, Inc. rendered during the nine months ended September 30, 2013 and 2012, respectively. As of September 30, 2013 and December 31, 2012, \$161,592 and \$62,844, respectively, of such expenses are included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets.

# SG BLOCKS, INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

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For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

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### 12. Related Party Transactions *(continued)*

The Lawrence Group is a minority stockholder of the Company and is a building design, development and project delivery firm. The Company recognized Cost of Goods Sold of \$52,966 for services The Lawrence Group rendered during the nine months ended September 30, 2013. As of September 30, 2013 and December 31, 2012, \$27,629 and \$37,233, respectively, of expenses were included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheet.

The Company has accrued certain reimbursable expenses of owners of the Company. Such expenses amounted to \$19,149 and \$2,779 for the nine months ended September 30, 2013 and the year ended December 31, 2012, respectively, and are included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets as of September 30, 2013 and December 31, 2012.

### 13. Cancellation of Trade Liabilities and Unpaid Interest

For the three months and nine months ended September 30, 2013 and 2012, the Company recognized debt forgiveness income of \$0, \$0, \$0, and \$31,447 respectively, as shown on the accompanying statements of operations, which represents forgiveness of trade accounts payable resulting from settlement agreements with vendors.

### 14. Subsequent Events

On October 1, 2013, the Company entered into a one year consulting agreement pursuant to which, in exchange for certain services, the consultant will receive up to 1,000,000 shares of the Company's common stock in addition to cash payments. In November 2013, the Company's board of directors approved the issuance of 1,000,000 shares of the Company's common stock to the consultant, of which 500,000 shares will be held in escrow. If neither party has terminated the consulting agreement during the first six month period after the execution of the agreement, the escrowed shares will be released to the consultant. The consultant will also be paid a monthly fee of \$7,000 beginning on October 1, 2013 through January 2014. Beginning February 2014 and May 2014, the monthly fee will increase to \$10,000 and \$12,500, respectively, for the duration of the agreement.

During November 2013, the Company's board of directors approved the 2013 Stock Plan. The 2013 Stock Plan covers up to 2,000,000 shares of common stock, and all officers, directors, employees, consultants and advisors are eligible to be granted awards under the 2013 Stock Plan. The 2013 Stock Plan is administered by the Company's board of directors.

During November 2013, two consultants of the Company were each granted options to purchase 200,000 shares of the Company's Common Stock with an exercise price of \$0.43 per share. These options were granted separate and apart from the 2011 Plan and were not granted from the shares available under the Company's 2011 Plan. These options were granted under the 2013 Stock Plan. One-third of the options vest upon the grant date, the second third vests on August 12, 2014, and the remaining third vests on August 12, 2015.

During November 2013, the Company's board of directors also approved a grant of 25,000 shares of the Company's common stock to a consultant in exchange for marketing services.



The number of shares of common stock of the Company issued and outstanding immediately following the consummation of the Merger on November 4, 2011 is summarized as follows:

	<b>Number of Shares</b>
SG Building shares outstanding prior to the Merger	1,786,000
Share exchange ratio (20.1851851852 to 1)	<u>20.1851851852</u>
	36,050,764
SG Blocks shares outstanding prior to the Merger	3,269,992
Shares issued in connection with the Merger	<u>408,750</u>
	<u><u>39,729,506</u></u>

In connection with the Merger Agreement, the Company entered into an escrow agreement with former shareholders of SG Building in order to provide for any payment to which the Company may be entitled with respect to post-closing rights to indemnification under the Merger Agreement. Under the terms of the escrow agreement, the former stockholders of SG Building placed in escrow (with an independent escrow agent) a total of 817,500 shares of common stock received by them in the Merger. Such shares of common stock held in escrow were the Company's sole remedy for rights to indemnification under the Merger Agreement. No claims for indemnification were asserted by the Company within the escrow period, and accordingly the escrowed shares were released from escrow in April 2012.

### **General**

SG Building, our wholly-owned subsidiary, offers the construction industry a safer, greener, faster, longer lasting and more economical alternative to conventional construction methods. SG Building redesigns, repurposes, and converts heavy-gauge steel cargo shipping containers into safe green building blocks for commercial, industrial, and residential building construction.

SG Building is a provider of code engineered cargo shipping containers that it modifies and delivers to meet the growing demand for safe and green construction. Rather than consuming new steel and lumber, SG Building capitalizes on the structural engineering and design parameters a shipping container must meet and repurposes them for use in building.

During 2011, the Company formed SG Blocks Sistema De Constucao Brasileiro LTDA. ("SG Brazil"), a wholly owned subsidiary of the Company. As of September 30, 2013, SG Brazil is inactive.

## Results of Operations

### Nine Months Ended September 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Loss from operations	(1,438,328)	(1,516,246)
Other income (expense)	(214,290)	59,622
Net Loss	<u>(1,652,618)</u>	<u>(1,456,624)</u>

### Revenue

Revenue for the nine months ended September 30, 2013 was \$4,309,989 compared to \$1,980,320 for the nine months ended September 30, 2012. This increase of \$2,329,669 results mainly from an increase of revenue from block “green steel” jobs and project management jobs as well as a decrease in revenue from engineering jobs. Revenue recognized from block “green steel” jobs and project management jobs increased approximately \$649,000 and \$2,280,000, respectively, and revenue recognized from engineering jobs decreased by approximately \$599,000 for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. During the nine months ended September 30, 2013 the Company recognized revenue from 10 project management jobs compared to 6 project management jobs for the nine months ended September 30, 2012. During the nine months ended September 30, 2013 the Company recognized revenue from 2 engineering jobs compared to 7 engineering jobs for the nine months ended September 30, 2012.

### Cost of Revenue and Gross Profit

Cost of revenue increased by \$2,489,896 to \$4,083,443 for the nine months ended September 30, 2013 from \$1,593,547 for the nine months ended September 30, 2012. The increase in cost of revenue results primarily from an increase of costs from block “green steel” costs and project management jobs, a decrease in costs from engineering jobs and loss accruals of approximately \$10,200. Costs recognized from block “green steel” jobs and project management jobs increased approximately \$611,000 and \$2,404,000, respectively, and costs recognized from engineering jobs decreased approximately \$526,000 for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. Gross profit decreased by \$160,227 to \$226,546 for the nine months ended September 30, 2013 compared to \$386,773 for the nine months ended September 30, 2012. Gross profit percentage decreased to 5% for the nine months ended September 30, 2013 compared to 20% for the nine months ended September 30, 2012. This decrease results primarily from a change in gross profit percentage from project management jobs from 10% for the nine months ended September 30, 2012 to (5)% for the nine months ended September 30, 2013. The Company incurred gross loss from project management revenue during the nine months ended September 30, 2013 due to losses recognized on four jobs totaling approximately \$182,000.

### Payroll and Related Expense

Payroll and related expense for the nine months ended September 30, 2013 was \$1,009,971 compared to \$1,073,808 for the nine months ended September 30, 2012. This decrease was mainly caused by voluntary salary reductions from management and staff in an effort to reduce operating costs.

### Other Operating Expenses

Other operating expenses for the nine months ended September 30, 2013 was \$654,903 compared to \$829,211 for the nine months ended September 30, 2012. The decrease of \$174,308 results primarily from a decrease of approximately \$151,000 in professional fees for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. This decrease results from Company efforts to lower overhead costs.

## Interest Expense

Interest expense for the nine months ended September 30, 2013 was \$505,378 compared to \$6,154 for the nine months ended September 30, 2012. This increase of \$499,224 results from accrued interest, amortization of debt discount on the Company's convertible debentures and amortization of debt issuance costs.

## Other income (expense)

During the nine months ended September 30, 2012, there was other income recognized from a cancellation of trade liabilities and accrued interest of \$31,447. Additionally during the nine months ended September 30, 2013 and 2012 there was other income of \$290,973 and \$34,224, respectively, recognized due to a change in fair value of financial instruments.

## Three Months Ended September 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Loss from operations	(303,756)	(524,987)
Other income (expense)	(161,626)	(870)
Net Loss	<u>(465,382)</u>	<u>(525,857)</u>

## Revenue

Revenue for the three months ended September 30, 2013 was \$1,732,201 compared to \$373,250 for the three months ended September 30, 2012. This increase of \$1,358,951 results mainly from an increase of revenue from block "green steel" jobs and project management jobs. Revenue recognized from block "green steel" jobs and project management jobs increased approximately \$598,000 and \$785,000, respectively, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. During the three months ended September 30, 2013 the Company recognized revenue from 8 project management jobs compared to 4 project management jobs for the three months ended June 30, 2012. The increase in revenue from block "green steel" jobs is primarily from a sale to one customer in the amount of \$488,000 being recognized during the three months ended September 30, 2013.

## Cost of Revenue and Gross Profit

Cost of revenue increased by \$1,209,492 to \$1,515,161 for the three months ended September 30, 2013 from \$305,669 for the three months ended September 30, 2012. The increase in cost of revenue results primarily from an increase of costs from block "green steel" jobs and project management jobs, as well as loss accruals of approximately \$10,200. Costs recognized from block "green steel" jobs and project management jobs increased approximately \$552,000 and \$695,000, respectively, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. Gross profit increased by \$149,459 to \$217,040 for the three months ended September 30, 2013 compared to \$67,581 for the three months ended September 30, 2012. Gross profit percentage decreased to 13% for the three months ended September 30, 2013 compared to 18% for the three months ended September 30, 2012. This decrease results primarily from a change in gross profit percentage from block "green steel" jobs from 25% for the three months ended September 30, 2012 to 14% for the three months ended September 30, 2013. The Company incurred gross loss from project management revenue during the three months ended September 30, 2013 due to losses recognized on four jobs totaling approximately \$48,000.

## Payroll and Related Expense

Payroll and related expense for the three months ended September 30, 2013 was \$332,878 compared to \$358,918 for the three months ended September 30, 2012. This decrease was mainly caused by voluntary salary reductions from management and staff in an effort to reduce operating costs.

## Other Operating Expenses

Other operating expenses for the three months ended September 30, 2013 was \$187,918 compared to \$233,650 for the three months ended September 30, 2012. The decrease of \$45,732 results primarily from a decrease of approximately \$30,000 in professional fees for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. This decrease results from Company efforts to lower overhead costs.

**Interest Expense**

Interest expense for the three months ended September 30, 2013 was \$184,277 compared to \$2,067 for the three months ended September 30, 2012. This increase of \$182,210 results from accrued interest, amortization of debt discount on the Company's convertible debentures and amortization of debt issuance costs.

**Other income (expense)**

During the three months ended September 30, 2013 and 2012 there was other income of \$22,616 and \$1,160, respectively, recognized due to a change in fair value of financial instruments.

**Income Tax Provision**

A 100% valuation allowance was provided against the deferred tax asset consisting of available net operating loss carry forwards and accordingly no income tax benefit was provided.

**Impact of Inflation**

The impact of inflation upon the Company's revenue and income/(loss) from continuing operations during each of the past two fiscal years has not been material to its financial position or results of operations for those years because the Company does not maintain any inventories whose costs are affected by inflation.

**Liquidity and Capital Resources**

Since SG Building's inception in 2008, SG Building has generated losses from operations and the Company anticipates that it will continue to generate losses from operations for the foreseeable future. As of September 30, 2013 and December 31, 2012, the Company's stockholders' deficiency was approximately \$1,864,000 and \$516,000, respectively. The Company's net loss from operations for the nine months ended September 30, 2013 was \$1,652,618. Net cash used in operating activities was \$1,152,333 for the nine months ended September 30, 2013.

Through September 30, 2013, the Company has incurred an accumulated deficiency since inception of \$8,689,394. At September 30, 2013, the Company had a cash balance of \$524,580. At November 13, 2013, the Company had a cash balance of approximately \$441,000.

Since the Company's inception, it has generated revenues from SG Block sales, engineering services, and project management.

The Company expects that through the next 10 to 16 months, the capital requirements to fund the Company's growth and to cover the operating costs of a public company will consume all of the cash flows that it expects to generate from its operations, as well as from the proceeds of intended issuances of debt and equity securities. The Company further believes that during this period, while the Company is focusing on the growth and expansion of its business, the gross profit that it expects to generate from operations will not generate sufficient funds to cover these anticipated operating costs. Accordingly, the Company requires external funding to sustain operations and to follow through on the execution of its business plan. However, there can be no assurance that the Company's plans will materialize and/or that the Company will be successful in funding estimated cash shortfalls through additional debt or equity capital and through the cash generated by the Company's operations. Given these conditions, the Company's ability to continue as a going concern is contingent upon it being able to secure an adequate amount of debt or equity capital to enable it to meet its cash requirements. In addition, the Company's ability to continue as a going concern must be considered in light of the problems, expenses and complications frequently encountered by entrants into established markets, the competitive environment in which the Company operates and the current capital raising environment.

Since inception, the Company's operations have primarily been funded through proceeds from equity and debt financings and sales activity. Although management believes that the Company has access to capital resources, there are currently no commitments in place for new financing at this time, and there is no assurance that the Company will be able to obtain funds on commercially acceptable terms, if at all.

During the nine months ended September 30, 2013, the Company raised \$850,000 in net new funds through the issuance of convertible debentures.

With respect to the debentures sold in 2012 and the nine months ended September 30, 2013, at any time after such issuance until the debentures are no longer outstanding, the debentures are convertible, in whole or in part, into shares of Common Stock of the Company at the option of the holder, subject to certain conversion limitations set forth in the Debenture. The initial conversion price for the Debenture is \$0.43 per share, subject to adjustments upon certain events, as set forth in the Debenture. The Company shall pay interest on the outstanding principal amount of the Debenture that has not been converted, at the rate of 8% per annum, payable quarterly on July 1, October 1, January 1 and April 1, beginning on July 1, 2013. Interest is payable in cash or at the Company's option in shares of Common Stock, provided certain conditions are met, as described in the debenture. On each of April 1, 2014, July 1, 2014, July 15, 2014 and October 15, 2014, the Company is obligated to redeem \$756,000, \$756,000, \$280,000 and \$280,000, respectively, (plus accrued but unpaid interest, liquidated damages and any other amounts then owing in respect of the Debenture) (the "Periodic Redemption Amount"). In lieu of a cash redemption and subject to the Company meeting certain equity conditions described in the Debenture, the Company may elect to pay the Periodic Redemption Amount in Common Stock based on a conversion price equal to the lesser of (a) \$0.43 per share, subject to adjustments upon certain events, and (b) 90% of the average of the volume weighted average price for the 20 consecutive trading days prior to the applicable redemption date, provided that the conversion price shall be equal to at least a \$0.01 discount to the volume weighted average price for the trading day that is immediately prior to the applicable redemption date. Upon any Event of Default (as defined in the Debenture), the outstanding principal amount of the Debenture, plus liquidated damages, interest, a premium of 30% and other amounts owing in respect thereof, shall become, at the holder's election, immediately due and payable in cash. Commencing five days after the occurrence of any Event of Default, the interest rate on the Debenture shall accrue at an interest rate equal to the lesser of 18% per annum or the maximum rate permitted under applicable law.

The Company intends to raise additional funds in 2014 through a private placement of its common stock as well as additional issuances of convertible debentures. The additional capital would be used to fund the Company's operations, including the costs that it expects to incur as a public company. The current level of cash and operating margins is not enough to cover the existing fixed and variable obligations of the Company, so increased revenue performance and the addition of capital through issuances of securities are critical to the Company's success. Should the Company not be able to raise additional capital through a private placement or some other financing source, the Company would take one or more of the following actions to conserve cash: reduction in employee headcount, reduction in base salaries to senior executives and employees, and other cost reduction measures. Assuming that the Company is successful in its growth plans and development efforts, the Company believes that it will be able to raise additional funds through sales of its stock. There is no guarantee that the Company will be able to raise such additional funds on acceptable terms, if at all.

These factors, among others, raise substantial doubt about the Company's ability to continue as a going concern.

The Company's financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should it be unable to continue as a going concern.

## **Off –Balance Sheet Arrangements**

As of September 30, 2013 and December 31, 2012, the Company had no material off-balance sheet arrangements other than operating leases to which SG Building is a party.

In the ordinary course of business, SG Building enters into agreements with third parties that include indemnification provisions which, in its judgment, are normal and customary for companies in its industry sector. These agreements are typically with consultants and certain vendors. Pursuant to these agreements, SG Building generally agrees to indemnify, hold harmless, and reimburse indemnified parties for losses suffered or incurred by the indemnified parties with respect to actions taken or omitted by SG Building. The maximum potential amount of future payments SG Building could be required to make under these indemnification provisions is unlimited. SG Building has not incurred material costs to defend lawsuits or settle claims related to these indemnification provisions. As a result, the estimated fair value of liabilities relating to these provisions is minimal. Accordingly, the Company has no liabilities recorded for these provisions as of September 30, 2013.

## **Critical Accounting Policies and New Accounting Pronouncements**

### **Critical Accounting Policies**

Our condensed consolidated financial statements have been prepared with generally accepted accounting principles in the United States (“GAAP”), which require management to make estimates and assumptions that affect reported amounts. The estimates and assumptions are based on historical experience and on other factors that management believes to be reasonable. Actual results may differ from those estimates. Critical accounting policies represent the areas where more significant judgments and estimates are used in the preparation of our condensed consolidated financial statements. A discussion of such critical accounting policies, which include share-based payments, derivative instruments, and revenue recognition can be found in our Annual Report on Form 10-K for the year ended December 31, 2012. There have been no material changes to the policies noted above as of the Quarterly Report on Form 10-Q for the period ended September 30, 2013.

### ***Related Party Transactions***

ConGlobal Industries, Inc. is a minority stockholder of the Company and provides containers and labor on domestic projects. The Company recognized Cost of Goods Sold of \$338,656 and \$238,578, for services ConGlobal Industries, Inc. rendered during the three months ended September 30, 2013 and 2012, respectively. The Company recognized Cost of Goods Sold of \$1,215,710 and \$803,149, for services ConGlobal Industries, Inc. rendered during the nine months ended September 30, 2013 and 2012, respectively. As of September 30, 2013 and December 31, 2012, \$161,592 and \$62,844, respectively, of such expenses are included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets.

The Lawrence Group is a minority stockholder of the Company and is a building design, development and project delivery firm. The Company recognized Cost of Goods Sold of \$52,966 for services The Lawrence Group rendered during the nine months ended September 30, 2013. As of September 30, 2013 and December 31, 2012, \$27,629 and \$37,233, respectively, of expenses were included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheet.

The Company has accrued certain reimbursable expenses of owners of the Company. Such expenses amounted to \$19,149 and \$2,779 for the nine months ended September 30, 2013 and the year ended December 31, 2012, respectively, and are included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets as of September 30, 2013 and December 31, 2012.

*Transactions with Vector*

On March 26, 2009, the Company entered into a \$50,000 Revolving Credit Promissory Note (the “ Revolver ”) with Vector, the Company’s pre-Merger principal stockholder, due December 31, 2012. During 2012, the Revolver was extended for a year, with a maturity date of December 31, 2013. The loan bears interest at 11% per year. On January 26, 2011, the Company and Vector entered into an amendment to the Revolver increasing the amount that it may borrow thereunder from \$50,000 to \$100,000. As of September 30, 2013 and December 31, 2012 the Revolver had \$73,500 of principal and \$26,570 and \$20,439, respectively, of interest outstanding.

*Transactions with Ladenburg*

During the first quarter of 2012, the Company engaged Ladenburg as its placement agent to conduct a best efforts private placement of the Company’s common stock at a valuation of \$0.35 per share (the 2012 Private Placement). In connection with the 2012 Private Placement, Ladenburg has and will receive compensation based on the following components: (a) a cash commission equal to 6% of the aggregate purchase price of the shares sold to all investors at each closing (or a lesser percentage with respect to certain investors, as agreed upon between the Ladenburg and the Company) and will be issued a five-year warrant to purchase shares of Common Stock of the Company equal to nine percent (9%) of the total number of shares sold to all investors at such closing (or a lesser percentage in the event certain investors invest, as agreed upon between Ladenburg and the Company), (b) the shares of Common Stock underlying the warrants issued to the Ladenburg will have the same registration rights as the investors with respect to their shares and (c) at the initial closing, the Company reimbursed Ladenburg for its reasonable expenses incurred in connection with the offering.

On March 28, 2012, we received net proceeds of \$433,608 from the 2012 Private Placement. On May 23, 2012, we received additional net proceeds of \$208,575 from the 2012 Private Placement.

Mr. Lampen is the president and chief executive officer of Ladenburg's parent company. Additionally, Vector beneficially owns approximately 8% of the Ladenburg Thalmann Financial Services Inc., the parent company and sole owner of Ladenburg.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Not applicable.

**Item 4. Controls and Procedures**

***(a) Disclosure Controls and Procedures.***

Management, with the participation of our Principal Executive Officer and Principal Financial Officer, carried out an evaluation of the effectiveness of our "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934, as amended (the "Exchange Act")) Rules 13a-15(e) and 15d-15(e) as of the end of the period covered by this Quarterly Report on Form 10-Q (the "Evaluation Date"). Based upon that evaluation, our Principal Executive Officer and Principal Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures are not effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported, within the time periods specified in the SEC rules and forms and (ii) is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Notwithstanding the conclusion that our disclosure controls and procedures were not effective as of the end of the period covered by this Quarterly Report, the Principal Executive Officer and the Principal Financial Officer believe that the condensed consolidated financial statements and other information contained in this Quarterly Report present fairly, in all material respects, our business, financial condition and results of operations.

Our management, including our Principal Executive Officer and Principal Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

In connection with the audit of our fiscal 2012 consolidated financial statements, our independent auditors identified certain significant deficiencies that together constitute a material weakness in our disclosure controls and procedures. These significant deficiencies primarily relate to our (i) difficulty in generating data in a form and format that facilitates the timely analysis of information needed to produce accurate financial reports, (ii) difficulty in applying complex accounting and financial reporting and disclosure rules required under GAAP and the SEC reporting regulations, and (iii) limited segregation of duties. These significant deficiencies together constitute a material weakness in our disclosure controls and procedures.

During the year ended December 31, 2012, we have taken certain steps in an effort to correct these material weaknesses, including retaining the Chief Financial Officer who has significant experience with publicly-held companies. Although this is an important step towards improving the application of complex accounting principles, the preparation of financial reports and the segregation of duties, additional time is still required to fully implement additional internal controls procedures and test their operating effectiveness before we can definitively conclude that we have remediated our deficiencies. Because these remediation steps have not yet been completed, we have performed additional analyses and other procedures to ensure that our consolidated financial statements contained in this Quarterly Report were prepared in accordance with GAAP and applicable SEC regulations.

We believe that our weaknesses in internal control over financial reporting and our disclosure controls relate in part to the fact that prior to the Merger, SG Building was a small, privately-held company and was not subject to public company disclosure requirements, including the requirement to report on internal control over financial reporting in compliance with Section 404 of the Sarbanes-Oxley Act of 2002 and Item 308 of Regulation S-K. Our internal controls are still in a state of transition as we work diligently to integrate and assimilate all of our operations and work to remedy the significant deficiencies that together constitute a material weakness in our internal control over financial reporting.

***(b) Changes in Internal Control over Financial Reporting***

Notwithstanding our remedial actions and integration of our financial reporting systems following the Merger, there was no change in our internal control over financial reporting that occurred during the third quarter of 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

None.

### Item 1A. Risk Factors

*Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below before making an investment decision. If any of the following risks or uncertainties occur, our business, prospects, financial condition or operating results could be materially adversely affected, the trading price of our common stock could decline, and you may lose all or part of your investment. In assessing the risks described below, you should also refer to the other information contained in this Quarterly Report on Form 10-Q, including our consolidated financial statements and the related notes and schedules, before deciding to purchase any shares of our common stock.*

*In addition to the risk factors below and other information set forth in this Quarterly Report, you should carefully consider the risk factors previously disclosed in "Item 1A, To Part II" of our Annual Report on Form 10-K for the year ended December 31, 2012. There were no material changes from these risk factors during the three months ended September 30, 2013.*

#### **Risks Relating to the Company**

***If we are not successful in our efforts to increase sales or raise capital, we will experience a shortfall in cash over the next twelve months and our ability to raise capital may be limited.***

As of September 30, 2013 and December 31, 2012, SG Building, our wholly-owned subsidiary, had cash and cash equivalents of \$524,580 and \$868,067, respectively. However, over the nine months ended September 30, 2013 and fiscal year ended December 31, 2012, we had a net loss of \$1,652,618 and \$1,766,025, respectively. We incurred additional losses during the quarter ending December 31, 2013. If we are not successful with our marketing efforts to increase sales, we will experience a shortfall in cash over the next twelve months. If necessary, we will implement a plan to fund such a deficit which could include, among other things, reducing operating expenses in an amount sufficient to operate the business for a reasonable period of time. During the nine months ended September 30, 2013, we received \$850,000 from the issuance of convertible debentures. We may also seek to obtain debt or additional equity financing to address any shortfalls in our cash. The type, timing and terms of the financing we may select will depend on, among other things, our cash needs, the availability of other financing sources and prevailing conditions in the financial markets. However, there can be no assurance that we would be able to secure additional funds if needed and that if such funds are available, whether the terms or conditions would be acceptable to us. In such case, the further reduction in operating expenses might need to be substantial in order for us to ensure enough liquidity to sustain our operations. It will also be difficult for us to make any acquisitions unless we can raise additional capital. Any financing would be dilutive to our stockholders.

The Company has identified cost reduction measures which when implemented would result in a reduction in employee headcount, reduction in base salaries to senior executives and employees, and other cost savings measures. These actions have been implemented and have begun to result in annual cost savings.

***We have incurred net losses in certain prior periods and there can be no assurance that we will generate income in the future.***

Our ability to achieve profitability will depend upon our ability to generate and sustain substantially increased revenues. We may incur operating losses in the future as we execute our growth strategy. We intend to make significant expenditures related to marketing, expansion of our website, hiring of additional personnel, and development of our technology and infrastructure. Although SG Building generated revenue from operations during the nine months ended September 30 2013 and the year ended December 31, 2012, it has incurred net losses of \$1,652,618 and \$1,766,025, respectively, during such periods. The likelihood that we will generate net income in the future must be considered in light of the difficulties facing the construction and construction management industries as a whole, economic conditions, the competitive environment in which we operate and the other risks and uncertainties discussed in this Quarterly Report. Our operating results for future periods are subject to numerous uncertainties, and it may not achieve sufficient revenues to sustain or increase profitability on a quarterly or annual basis.

***The Company's ability to continue as a going concern is contingent upon securing additional capital.***

The Company expects that through the next 10 to 16 months, the capital requirements to fund the Company's growth and to cover the operating costs of a public company will consume substantially all of the cash flows that it expects to generate from its operations, as well as from the proceeds of intended issuances of debt and equity securities. The Company further believes that during this period, while the Company is focusing on the growth and expansion of its business, the gross profit that it expects to generate from operations will not generate sufficient funds to cover these anticipated operating costs. Accordingly, the Company requires external funding to sustain operations and to follow through on the execution of its business plan. However, there can be no assurance that the Company's plans will materialize and/or that the Company will be successful in funding estimated cash shortfalls through additional debt or equity capital and through the cash generated by the Company's operations. Given these conditions, the Company's ability to continue as a going concern is contingent upon it being able to secure an adequate amount of debt or equity capital to enable it to meet its cash requirements. In addition, the Company's ability to continue as a going concern must be considered in light of the problems, expenses and complications frequently encountered by entrants into established markets, the competitive environment in which the Company operates and the current capital raising environment.

***The exercise of outstanding warrants and options will dilute the percentage ownership of then-existing stockholders.***

As of October 31, 2013, there are outstanding Warrants to purchase 6,119,864 shares of common stock and options to purchase 10,330,001 shares of common stock. Options to purchase 7,996,072 shares were granted under our 2011 Incentive Stock Plan. We also have outstanding convertible debt which is initially convertible into 4,818,605 shares of the Company's common stock. However, the terms of the convertible debentures provide that under certain circumstances the number of shares issuable upon the conversion of the debentures can be increased based on the market price of the Company's common stock at the time of conversion. Accordingly, if the price of the common stock is significantly below \$0.43 per share, the number of shares the convertible debt is convertible into could be significantly higher than 4,818,605 shares. The exercise of such outstanding warrants and options or the conversion into common stock of our convertible debt would dilute the then-existing stockholders' percentage ownership of the Company's stock, and any sales in the public market of common stock underlying such securities could adversely affect prevailing market prices for the common stock. Moreover, the terms upon which the Company would be able to obtain additional equity capital could be adversely affected since the holders of such securities can be expected to exercise or convert them at a time when the Company would, in all likelihood, be able to obtain any needed capital on terms more favourable to the Company than those provided by such securities.

***We are dependent on the services of key personnel, and the unexpected loss of their services may adversely affect its operations.***

Our success depends highly upon the personal efforts and abilities of our senior management team, specifically the efforts of Paul Galvin, the Company's Chief Executive Officer and Director, Stevan Armstrong, the Company's President and Chief Operating Officer and Director, Brian Wasserman, the Company's Chief Financial Officer and Director, and Jennifer Strumingher, the Company's Chief Administrative Officer. The employment agreements for Mr. Galvin, Mr. Armstrong and Ms. Strumingher expired on October 26, 2013. Mr. Galvin, Mr. Armstrong and Ms. Strumingher continue to be employed by the Company, but without an employment agreement. The loss of the services of one or more of these individuals could have a material adverse effect on our business. Our ability to achieve profitability and generate increased revenue will depend upon our ability to retain, and attract if necessary, experienced management personnel.

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

During the three months ended September 30, 2013, the Company issued the following options to purchase the Company's common stock to consultants, directors, officers and employees of the Company:

<b>Recipient</b>	<b>Date</b>	<b>Exercise Price</b>	<b>Amount</b>
Edmund P. Giambastiani, Jr. - Consultant	07/31/2013	\$ 0.19	10,000
	08/30/2013	\$ 0.19	10,000
	09/30/2013	\$ 0.30	10,000
<b>TOTAL</b>			<b>30,000</b>

Options to purchase 30,000 shares of the Company's common stock were awarded by approval of the Company's board of directors. One third of the options vest upon grant, the second third vests on the first anniversary of the grant date, and the remaining third vests on the second anniversary of the grant date. These options generally have the same terms and conditions as provided under the 2011 Incentive Stock Plan (See Note 10). The aggregate number of such options granted to consultants is 30,000 options. The issuance of such options was exempt from the registration requirements under the Securities Act, pursuant to Section 4(2) thereof, because the transaction did not involve a public offering.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

Mr. Wasserman served as Chief Financial officer of ContinuityX Solutions, Inc. ("Continuity") from August 16, 2012 to February 7, 2013. Mr. Wasserman was sued by certain of Continuity's lenders alleging negligent misrepresentation to those lenders in connection with information provided to the lenders from Mr. Wasserman and Continuity. Mr. Wasserman believed the allegations were without merit and Mr. Wasserman vigorously defended himself against the lawsuit. On October 15, 2013, the lawsuit against Mr. Wasserman was dismissed by court order issued by the Federal Court in Maryland.

**Item 6. Exhibits**

- 10.1 Form Securities Purchase Agreement, dated December 27, 2012 (as amended).
- 31.2+ Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2+ Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1+ Certification by Chief Executive Officer and 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.

+ **Transmitted herewith.**

**SIGNATURE**

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.

**SG BLOCKS, INC.**  
(Registrant)

Date: November 14, 2013

By: /s/ Brian Wasserman  
Brian Wasserman  
Chief Financial Officer  
(Duly Authorized Officer and Principal Financial and Chief  
Accounting Officer)

**SECURITIES PURCHASE AGREEMENT**

This Securities Purchase Agreement (this "Agreement") is dated as of December 27, 2012, between SG Blocks, Inc., a Delaware corporation (the "Company"), and each purchaser identified on the signature pages hereto (each, including its successors and assigns, a "Purchaser" and collectively, the "Purchasers").

WHEREAS, subject to the terms and conditions set forth in this Agreement and pursuant to Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), and Rule 506 promulgated thereunder, the Company desires to issue and sell to each Purchaser, and each Purchaser, severally and not jointly, desires to purchase from the Company, securities of the Company as more fully described in this Agreement.

NOW, THEREFORE, IN CONSIDERATION of the mutual covenants contained in this Agreement, and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, the Company and each Purchaser agree as follows:

**ARTICLE I.  
DEFINITIONS**

1 . 1 Definitions. In addition to the terms defined elsewhere in this Agreement: (a) capitalized terms that are not otherwise defined herein have the meanings given to such terms in the Debentures (as defined herein), and (b) the following terms have the meanings set forth in this Section 1.1:

"Acquiring Person" shall have the meaning ascribed to such term in Section 4.7.

"Action" shall have the meaning ascribed to such term in Section 3.1(j).

"Affiliate" means any Person that, directly or indirectly through one or more intermediaries, controls or is controlled by or is under common control with a Person, as such terms are used in and construed under Rule 405 under the Securities Act.

"Board of Directors" means the board of directors of the Company.

"Business Day" means any day except any Saturday, any Sunday, any day which is a federal legal holiday in the United States or any day on which banking institutions in the State of New York are authorized or required by law or other governmental action to close.

"Closing" means the closing of the purchase and sale of the Securities pursuant to Section 2.1.

"Closing Date" means the Trading Day on which all of the Transaction Documents have been executed and delivered by the applicable parties thereto, and all conditions precedent to (i) the Purchasers' obligations to pay the Subscription Amount and (ii) the Company's obligations to deliver the Securities, in each case, have been satisfied or waived, but in no event later than the third Trading Day following the date hereof.

“Closing Price” means the arithmetic average of the VWAPs for the Common Stock for each of the 10 Trading Days ending on the Trading Day immediately prior to the Closing Date.

“Commission” means the United States Securities and Exchange Commission.

“Common Stock” means the common stock of the Company, par value \$0.01 per share, and any other class of securities into which such securities may hereafter be reclassified or changed.

“Common Stock Equivalents” means any securities of the Company or the Subsidiaries which would entitle the holder thereof to acquire at any time Common Stock, including, without limitation, any debt, preferred stock, right, option, warrant or other instrument that is at any time convertible into or exercisable or exchangeable for, or otherwise entitles the holder thereof to receive, Common Stock.

“Company Counsel” means Olshan Frome Wolosky LLP, with offices located at Park Avenue Tower, 65 East 55th Street, New York, NY 10022.

“Conversion Price” shall have the meaning ascribed to such term in the Debentures.

“Conversion Shares” shall have the meaning ascribed to such term in the Debentures.

“Debentures” means the 8% Original Issue Discount Senior Secured Convertible Debentures due July 1, 2014, subject to the terms therein, issued by the Company to the Purchasers hereunder, in the form of Exhibit A attached hereto.

“Disclosure Schedules” shall have the meaning ascribed to such term in Section 3.1.

“EGS” means Ellenoff Grossman & Schole LLP, with offices located at 150 East 42nd Street, New York, New York 10017.

“Effective Date” means the earliest of the date that (a) all of the Underlying Shares have been sold pursuant to Rule 144 or may be sold pursuant to Rule 144 without the requirement for the Company to be in compliance with the current public information required under Rule 144 and without volume or manner-of-sale restrictions or (b) following the one year anniversary of the Closing Date provided that a holder of Underlying Shares is not an Affiliate of the Company, all of the Underlying Shares may be sold pursuant to an exemption from registration under Section 4(1) of the Securities Act without volume or manner-of-sale restrictions and Company counsel has delivered to such holders a standing written unqualified opinion that resales may then be made by such holders of Underlying Shares pursuant to such exemption which opinion shall be in form and substance reasonably acceptable to such holders.

“Evaluation Date” shall have the meaning ascribed to such term in Section 3.1(r).

“Exchange Act” means the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

“Exempt Issuance” means the issuance of (a) shares of Common Stock or options to employees, officers or directors of the Company pursuant to any stock or option plan duly adopted for such purpose, by a majority of the non-employee members of the Board of Directors or a majority of the members of a committee of non-employee directors established for such purpose, plus up to 60,000 options to consultants and up to 100,000 shares of Common Stock to service providers in connection with Company projects, (b) securities upon the exercise or exchange of or conversion of any Securities issued hereunder and/or other securities exercisable or exchangeable for or convertible into shares of Common Stock issued and outstanding on the date of this Agreement, provided that such securities have not been amended since the date of this Agreement to increase the number of such securities or to decrease the exercise price, exchange price or conversion price of such securities, (c) securities issued pursuant to acquisitions or strategic transactions approved by a majority of the disinterested directors of the Company, provided that any such issuance shall only be to a Person (or to the equityholders of a Person) which is, itself or through its subsidiaries, an operating company or an owner of an asset in a business synergistic with the business of the Company and shall provide to the Company additional benefits in addition to the investment of funds, but shall not include a transaction in which the Company is issuing securities primarily for the purpose of raising capital or to an entity whose primary business is investing in securities, and (d) warrants and the underlying securities issued to Merriman Capital, Inc. with respect to fees payable in connection with the transactions contemplated by the Transaction Documents.

“FCPA” means the Foreign Corrupt Practices Act of 1977, as amended.

“GAAP” shall have the meaning ascribed to such term in Section 3.1(h).

“Indebtedness” shall have the meaning ascribed to such term in Section 3.1(aa).

“Intellectual Property Rights” shall have the meaning ascribed to such term in Section 3.1(o).

“Legend Removal Date” shall have the meaning ascribed to such term in Section 4.1(c).

“Liens” means a lien, charge, pledge, security interest, encumbrance, right of first refusal, preemptive right or other restriction.

“Material Adverse Effect” shall have the meaning assigned to such term in Section 3.1(b).

“Material Permits” shall have the meaning ascribed to such term in Section 3.1(m).

“Maximum Rate” shall have the meaning ascribed to such term in Section 5.17.

“Participation Maximum” shall have the meaning ascribed to such term in Section 4.12(a).

“Person” means an individual or corporation, partnership, trust, incorporated or unincorporated association, joint venture, limited liability company, joint stock company, government (or an agency or subdivision thereof) or other entity of any kind.

“Pre-Notice” shall have the meaning ascribed to such term in Section 4.12(b).

“Principal Amount” means, as to each Purchaser, the amounts set forth below such Purchaser’s signature block on the signature pages hereto next to the heading “Principal Amount,” in United States Dollars, which shall equal such Purchaser’s Subscription Amount multiplied by 1.12.

“Pro Rata Portion” shall have the meaning ascribed to such term in Section 4.12(e).

“Proceeding” means an action, claim, suit, investigation or proceeding (including, without limitation, an informal investigation or partial proceeding, such as a deposition), whether commenced or threatened.

“Public Information Failure” shall have the meaning ascribed to such term in Section 4.3(b).

“Public Information Failure Payments” shall have the meaning ascribed to such term in Section 4.3(b).

“Purchaser Party” shall have the meaning ascribed to such term in Section 4.10.

“Required Approvals” shall have the meaning ascribed to such term in Section 3.1(e).

“Required Minimum” means, as of any date, the maximum aggregate number of shares of Common Stock then issued or potentially issuable in the future pursuant to the Transaction Documents, including any Underlying Shares issuable upon exercise in full of all Warrants or conversion in full of all outstanding Debentures (including Underlying Shares issuable as payment of interest on the Debentures), ignoring any conversion or exercise limits set forth therein, and assuming that the Conversion Price is at all times on and after the date of determination 75% of the then Conversion Price on the Trading Day immediately prior to the date of determination.

“Rule 144” means Rule 144 promulgated by the Commission pursuant to the Securities Act, as such Rule may be amended from time to time, or any similar rule or regulation hereafter adopted by the Commission having substantially the same effect as such Rule.

“Rule 424” means Rule 424 promulgated by the Commission pursuant to the Securities Act, as such Rule may be amended or interpreted from time to time, or any similar rule or regulation hereafter adopted by the Commission having substantially the same purpose and effect as such Rule.

“SEC Reports” shall have the meaning ascribed to such term in Section 3.1(h).

“Securities” means the Debentures, the Warrants, the Warrant Shares and the Underlying Shares.

“Securities Act” means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

“Security Agreement” means the Security Agreement, dated the date hereof, among the Company and the Purchasers, in the form of Exhibit D attached hereto.

“Security Documents” shall mean the Security Agreement, the Subsidiary Guarantees and any other documents and filing required thereunder in order to grant the Purchasers a first priority security interest in the assets of the Company and the Subsidiaries as provided in the Security Agreement, including all UCC-1 filing receipts.

“Short Sales” means all “short sales” as defined in Rule 200 of Regulation SHO under the Exchange Act (but shall not be deemed to include the location and/or reservation of borrowable shares of Common Stock).

“Subscription Amount” means, as to each Purchaser, the aggregate amount to be paid for Debentures and Warrants purchased hereunder as specified below such Purchaser’s name on the signature page of this Agreement and next to the heading “Subscription Amount,” in United States dollars and in immediately available funds.

“Subsequent Financing” shall have the meaning ascribed to such term in Section 4.12(a).

“Subsequent Financing Notice” shall have the meaning ascribed to such term in Section 4.12(b).

“Subsidiary” means any subsidiary of the Company as set forth on Schedule 3.1(a) and shall, where applicable, also include any direct or indirect subsidiary of the Company formed or acquired after the date hereof.

“Subsidiary Guarantee” means the Subsidiary Guarantee, dated the date hereof, by each Subsidiary in favor of the Purchasers, in the form of Exhibit E attached hereto.

“Trading Day” means a day on which the principal Trading Market is open for trading.

“Trading Market” means any of the following markets or exchanges on which the Common Stock is listed or quoted for trading on the date in question: the NYSE MKT, the Nasdaq Capital Market, the Nasdaq Global Market, the Nasdaq Global Select Market, the New York Stock Exchange, OTC Markets Inc., or the OTC Bulletin Board (or any successors to any of the foregoing).

“Transaction Documents” means this Agreement, the Debentures, the Warrants, the Security Agreement, the Subsidiary Guarantee, all exhibits and schedules thereto and hereto and any other documents or agreements executed in connection with the transactions contemplated hereunder.

“Transfer Agent” means American Stock Transfer & Trust Company LLC, the current transfer agent of the Company, with a mailing address of: Operations Center, 6201 15th Avenue, Brooklyn, NY 11219 and a facsimile number of: \_\_\_\_\_, and any successor transfer agent of the Company.

“Underlying Shares” means the shares of Common Stock issued and issuable upon conversion or redemption of the Debentures and upon exercise of the Warrants and issued and issuable in lieu of the cash payment of interest on the Debentures in accordance with the terms of the Debentures.

“Variable Rate Transaction” shall have the meaning ascribed to such term in Section 4.13(b).

“VWAP” means, for any date, the price determined by the first of the following clauses that applies: (a) if the Common Stock is then listed or quoted on a Trading Market, the daily volume weighted average price of the Common Stock for such date (or the nearest preceding date on which the Common Stock actually trades) on the Trading Market on which the Common Stock is then listed or quoted as reported by Bloomberg L.P. (based on a Trading Day from 9:30 a.m. (New York City time) to 4:02 p.m. (New York City time)), (b) if the OTC Bulletin Board is not a Trading Market, the volume weighted average price of the Common Stock for such date (or the nearest preceding date) on the OTC Bulletin Board, (c) if the Common Stock is not then listed or quoted for trading on the OTC Bulletin Board and if prices for the Common Stock are then reported in the “Pink Sheets” published by Pink OTC Markets, Inc. (or a similar organization or agency succeeding to its functions of reporting prices), the most recent bid price per share of the Common Stock so reported, or (d) in all other cases, the fair market value of a share of Common Stock as determined by an independent appraiser selected in good faith by the Purchasers of a majority in interest of the Securities then outstanding and reasonably acceptable to the Company, the fees and expenses of which shall be paid by the Company.

“Warrants” means, collectively, the Common Stock purchase warrants delivered to the Purchasers at the Closing in accordance with Section 2.2(a) hereof, which Warrants shall be exercisable six months after the Closing Date and have a term of exercise equal to five years from the Initial Exercise Date, in the form of Exhibit C attached hereto.

“Warrant Shares” means the shares of Common Stock issuable upon exercise of the Warrants.

**ARTICLE II.  
PURCHASE AND SALE**

2.1 Closing. On the Closing Date, upon the terms and subject to the conditions set forth herein, substantially concurrent with the execution and delivery of this Agreement by the parties hereto, the Company agrees to sell, and the Purchasers, severally and not jointly, agree to purchase, up to an aggregate of \$1,960,000 in principal amount of the Debentures. Each Purchaser shall deliver to the Company, via wire transfer or a certified check, immediately available funds equal to such Purchaser's Subscription Amount as set forth on the signature page hereto executed by such Purchaser, and the Company shall deliver to each Purchaser its respective Debenture and a Warrant, as determined pursuant to Section 2.2(a), and the Company and each Purchaser shall deliver the other items set forth in Section 2.2 deliverable at the Closing. Upon satisfaction or waiver of the covenants and conditions set forth in Sections 2.2 and 2.3, the Closing shall occur at the offices of EGS or such other location as the parties shall mutually agree.

2.2 Deliveries.

- (a) On or prior to the Closing Date, the Company shall deliver or cause to be delivered to each Purchaser the following:
- (i) this Agreement duly executed by the Company;
  - (ii) a legal opinion of Company Counsel, substantially in the form of Exhibit B attached hereto;
  - (iii) a Debenture with a principal amount equal to such Purchaser's Principal Amount, registered in the name of such Purchaser;
  - (iv) a Warrant registered in the name of such Purchaser to purchase up to a number of shares of Common Stock equal to 100% of such Purchaser's Conversion Shares on the Closing Date, with an exercise price equal to \$0.4488, subject to adjustment therein (such Warrant certificate may be delivered within three Trading Days of the Closing Date);
  - (v) waivers of dilution and/or reset rights contractually granted to purchasers of the Company's common Stock in private placements completed in 2012, and adoption of a resolution of the Board of Directors revoking any purported extension of such dilution and/or reset rights to other purchasers of the Common Stock during 2012 of such shares; and
  - (vi) the Security Agreement, duly executed by the Company and each Subsidiary, along with all of the Security Documents, including the Subsidiary Guarantee.

- (b) On or prior to the Closing Date, each Purchaser shall deliver or cause to be delivered to the Company, the following:
  - (i) this Agreement duly executed by such Purchaser;
  - (ii) such Purchaser's Subscription Amount by wire transfer to the account specified in writing by the Company;and
  - (iii) the Security Agreement duly executed by such Purchaser.

2.3 Closing Conditions.

(a) The obligations of the Company hereunder in connection with the Closing are subject to the following conditions being met:

- (i) the accuracy in all material respects on the Closing Date of the representations and warranties of the Purchasers contained herein (unless as of a specific date therein in which case they shall be accurate as of such date);
- (ii) all obligations, covenants and agreements of each Purchaser required to be performed at or prior to the Closing Date shall have been performed; and
- (iii) the delivery by each Purchaser of the items set forth in Section 2.2(b) of this Agreement.

(b) The respective obligations of the Purchasers hereunder in connection with the Closing are subject to the following conditions being met:

- (i) the accuracy in all material respects when made and on the Closing Date of the representations and warranties of the Company contained herein (unless as of a specific date therein in which case they shall be accurate as of such date);
- (ii) all obligations, covenants and agreements of the Company required to be performed at or prior to the Closing Date shall have been performed;
- (iii) the delivery by the Company of the items set forth in Section 2.2(a) of this Agreement;
- (iv) there shall have been no Material Adverse Effect with respect to the Company since the date hereof; and
- (v) from the date hereof to the Closing Date, trading in the Common Stock shall not have been suspended by the Commission or the Company's principal Trading Market and, at any time prior to the Closing Date, trading in securities generally as reported by Bloomberg L.P. shall not have been suspended or limited, or minimum prices shall not have been established on securities whose trades are reported by such service, or on any Trading Market, nor shall a banking moratorium have been declared either by the United States or New York State authorities nor shall there have occurred any material outbreak or escalation of hostilities or other national or international calamity of such magnitude in its effect on, or any material adverse change in, any financial market which, in each case, in the reasonable judgment of such Purchaser, makes it impracticable or inadvisable to purchase the Securities at the Closing.

**ARTICLE III.  
REPRESENTATIONS AND WARRANTIES**

3 . 1     Representations and Warranties of the Company. Except as set forth in the Disclosure Schedules, which Disclosure Schedules shall be deemed a part hereof and shall qualify any representation or otherwise made herein to the extent of the disclosure contained in the corresponding section of the Disclosure Schedules, the Company hereby makes the following representations and warranties to each Purchaser:

( a )     Subsidiaries. All of the direct and indirect subsidiaries of the Company are set forth on Schedule 3.1(a). The Company owns, directly or indirectly, all of the capital stock or other equity interests of each Subsidiary free and clear of any Liens, and all of the issued and outstanding shares of capital stock of each Subsidiary are validly issued and are fully paid, non-assessable and free of preemptive and similar rights to subscribe for or purchase securities. If the Company has no subsidiaries, all other references to the Subsidiaries or any of them in the Transaction Documents shall be disregarded.

( b )     Organization and Qualification. The Company and each of the Subsidiaries is an entity duly incorporated or otherwise organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation or organization, with the requisite power and authority to own and use its properties and assets and to carry on its business as currently conducted. Neither the Company nor any Subsidiary is in violation nor default of any of the provisions of its respective certificate or articles of incorporation, bylaws or other organizational or charter documents. Each of the Company and the Subsidiaries is duly qualified to conduct business and is in good standing as a foreign corporation or other entity in each jurisdiction in which the nature of the business conducted or property owned by it makes such qualification necessary, except where the failure to be so qualified or in good standing, as the case may be, could not have or reasonably be expected to result in: (i) a material adverse effect on the legality, validity or enforceability of any Transaction Document, (ii) a material adverse effect on the results of operations, assets, business, prospects or condition (financial or otherwise) of the Company and the Subsidiaries, taken as a whole, or (iii) a material adverse effect on the Company's ability to perform in any material respect on a timely basis its obligations under any Transaction Document (any of (i), (ii) or (iii), a "Material Adverse Effect"; and provided, that changes in the trading price of the Common Stock shall not, in and of itself, constitute a Material Adverse Effect) and no Proceeding has been instituted in any such jurisdiction revoking, limiting or curtailing or seeking to revoke, limit or curtail such power and authority or qualification.

( c ) Authorization; Enforcement. The Company has the requisite corporate power and authority to enter into and to consummate the transactions contemplated by this Agreement and each of the other Transaction Documents and otherwise to carry out its obligations hereunder and thereunder. The execution and delivery of this Agreement and each of the other Transaction Documents by the Company and the consummation by it of the transactions contemplated hereby and thereby have been duly authorized by all necessary action on the part of the Company and no further action is required by the Company, the Board of Directors or the Company's stockholders in connection herewith or therewith other than in connection with the Required Approvals. This Agreement and each other Transaction Document to which it is a party has been (or upon delivery will have been) duly executed by the Company and, when delivered in accordance with the terms hereof and thereof, will constitute the valid and binding obligation of the Company enforceable against the Company in accordance with its terms, except: (i) as limited by general equitable principles and applicable bankruptcy, insolvency, reorganization, moratorium and other laws of general application affecting enforcement of creditors' rights generally, (ii) as limited by laws relating to the availability of specific performance, injunctive relief or other equitable remedies and (iii) insofar as indemnification and contribution provisions may be limited by applicable law.

( d ) No Conflicts. Except as provided in Schedule 3.1(d), the execution, delivery and performance by the Company of this Agreement and the other Transaction Documents to which it is a party, the issuance and sale of the Securities and the consummation by it of the transactions contemplated hereby and thereby do not and will not: (i) conflict with or violate any provision of the Company's or any Subsidiary's certificate or articles of incorporation, bylaws or other organizational or charter documents, (ii) conflict with, or constitute a default (or an event that with notice or lapse of time or both would become a default) under, result in the creation of any Lien upon any of the properties or assets of the Company or any Subsidiary, or give to others any rights of termination, amendment, acceleration or cancellation (with or without notice, lapse of time or both) of, any agreement, credit facility, debt or other instrument (evidencing a Company or Subsidiary debt or otherwise) or other understanding to which the Company or any Subsidiary is a party or by which any property or asset of the Company or any Subsidiary is bound or affected, or (iii) subject to the Required Approvals, conflict with or result in a violation of any law, rule, regulation, order, judgment, injunction, decree or other restriction of any court or governmental authority to which the Company or a Subsidiary is subject (including federal and state securities laws and regulations), or by which any property or asset of the Company or a Subsidiary is bound or affected; except in the case of each of clauses (ii) and (iii), such as could not have or reasonably be expected to result in a Material Adverse Effect.

( e ) Filings, Consents and Approvals. The Company is not required to obtain any consent, waiver, authorization or order of, give any notice to, or make any filing or registration with, any court or other federal, state, local or other governmental authority or other Person in connection with the execution, delivery and performance by the Company of the Transaction Documents, other than: (i) the filings required pursuant to Section 4.6 of this Agreement, (ii) the notice and/or application(s) to each applicable Trading Market for the issuance and sale of the Securities and the listing of the Conversion Shares and Warrant Shares for trading thereon in the time and manner required thereby, (iii) the filing of Form D with the Commission and such filings as are required to be made under applicable state securities laws and (iv) as set forth on Schedule 3.1(e) (collectively, the "Required Approvals").

(f) Issuance of the Securities. The Securities are duly authorized and, when issued and paid for in accordance with the applicable Transaction Documents, will be duly and validly issued, fully paid and nonassessable, free and clear of all Liens imposed by the Company other than restrictions on transfer provided for in the Transaction Documents. The Underlying Shares, when issued in accordance with the terms of the Transaction Documents, will be validly issued, fully paid and nonassessable, free and clear of all Liens imposed by the Company other than restrictions on transfer provided for in the Transaction Documents. The Company has reserved from its duly authorized capital stock a number of shares of Common Stock for issuance of the Underlying Shares at least equal to the Required Minimum on the date hereof.

(g) Capitalization. Except as provided in Schedule 3.1(g), the capitalization of the Company is as described in the SEC Reports. Schedule 3.1(g) also includes the number of shares of Common Stock owned beneficially, and of record, by Affiliates of the Company as of the date hereof. The Company has not issued any capital stock since its most recently filed periodic report under the Exchange Act, other than pursuant to the exercise of employee stock options under the Company's stock option plans, the issuance of shares of Common Stock to employees pursuant to the Company's employee stock purchase plans and pursuant to the conversion and/or exercise of Common Stock Equivalents outstanding as of the date of the most recently filed periodic report under the Exchange Act. No Person has any right of first refusal, preemptive right, right of participation, or any similar right to participate in the transactions contemplated by the Transaction Documents. Except as a result of the purchase and sale of the Securities, there are no outstanding options, warrants, scrip rights to subscribe to, calls or commitments of any character whatsoever relating to, or securities, rights or obligations convertible into or exercisable or exchangeable for, or giving any Person any right to subscribe for or acquire any shares of Common Stock, or contracts, commitments, understandings or arrangements by which the Company or any Subsidiary is or may become bound to issue additional shares of Common Stock or Common Stock Equivalents. Except as set forth in Schedule 3.1(g), the issuance and sale of the Securities will not obligate the Company to issue shares of Common Stock or other securities to any Person (other than the Purchasers) and will not result in a right of any holder of Company securities to adjust the exercise, conversion, exchange or reset price under any of such securities. All of the outstanding shares of capital stock of the Company are duly authorized, validly issued, fully paid and nonassessable, have been issued in compliance with all federal and state securities laws, and none of such outstanding shares was issued in violation of any preemptive rights or similar rights to subscribe for or purchase securities. No further approval or authorization of any stockholder, the Board of Directors or others is required for the issuance and sale of the Securities. There are no stockholders agreements, voting agreements or other similar agreements with respect to the Company's capital stock to which the Company is a party or, to the knowledge of the Company, between or among any of the Company's stockholders.

( h ) SEC Reports; Financial Statements. The Company has filed all reports, schedules, forms, statements and other documents required to be filed by the Company under the Securities Act and the Exchange Act, including pursuant to Section 13(a) or 15(d) thereof, for the two years preceding the date hereof (or such shorter period as the Company was required by law or regulation to file such material) (the foregoing materials, including the exhibits thereto and documents incorporated by reference therein, being collectively referred to herein as the “SEC Reports”). Except as described on Schedule 3.1(h), such SEC Reports were filed on a timely basis or the Company received a valid extension of such time of filing and has filed any such SEC Reports prior to the expiration of any such extension. As of their respective dates, the SEC Reports complied in all material respects with the requirements of the Securities Act and the Exchange Act, as applicable, and none of the SEC Reports, when filed, contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading. The financial statements of the Company included in the SEC Reports comply in all material respects with applicable accounting requirements and the rules and regulations of the Commission with respect thereto as in effect at the time of filing. Such financial statements have been prepared in accordance with United States generally accepted accounting principles applied on a consistent basis during the periods involved (“GAAP”), except as may be otherwise specified in such financial statements or the notes thereto and except that unaudited financial statements may not contain all footnotes required by GAAP, and fairly present in all material respects the financial position of the Company and its consolidated Subsidiaries as of and for the dates thereof and the results of operations and cash flows for the periods then ended, subject, in the case of unaudited statements, to normal, immaterial, year-end audit adjustments.

(i) Material Changes; Undisclosed Events, Liabilities or Developments. Except as provided in Schedule 3.1(i) since the date of the latest audited financial statements included within the SEC Reports, except as specifically disclosed in a subsequent SEC Report filed prior to the date hereof: (i) there has been no event, occurrence or development that has had or that could reasonably be expected to result in a Material Adverse Effect, (ii) the Company has not incurred any liabilities (contingent or otherwise) other than (A) trade payables and accrued expenses incurred in the ordinary course of business consistent with past practice and (B) liabilities not required to be reflected in the Company’s financial statements pursuant to GAAP or disclosed in filings made with the Commission, (iii) the Company has not altered its method of accounting, (iv) the Company has not declared or made any dividend or distribution of cash or other property to its stockholders or purchased, redeemed or made any agreements to purchase or redeem any shares of its capital stock and (v) the Company has not issued any equity securities to any officer, director or Affiliate, except pursuant to existing Company stock option plans. The Company does not have pending before the Commission any request for confidential treatment of information. Except for the issuance of the Securities contemplated by this Agreement or as set forth on Schedule 3.1(i), no event, liability, fact, circumstance, occurrence or development has occurred or exists or is reasonably expected to occur or exist with respect to the Company or its Subsidiaries or their respective businesses, properties, operations, assets or financial condition, that would be required to be disclosed by the Company under applicable securities laws at the time this representation is made or deemed made that has not been publicly disclosed at least 1 Trading Day prior to the date that this representation is made.

(j) Litigation. Except as provided in Schedule 3.1(j), there is no action, suit, inquiry, notice of violation, proceeding or investigation pending or, to the knowledge of the Company, threatened against or affecting the Company, any Subsidiary or any of their respective properties before or by any court, arbitrator, governmental or administrative agency or regulatory authority (federal, state, county, local or foreign) (collectively, an “Action”) which (i) adversely affects or challenges the legality, validity or enforceability of any of the Transaction Documents or the Securities or (ii) could, if there were an unfavorable decision, have or reasonably be expected to result in a Material Adverse Effect. Neither the Company nor any Subsidiary, nor any director or officer thereof, is or has been the subject of any Action involving a claim of violation of or liability under federal or state securities laws or a claim of breach of fiduciary duty. There has not been, and to the knowledge of the Company, there is not pending or contemplated, any investigation by the Commission involving the Company or any current or former director or officer of the Company. The Commission has not issued any stop order or other order suspending the effectiveness of any registration statement filed by the Company or any Subsidiary under the Exchange Act or the Securities Act.

(k) Labor Relations. No labor dispute exists or, to the knowledge of the Company, is imminent with respect to any of the employees of the Company, which could reasonably be expected to result in a Material Adverse Effect. None of the Company’s or its Subsidiaries’ employees is a member of a union that relates to such employee’s relationship with the Company or such Subsidiary, and neither the Company nor any of its Subsidiaries is a party to a collective bargaining agreement, and the Company and its Subsidiaries believe that their relationships with their employees are good. To the knowledge of the Company, no executive officer of the Company or any Subsidiary, is, or is now expected to be, in violation of any material term of any employment contract, confidentiality, disclosure or proprietary information agreement or non-competition agreement, or any other contract or agreement or any restrictive covenant in favor of any third party, and the continued employment of each such executive officer does not subject the Company or any of its Subsidiaries to any liability with respect to any of the foregoing matters. The Company and its Subsidiaries are in compliance with all U.S. federal, state, local and foreign laws and regulations relating to employment and employment practices, terms and conditions of employment and wages and hours, except where the failure to be in compliance could not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect.

(l) Compliance. Neither the Company nor any Subsidiary: (i) is in default under or in violation of (and no event has occurred that has not been waived that, with notice or lapse of time or both, would result in a default by the Company or any Subsidiary under), nor has the Company or any Subsidiary received notice of a claim that it is in default under or that it is in violation of, any indenture, loan or credit agreement or any other agreement or instrument to which it is a party or by which it or any of its properties is bound (whether or not such default or violation has been waived), (ii) is in violation of any judgment, decree or order of any court, arbitrator or other governmental authority or (iii) is or has been in violation of any statute, rule, ordinance or regulation of any governmental authority, including without limitation all foreign, federal, state and local laws relating to taxes, environmental protection, occupational health and safety, product quality and safety and employment and labor matters, except in each case as could not have or reasonably be expected to result in a Material Adverse Effect.

(m) Regulatory Permits. The Company and the Subsidiaries possess all certificates, authorizations and permits issued by the appropriate federal, state, local or foreign regulatory authorities necessary to conduct their respective businesses as described in the SEC Reports, except where the failure to possess such permits could not reasonably be expected to result in a Material Adverse Effect (“Material Permits”), and neither the Company nor any Subsidiary has received any notice of proceedings relating to the revocation or modification of any Material Permit.

(n) Title to Assets. The Company and the Subsidiaries have good and marketable title in fee simple to all real property owned by them and good and marketable title in all personal property owned by them that is material to the business of the Company and the Subsidiaries, in each case free and clear of all Liens, except for (i) the Liens disclosed on Schedule 3.1(n), (ii) Liens as do not materially affect the value of such property and do not materially interfere with the use made and proposed to be made of such property by the Company and the Subsidiaries and (iii) Liens for the payment of federal, state or other taxes, for which appropriate reserves have been made therefor in accordance with GAAP and, the payment of which is neither delinquent nor subject to penalties. Any real property and facilities held under lease by the Company and the Subsidiaries are held by them under valid, subsisting and enforceable leases with which the Company and the Subsidiaries are in compliance.

(o) Intellectual Property. The Company and the Subsidiaries have, or have rights to use, all patents, patent applications, trademarks, trademark applications, service marks, trade names, trade secrets, inventions, copyrights, licenses and other intellectual property rights and similar rights as described in the SEC Reports as necessary or required for use in connection with their respective businesses and which the failure to so have could have a Material Adverse Effect (collectively, the “Intellectual Property Rights”). None of, and neither the Company nor any Subsidiary has received a notice (written or otherwise) that any of, the Intellectual Property Rights has expired, terminated or been abandoned, or is expected to expire or terminate or be abandoned, within two (2) years from the date of this Agreement. Neither the Company nor any Subsidiary has received, since the date of the latest audited financial statements included within the SEC Reports, a written notice of a claim or otherwise has any knowledge that the Intellectual Property Rights violate or infringe upon the rights of any Person, except as could not have or reasonably be expected to not have a Material Adverse Effect. To the knowledge of the Company, all such Intellectual Property Rights are enforceable and there is no existing infringement by another Person of any of the Intellectual Property Rights. The Company and its Subsidiaries have taken reasonable security measures to protect the secrecy, confidentiality and value of all of their intellectual properties, except where failure to do so could not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect.

(p) Insurance. The Company and the Subsidiaries are insured by insurers of recognized financial responsibility against such losses and risks and in such amounts as are prudent and customary in the businesses in which the Company and the Subsidiaries are engaged, including, but not limited to, directors and officers insurance coverage at least equal to the aggregate Subscription Amount. Neither the Company nor any Subsidiary has any reason to believe that it will not be able to renew its existing insurance coverage as and when such coverage expires or to obtain similar coverage from similar insurers as may be necessary to continue its business without a significant increase in cost.

(q) Transactions With Affiliates and Employees. Except as set forth in the SEC Reports, none of the officers or directors of the Company or any Subsidiary and, to the knowledge of the Company, none of the employees of the Company or any Subsidiary is presently a party to any transaction with the Company or any Subsidiary (other than for services as employees, officers and directors), including any contract, agreement or other arrangement providing for the furnishing of services to or by, providing for rental of real or personal property to or from providing for the borrowing of money from or lending of money to, or otherwise requiring payments to or from any officer, director or such employee or, to the knowledge of the Company, any entity in which any officer, director, or any such employee has a substantial interest or is an officer, director, trustee, stockholder, member or partner, in each case in excess of \$120,000 other than for: (i) payment of salary or consulting fees for services rendered, (ii) reimbursement for expenses incurred on behalf of the Company and (iii) other employee benefits, including stock option agreements under any stock option plan of the Company.

(r) Sarbanes-Oxley: Internal Accounting Controls. The Company and the Subsidiaries are in compliance with any and all applicable requirements of the Sarbanes-Oxley Act of 2002 that are effective as of the date hereof, and any and all applicable rules and regulations promulgated by the Commission thereunder that are effective as of the date hereof and as of the Closing Date. The Company and the Subsidiaries maintain a system of internal accounting controls sufficient to provide reasonable assurance that: (i) transactions are executed in accordance with management's general or specific authorizations, (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain asset accountability, (iii) access to assets is permitted only in accordance with management's general or specific authorization, and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences. The Company and the Subsidiaries have established disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Company and the Subsidiaries and designed such disclosure controls and procedures to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. The Company's certifying officers have evaluated the effectiveness of the disclosure controls and procedures of the Company and the Subsidiaries as of the end of the period covered by the most recently filed periodic report under the Exchange Act (such date, the "Evaluation Date"). The Company presented in its most recently filed periodic report under the Exchange Act the conclusions of the certifying officers about the effectiveness of the disclosure controls and procedures based on their evaluations as of the Evaluation Date. Since the Evaluation Date, there have been no changes in the internal control over financial reporting (as such term is defined in the Exchange Act) that have materially affected, or is reasonably likely to materially affect, the internal control over financial reporting of the Company and its Subsidiaries.

(s) Certain Fees. Except for fees payable to Merriman Capital, Inc., no brokerage or finder's fees or commissions are or will be payable by the Company or any Subsidiaries to any broker, financial advisor or consultant, finder, placement agent, investment banker, bank or other Person with respect to the transactions contemplated by the Transaction Documents. The Purchasers shall have no obligation with respect to any fees or with respect to any claims made by or on behalf of other Persons for fees of a type contemplated in this Section that may be due in connection with the transactions contemplated by the Transaction Documents.

(t) Private Placement. Assuming the accuracy of the Purchasers' representations and warranties set forth in Section 3.2, no registration under the Securities Act is required for the offer and sale of the Securities by the Company to the Purchasers as contemplated hereby. The issuance and sale of the Securities hereunder does not contravene the rules and regulations of the Trading Market.

(u) Investment Company. The Company is not, and is not an Affiliate of, and immediately after receipt of payment for the Securities, will not be or be an Affiliate of, an "investment company" within the meaning of the Investment Company Act of 1940, as amended. The Company shall conduct its business in a manner so that it will not become an "investment company" subject to registration under the Investment Company Act of 1940, as amended.

(v) Registration Rights. Except as set forth on Schedule 3.1(v), no Person has any right to cause the Company to effect the registration under the Securities Act of any securities of the Company or any Subsidiaries.

(w) Listing and Maintenance Requirements. The Common Stock is registered pursuant to Section 12(g) of the Exchange Act, and the Company has taken no action designed to, or which to its knowledge is likely to have the effect of, terminating the registration of the Common Stock under the Exchange Act nor has the Company received any notification that the Commission is contemplating terminating such registration. The Company has not, in the 12 months preceding the date hereof, received notice from any Trading Market on which the Common Stock is or has been listed or quoted to the effect that the Company is not in compliance with the listing or maintenance requirements of such Trading Market. The Company is, and has no reason to believe that it will not in the foreseeable future continue to be, in compliance with all such listing and maintenance requirements.

( x ) Application of Takeover Protections. The Company and the Board of Directors have taken all necessary action, if any, in order to render inapplicable any control share acquisition, business combination, poison pill (including any distribution under a rights agreement) or other similar anti-takeover provision under the Company's certificate of incorporation (or similar charter documents) or the laws of its state of incorporation that is or could become applicable to the Purchasers as a result of the Purchasers and the Company fulfilling their obligations or exercising their rights under the Transaction Documents, including without limitation as a result of the Company's issuance of the Securities and the Purchasers' ownership of the Securities.

( y ) Disclosure. Except with respect to the material terms and conditions of the transactions contemplated by the Transaction Documents, the Company confirms that neither it nor any other Person acting on its behalf has provided any of the Purchasers or their agents or counsel with any information that it believes constitutes or might reasonably constitute material, non-public information. The Company understands and confirms that the Purchasers will rely on the foregoing representation in effecting transactions in securities of the Company. All of the disclosure furnished by or on behalf of the Company to the Purchasers regarding the Company and its Subsidiaries, their respective businesses and the transactions contemplated hereby, including the Disclosure Schedules to this Agreement, is true and correct and does not contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made therein, in light of the circumstances under which they were made, not misleading. The press releases disseminated by the Company during the twelve months preceding the date of this Agreement taken as a whole do not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made and when made, not misleading. The Company acknowledges and agrees that no Purchaser makes or has made any representations or warranties with respect to the transactions contemplated hereby other than those specifically set forth in Section 3.2 hereof.

( z ) No Integrated Offering. Assuming the accuracy of the Purchasers' representations and warranties set forth in Section 3.2, neither the Company, nor any of its Affiliates, nor any Person acting on its or their behalf has, directly or indirectly, made any offers or sales of any security or solicited any offers to buy any security, under circumstances that would cause this offering of the Securities to be integrated with prior offerings by the Company for purposes of (i) the Securities Act which would require the registration of any such securities under the Securities Act, or (ii) any applicable shareholder approval provisions of any Trading Market on which any of the securities of the Company are listed or designated.

(aa) Solvency. Based on the consolidated financial condition of the Company as of the Closing Date, after giving effect to the receipt by the Company of the proceeds from the sale of the Securities hereunder: (i) the fair saleable value of the Company's assets exceeds the amount that will be required to be paid on or in respect of the Company's existing debts and other liabilities (including known contingent liabilities) as they mature, (ii) the Company's assets do not constitute unreasonably small capital to carry on its business as now conducted and as proposed to be conducted including its capital needs taking into account the particular capital requirements of the business conducted by the Company, consolidated and projected capital requirements and capital availability thereof, and (iii) the current cash flow of the Company, together with the proceeds the Company would receive, were it to liquidate all of its assets, after taking into account all anticipated uses of the cash, would be sufficient to pay all amounts on or in respect of its liabilities when such amounts are required to be paid. The Company does not intend to incur debts beyond its ability to pay such debts as they mature (taking into account the timing and amounts of cash to be payable on or in respect of its debt). The Company has no knowledge of any facts or circumstances which lead it to believe that it will file for reorganization or liquidation under the bankruptcy or reorganization laws of any jurisdiction within one year from the Closing Date. Schedule 3.1(aa) sets forth as of the date hereof all outstanding secured and unsecured Indebtedness of the Company or any Subsidiary, or for which the Company or any Subsidiary has commitments. For the purposes of this Agreement, "Indebtedness" means (x) any liabilities for borrowed money or amounts owed in excess of \$50,000 (other than trade accounts payable incurred in the ordinary course of business), (y) all guaranties, endorsements and other contingent obligations in respect of indebtedness of others, whether or not the same are or should be reflected in the Company's consolidated balance sheet (or the notes thereto), except guaranties by endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of business; and (z) the present value of any lease payments in excess of \$50,000 due under leases required to be capitalized in accordance with GAAP. Neither the Company nor any Subsidiary is in default with respect to any Indebtedness.

(bb) Tax Status. Except for matters that would not, individually or in the aggregate, have or reasonably be expected to result in a Material Adverse Effect, the Company and its Subsidiaries each (i) has made or filed all United States federal, state and local income and all foreign income and franchise tax returns, reports and declarations required by any jurisdiction to which it is subject, (ii) has paid all taxes and other governmental assessments and charges that are material in amount, shown or determined to be due on such returns, reports and declarations and (iii) has set aside on its books provision reasonably adequate for the payment of all material taxes for periods subsequent to the periods to which such returns, reports or declarations apply. There are no unpaid taxes in any material amount claimed to be due by the taxing authority of any jurisdiction, and the officers of the Company or of any Subsidiary know of no basis for any such claim.

(cc) No General Solicitation. Neither the Company nor any person acting on behalf of the Company has offered or sold any of the Securities by any form of general solicitation or general advertising. The Company has offered the Securities for sale only to the Purchasers and certain other "accredited investors" within the meaning of Rule 501 under the Securities Act.

(dd) Foreign Corrupt Practices. Neither the Company nor any Subsidiary, nor to the knowledge of the Company or any Subsidiary, any agent or other person acting on behalf of the Company or any Subsidiary, has: (i) directly or indirectly, used any funds for unlawful contributions, gifts, entertainment or other unlawful expenses related to foreign or domestic political activity, (ii) made any unlawful payment to foreign or domestic government officials or employees or to any foreign or domestic political parties or campaigns from corporate funds, (iii) failed to disclose fully any contribution made by the Company or any Subsidiary (or made by any person acting on its behalf of which the Company is aware) which is in violation of law or (iv) violated in any material respect any provision of FCPA.

(ee) Accountants. The Company's accounting firm is set forth on Schedule 3.1(ee) of the Disclosure Schedules. To the knowledge and belief of the Company, such accounting firm: (i) is a registered public accounting firm as required by the Exchange Act and (ii) shall express its opinion with respect to the financial statements to be included in the Company's Annual Report for the fiscal year ending December 31, 2012.

(ff) Seniority. As of the Closing Date, no Indebtedness or other claim against the Company is senior to the Debentures in right of payment, whether with respect to interest or upon liquidation or dissolution, or otherwise, other than indebtedness secured by purchase money security interests (which is senior only as to underlying assets covered thereby) and capital lease obligations (which is senior only as to the property covered thereby).

(g g) No Disagreements with Accountants and Lawyers. There are no disagreements of any kind presently existing, or reasonably anticipated by the Company to arise, between the Company and the accountants and lawyers formerly or presently employed by the Company and the Company is current with respect to any fees owed to its accountants and lawyers which could affect the Company's ability to perform any of its obligations under any of the Transaction Documents.

(hh) Acknowledgment Regarding Purchasers' Purchase of Securities. The Company acknowledges and agrees that each of the Purchasers is acting solely in the capacity of an arm's length purchaser with respect to the Transaction Documents and the transactions contemplated thereby. The Company further acknowledges that no Purchaser is acting as a financial advisor or fiduciary of the Company (or in any similar capacity) with respect to the Transaction Documents and the transactions contemplated thereby and any advice given by any Purchaser or any of their respective representatives or agents in connection with the Transaction Documents and the transactions contemplated thereby is merely incidental to the Purchasers' purchase of the Securities. The Company further represents to each Purchaser that the Company's decision to enter into this Agreement and the other Transaction Documents has been based solely on the independent evaluation of the transactions contemplated hereby by the Company and its representatives.

(ii) **Acknowledgment Regarding Purchaser's Trading Activity.** Anything in this Agreement or elsewhere herein to the contrary notwithstanding (except for Sections 3.2(f) and 4.15 hereof), it is understood and acknowledged by the Company that: (i) none of the Purchasers has been asked by the Company to agree, nor has any Purchaser agreed, to desist from purchasing or selling, long and/or short, securities of the Company, or "derivative" securities based on securities issued by the Company or to hold the Securities for any specified term, (ii) past or future open market or other transactions by any Purchaser, specifically including, without limitation, Short Sales or "derivative" transactions, before or after the closing of this or future private placement transactions, may negatively impact the market price of the Company's publicly-traded securities, (iii) any Purchaser, and counter-parties in "derivative" transactions to which any such Purchaser is a party, directly or indirectly, may presently have a "short" position in the Common Stock and (iv) each Purchaser shall not be deemed to have any affiliation with or control over any arm's length counter-party in any "derivative" transaction; provided, that no Purchaser shall engage in a Net Short Sale (as defined in Section 4.15) until such Purchaser no longer holds any Debentures or Warrants. The Company further understands and acknowledges that (y) one or more Purchasers may engage in hedging activities at various times during the period that the Securities are outstanding, including, without limitation, during the periods that the value of the Underlying Shares deliverable with respect to Securities are being determined, and (z) such hedging activities (if any) could reduce the value of the existing stockholders' equity interests in the Company at and after the time that the hedging activities are being conducted. The Company acknowledges that such aforementioned hedging activities do not constitute a breach of any of the Transaction Documents.

(jj) **Regulation M Compliance.** The Company has not, and to its knowledge no one acting on its behalf has, (i) taken, directly or indirectly, any action designed to cause or to result in the stabilization or manipulation of the price of any security of the Company to facilitate the sale or resale of any of the Securities, (ii) sold, bid for, purchased, or paid any compensation for soliciting purchases of, any of the Securities, or (iii) paid or agreed to pay to any Person any compensation for soliciting another to purchase any other securities of the Company, other than, in the case of clauses (ii) and (iii), compensation paid to the Company's placement agent in connection with the placement of the Securities.

(kk) **Stock Option Plans.** Each stock option granted by the Company under the Company's stock option plan was granted (i) in accordance with the terms of the Company's stock option plan or the terms of the stock option agreements between the Company and the optionee and (ii) with an exercise price at least equal to the fair market value of the Common Stock on the date such stock option would be considered granted under GAAP and applicable law. No stock option granted under the Company's stock option plan has been backdated. The Company has not knowingly granted, and there is no and has been no Company policy or practice to knowingly grant, stock options prior to, or otherwise knowingly coordinate the grant of stock options with, the release or other public announcement of material information regarding the Company or its Subsidiaries or their financial results or prospects.

(11) Office of Foreign Assets Control. Neither the Company nor any Subsidiary nor, to the Company's knowledge, any director, officer, agent, employee or affiliate of the Company or any Subsidiary is currently subject to any U.S. sanctions administered by the Office of Foreign Assets Control of the U.S. Treasury Department ("OFAC").

(m m) U.S. Real Property Holding Corporation. The Company is not and has never been a U.S. real property holding corporation within the meaning of Section 897 of the Internal Revenue Code of 1986, as amended, and the Company shall so certify upon Purchaser's request.

(nn) Money Laundering. The operations of the Company and its Subsidiaries are and have been conducted at all times in compliance with applicable financial record-keeping and reporting requirements of the Currency and Foreign Transactions Reporting Act of 1970, as amended, applicable money laundering statutes and applicable rules and regulations thereunder (collectively, the "Money Laundering Laws"), and no action, suit or proceeding by or before any court or governmental agency, authority or body or any arbitrator involving the Company or any Subsidiary with respect to the Money Laundering Laws is pending or, to the knowledge of the Company or any Subsidiary, threatened.

3 . 2 Representations and Warranties of the Purchasers. Each Purchaser, for itself and for no other Purchaser, hereby represents and warrants as of the date hereof and as of the Closing Date to the Company as follows (unless as of a specific date therein):

( a ) Organization; Authority. Such Purchaser is either an individual or an entity duly incorporated or formed, validly existing and in good standing under the laws of the jurisdiction of its incorporation or formation with full right, corporate, partnership, limited liability company or similar power and authority to enter into and to consummate the transactions contemplated by the Transaction Documents and otherwise to carry out its obligations hereunder and thereunder. The execution and delivery of the Transaction Documents and performance by such Purchaser of the transactions contemplated by the Transaction Documents have been duly authorized by all necessary corporate, partnership, limited liability company or similar action, as applicable, on the part of such Purchaser. Each Transaction Document to which it is a party has been duly executed by such Purchaser, and when delivered by such Purchaser in accordance with the terms hereof, will constitute the valid and legally binding obligation of such Purchaser, enforceable against it in accordance with its terms, except: (i) as limited by general equitable principles and applicable bankruptcy, insolvency, reorganization, moratorium and other laws of general application affecting enforcement of creditors' rights generally, (ii) as limited by laws relating to the availability of specific performance, injunctive relief or other equitable remedies and (iii) insofar as indemnification and contribution provisions may be limited by applicable law.

(b) Own Account. Such Purchaser understands that the Securities are "restricted securities" and have not been registered under the Securities Act or any applicable state securities law and is acquiring the Securities as principal for its own account and not with a view to or for distributing or reselling such Securities or any part thereof in violation of the Securities Act or any applicable state securities law, has no present intention of distributing any of such Securities in violation of the Securities Act or any applicable state securities law and has no direct or indirect arrangement or understandings with any other persons to distribute or regarding the distribution of such Securities in violation of the Securities Act or any applicable state securities law (this representation and warranty not limiting such Purchaser's right to sell the Securities in compliance with applicable federal and state securities laws). Such Purchaser is acquiring the Securities hereunder in the ordinary course of its business.

(c) Purchaser Status. At the time such Purchaser was offered the Securities, it was, and as of the date hereof it is, and on each date on which it exercises any Warrants or converts any Debentures it will be either: (i) an “accredited investor” as defined in Rule 501(a)(1), (a)(2), (a)(3), (a)(7) or (a)(8) under the Securities Act or (ii) a “qualified institutional buyer” as defined in Rule 144A(a) under the Securities Act.

(d) Experience of Such Purchaser. Such Purchaser, either alone or together with its representatives, has such knowledge, sophistication and experience in business and financial matters so as to be capable of evaluating the merits and risks of the prospective investment in the Securities, and has so evaluated the merits and risks of such investment. Such Purchaser is able to bear the economic risk of an investment in the Securities and, at the present time, is able to afford a complete loss of such investment.

(e) General Solicitation. Such Purchaser is not purchasing the Securities as a result of any advertisement, article, notice or other communication regarding the Securities published in any newspaper, magazine or similar media or broadcast over television or radio or presented at any seminar or any other general solicitation or general advertisement.

(f) Certain Transactions and Confidentiality. Other than consummating the transactions contemplated hereunder, such Purchaser has not directly or indirectly, nor has any Person acting on behalf of or pursuant to any understanding with such Purchaser, executed any purchases or sales, including Short Sales, of the securities of the Company during the period commencing as of the time that such Purchaser first received a term sheet (written or oral) from the Company or any other Person representing the Company setting forth the material terms of the transactions contemplated hereunder and ending immediately prior to the execution hereof. Notwithstanding the foregoing, in the case of a Purchaser that is a multi-managed investment vehicle whereby separate portfolio managers manage separate portions of such Purchaser’s assets and the portfolio managers have no direct knowledge of the investment decisions made by the portfolio managers managing other portions of such Purchaser’s assets, the representation set forth above shall only apply with respect to the portion of assets managed by the portfolio manager that made the investment decision to purchase the Securities covered by this Agreement. Other than to other Persons party to this Agreement, such Purchaser has maintained the confidentiality of all disclosures made to it in connection with this transaction (including the existence and terms of this transaction). Notwithstanding the foregoing, for avoidance of doubt, nothing contained herein shall constitute a representation or warranty, or preclude any actions, with respect to the identification of the availability of, or securing of, available shares to borrow in order to effect Short Sales or similar transactions in the future.

The Company acknowledges and agrees that the representations contained in Section 3.2 shall not modify, amend or affect such Purchaser's right to rely on the Company's representations and warranties contained in this Agreement or any representations and warranties contained in any other Transaction Document or any other document or instrument executed and/or delivered in connection with this Agreement or the consummation of the transaction contemplated hereby.

**ARTICLE IV.  
OTHER AGREEMENTS OF THE PARTIES**

4.1 Transfer Restrictions.

(a) The Securities may only be disposed of in compliance with state and federal securities laws. In connection with any transfer of Securities other than pursuant to an effective registration statement or Rule 144, to the Company or to an Affiliate of a Purchaser or in connection with a pledge as contemplated in Section 4.1(b), the Company may require the transferor thereof to provide to the Company an opinion of counsel selected by the transferor and reasonably acceptable to the Company, the form and substance of which opinion shall be reasonably satisfactory to the Company, to the effect that such transfer does not require registration of such transferred Securities under the Securities Act. As a condition of transfer, any such transferee shall agree in writing to be bound by the terms of this Agreement and shall make the representations set forth in Section 3.2, and then shall have the rights and obligations of a Purchaser under this Agreement.

(b) The Purchasers agree to the imprinting, so long as is required by this Section 4.1, of a legend on any of the Securities in the following form:

[NEITHER] THIS SECURITY [NOR THE SECURITIES INTO WHICH THIS SECURITY IS [EXERCISABLE] [CONVERTIBLE]] HAS [NOT] BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION OR THE SECURITIES COMMISSION OF ANY STATE IN RELIANCE UPON AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND, ACCORDINGLY, MAY NOT BE OFFERED OR SOLD EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OR PURSUANT TO AN AVAILABLE EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND IN ACCORDANCE WITH APPLICABLE STATE SECURITIES LAWS AS EVIDENCED BY A LEGAL OPINION OF COUNSEL TO THE TRANSFEROR TO SUCH EFFECT, THE SUBSTANCE OF WHICH SHALL BE REASONABLY ACCEPTABLE TO THE COMPANY. THIS SECURITY [AND THE SECURITIES ISSUABLE UPON [EXERCISE] [CONVERSION] OF THIS SECURITY] MAY BE PLEDGED IN CONNECTION WITH A BONA FIDE MARGIN ACCOUNT WITH A REGISTERED BROKER-DEALER OR OTHER LOAN WITH A FINANCIAL INSTITUTION THAT IS AN "ACCREDITED INVESTOR" AS DEFINED IN RULE 501(a) UNDER THE SECURITIES ACT OR OTHER LOAN SECURED BY SUCH SECURITIES.

The Company acknowledges and agrees that a Purchaser may from time to time pledge pursuant to a bona fide margin agreement with a registered broker-dealer or grant a security interest in some or all of the Securities to a financial institution that is an “accredited investor” as defined in Rule 501(a) under the Securities Act and who agrees to be bound by the provisions of this Agreement and, if required under the terms of such arrangement, such Purchaser may transfer pledged or secured Securities to the pledgees or secured parties. Such a pledge or transfer would not be subject to approval of the Company and no legal opinion of legal counsel of the pledgee, secured party or pledgor shall be required in connection therewith. Further, no notice shall be required of such pledge. At the appropriate Purchaser’s expense, the Company will execute and deliver such reasonable documentation as a pledgee or secured party of Securities may reasonably request in connection with a pledge or transfer of the Securities.

(c) Certificates evidencing the Underlying Shares shall not contain any legend (including the legend set forth in Section 4.1(b) hereof): (i) while a registration statement (including the Registration Statement) covering the resale of such security is effective under the Securities Act, (ii) following any sale of such Underlying Shares pursuant to Rule 144, (iii) if such Underlying Shares are eligible for sale under Rule 144, without the requirement for the Company to be in compliance with the current public information required under Rule 144 as to such Underlying Shares and without volume or manner-of-sale restrictions or (iv) if such legend is not required under applicable requirements of the Securities Act (including judicial interpretations and pronouncements issued by the staff of the Commission). The Company shall cause its counsel to issue a legal opinion to the Transfer Agent promptly after the Effective Date if required by the Transfer Agent to effect the removal of the legend hereunder. If all or any portion of a Debenture is converted or Warrant is exercised at a time when there is an effective registration statement to cover the resale of the Underlying Shares, or if such Underlying Shares may be sold under Rule 144 without the requirement for the Company to be in compliance with the current public information required under Rule 144 as to such Underlying Shares and without volume or manner-of-sale restrictions or if such legend is not otherwise required under applicable requirements of the Securities Act (including judicial interpretations and pronouncements issued by the staff of the Commission) then such Underlying Shares shall be issued free of all legends. The Company agrees that following the Effective Date or at such time as such legend is no longer required under this Section 4.1(c), it will, no later than three Trading Days following the delivery by a Purchaser to the Company or the Transfer Agent of a certificate representing Underlying Shares, as applicable, issued with a restrictive legend (such third Trading Day, the “Legend Removal Date”), deliver or cause to be delivered to such Purchaser a certificate representing such shares that is free from all restrictive and other legends. The Company may not make any notation on its records or give instructions to the Transfer Agent that enlarge the restrictions on transfer set forth in this Section 4. Certificates for Underlying Shares subject to legend removal hereunder shall be transmitted by the Transfer Agent to the Purchaser by crediting the account of the Purchaser’s prime broker with the Depository Trust Company System as directed by such Purchaser.

(d) In addition to such Purchaser's other available remedies, the Company shall pay to a Purchaser, in cash, as partial liquidated damages and not as a penalty, for each \$1,000 of Underlying Shares (based on the VWAP of the Common Stock on the date such Securities are submitted to the Transfer Agent) delivered for removal of the restrictive legend and subject to Section 4.1(c), \$10 per Trading Day (increasing to \$15 per Trading Day five (5) Trading Days after such damages have begun to accrue) for each Trading Day after the Legend Removal Date until such certificate is delivered without a legend. Nothing herein shall limit such Purchaser's right to pursue actual damages for the Company's failure to deliver certificates representing any Securities as required by the Transaction Documents, and such Purchaser shall have the right to pursue all remedies available to it at law or in equity including, without limitation, a decree of specific performance and/or injunctive relief.

(e) Each Purchaser, severally and not jointly with the other Purchasers, agrees with the Company that such Purchaser will sell any Securities pursuant to either the registration requirements of the Securities Act, including any applicable prospectus delivery requirements, or an exemption therefrom, and that if Securities are sold pursuant to a Registration Statement, they will be sold in compliance with the plan of distribution set forth therein, and acknowledges that the removal of the restrictive legend from certificates representing Securities as set forth in this Section 4.1 is predicated upon the Company's reliance upon this understanding.

4.2 Acknowledgment of Dilution. The Company acknowledges that the issuance of the Securities may result in dilution of the outstanding shares of Common Stock, which dilution may be substantial under certain market conditions. The Company further acknowledges that its obligations under the Transaction Documents, including, without limitation, its obligation to issue the Underlying Shares pursuant to the Transaction Documents, are unconditional and absolute and not subject to any right of set off, counterclaim, delay or reduction, regardless of the effect of any such dilution or any claim the Company may have against any Purchaser and regardless of the dilutive effect that such issuance may have on the ownership of the other stockholders of the Company.

4.3 Furnishing of Information; Public Information.

(a) If the Common Stock is not registered under Section 12(b) or 12(g) of the Exchange Act on the date hereof, the Company agrees to cause the Common Stock to be registered under Section 12(g) of the Exchange Act on or before the 60<sup>th</sup> calendar day following the date hereof. Until the earliest of the time that (i) no Purchaser owns Securities or (ii) the Warrants have expired, the Company covenants to maintain the registration of the Common Stock under Section 12(b) or 12(g) of the Exchange Act and to timely file (or obtain extensions in respect thereof and file within the applicable grace period) all reports required to be filed by the Company after the date hereof pursuant to the Exchange Act even if the Company is not then subject to the reporting requirements of the Exchange Act.

(b) At any time during the period commencing from the six (6) month anniversary of the date hereof and ending at such time that all of the Securities may be sold without the requirement for the Company to be in compliance with Rule 144(c)(1) and otherwise without restriction or limitation pursuant to Rule 144, if the Company shall fail for any reason to satisfy the current public information requirement under Rule 144(c) (a “Public Information Failure”) then, in addition to such Purchaser’s other available remedies, the Company shall pay to a Purchaser, in cash, as partial liquidated damages and not as a penalty, by reason of any such delay in or reduction of its ability to sell the Securities, an amount in cash equal to two percent (2.0%) of the aggregate Subscription Amount of such Purchaser’s Securities on the day of a Public Information Failure and on every thirtieth (30<sup>th</sup>) day (pro rated for periods totaling less than thirty days) thereafter until the earlier of (a) the date such Public Information Failure is cured and (b) such time that such public information is no longer required for the Purchasers to transfer the Underlying Shares pursuant to Rule 144. The payments to which a Purchaser shall be entitled pursuant to this Section 4.3(b) are referred to herein as “Public Information Failure Payments.” Public Information Failure Payments shall be paid on the earlier of (i) the last day of the calendar month during which such Public Information Failure Payments are incurred and (ii) the third (3<sup>rd</sup>) Business Day after the event or failure giving rise to the Public Information Failure Payments is cured. In the event the Company fails to make Public Information Failure Payments in a timely manner, such Public Information Failure Payments shall bear interest at the rate of 1.5% per month (prorated for partial months) until paid in full. Nothing herein shall limit such Purchaser’s right to pursue actual damages for the Public Information Failure, and such Purchaser shall have the right to pursue all remedies available to it at law or in equity including, without limitation, a decree of specific performance and/or injunctive relief.

4.4 Integration. The Company shall not sell, offer for sale or solicit offers to buy or otherwise negotiate in respect of any security (as defined in Section 2 of the Securities Act) that would be integrated with the offer or sale of the Securities in a manner that would require the registration under the Securities Act of the sale of the Securities or that would be integrated with the offer or sale of the Securities for purposes of the rules and regulations of any Trading Market such that it would require shareholder approval prior to the closing of such other transaction unless shareholder approval is obtained before the closing of such subsequent transaction.

4.5 Conversion and Exercise Procedures. Each of the form of Notice of Exercise included in the Warrants and the form of Notice of Conversion included in the Debentures set forth the totality of the procedures required of the Purchasers in order to exercise the Warrants or convert the Debentures. No additional legal opinion, other information or instructions shall be required of the Purchasers to exercise their Warrants or convert their Debentures. The Company shall honor exercises of the Warrants and conversions of the Debentures and shall deliver Underlying Shares in accordance with the terms, conditions and time periods set forth in the Transaction Documents.

4.6 Securities Laws Disclosure; Publicity. The Company shall (a) by 9:30 a.m. (New York City time) on the fourth Trading Day immediately following the date hereof, issue a press release disclosing the material terms of the transactions contemplated hereby, and (b) file a Current Report on Form 8-K, including the Transaction Documents as exhibits thereto, with the Commission within the time required by the Exchange Act. From and after the issuance of such press release, the Company represents to the Purchasers that it shall have publicly disclosed all material, non-public information delivered to any of the Purchasers by the Company or any of its Subsidiaries, or any of their respective officers, directors, employees or agents in connection with the transactions contemplated by the Transaction Documents. The Company and each Purchaser shall consult with each other in issuing any other press releases with respect to the transactions contemplated hereby, and neither the Company nor any Purchaser shall issue any such press release nor otherwise make any such public statement without the prior consent of the Company, with respect to any press release of any Purchaser, or without the prior consent of each Purchaser, with respect to any press release of the Company, which consent shall not unreasonably be withheld or delayed, except if such disclosure is required by law, in which case the disclosing party shall promptly provide the other party with prior notice of such public statement or communication. Notwithstanding the foregoing, the Company shall not publicly disclose the name of any Purchaser, or include the name of any Purchaser in any filing with the Commission or any regulatory agency or Trading Market, without the prior written consent of such Purchaser, except: (a) as required by federal securities law in connection with the filing of final Transaction Documents with the Commission, (b) to the extent requested by the Commission and (c) to the extent such disclosure is required by law or Trading Market regulations, in which case the Company shall provide the Purchasers with prior notice of such disclosure permitted under clauses (b) and (c).

4.7 Shareholder Rights Plan. No claim will be made or enforced by the Company or, with the consent of the Company, any other Person, that any Purchaser is an “Acquiring Person” under any control share acquisition, business combination, poison pill (including any distribution under a rights agreement) or similar anti-takeover plan or arrangement in effect or hereafter adopted by the Company, or that any Purchaser could be deemed to trigger the provisions of any such plan or arrangement, by virtue of receiving Securities under the Transaction Documents or under any other agreement between the Company and the Purchasers.

4.8 Non-Public Information. Except with respect to the material terms and conditions of the transactions contemplated by the Transaction Documents, the Company covenants and agrees that neither it, nor any other Person acting on its behalf, will provide any Purchaser or its agents or counsel with any information that the Company believes constitutes material non-public information, unless prior thereto such Purchaser shall have entered into a written agreement with the Company regarding the confidentiality and use of such information. The Company understands and confirms that each Purchaser shall be relying on the foregoing covenant in effecting transactions in securities of the Company.

4.9 Use of Proceeds. Except as set forth on Schedule 4.9 attached hereto, the Company shall use the net proceeds from the sale of the Securities hereunder for working capital purposes and shall not use such proceeds: (a) for the satisfaction of any portion of the Company’s debt (other than payment of trade payables in the ordinary course of the Company’s business and prior practices), (b) for the redemption of any Common Stock or Common Stock Equivalents, (c) for the settlement of any outstanding litigation or (d) in violation of FCPA or OFAC regulations.

4.10 Indemnification of Purchasers. Subject to the provisions of this Section 4.10, the Company will indemnify and hold each Purchaser and its directors, officers, shareholders, members, partners, employees and agents (and any other Persons with a functionally equivalent role of a Person holding such titles notwithstanding a lack of such title or any other title), each Person who controls such Purchaser (within the meaning of Section 15 of the Securities Act and Section 20 of the Exchange Act), and the directors, officers, shareholders, agents, members, partners or employees (and any other Persons with a functionally equivalent role of a Person holding such titles notwithstanding a lack of such title or any other title) of such controlling persons (each, a "Purchaser Party") harmless from any and all losses, liabilities, obligations, claims, contingencies, damages, costs and expenses, including all judgments, amounts paid in settlements, court costs and reasonable attorneys' fees and costs of investigation that any such Purchaser Party may suffer or incur as a result of or relating to (a) any breach of any of the representations, warranties, covenants or agreements made by the Company in this Agreement or in the other Transaction Documents or (b) any action instituted against the Purchaser Parties in any capacity, or any of them or their respective Affiliates, by any stockholder of the Company who is not an Affiliate of such Purchaser Party, with respect to any of the transactions contemplated by the Transaction Documents (unless such action is based upon a breach of such Purchaser Party's representations, warranties or covenants under the Transaction Documents or any agreements or understandings such Purchaser Party may have with any such stockholder or any violations by such Purchaser Party of state or federal securities laws or any conduct by such Purchaser Party which constitutes fraud, gross negligence, willful misconduct or malfeasance). If any action shall be brought against any Purchaser Party in respect of which indemnity may be sought pursuant to this Agreement, such Purchaser Party shall promptly notify the Company in writing, and the Company shall have the right to assume the defense thereof with counsel of its own choosing reasonably acceptable to the Purchaser Party. Any Purchaser Party shall have the right to employ separate counsel in any such action and participate in the defense thereof, but the fees and expenses of such counsel shall be at the expense of such Purchaser Party except to the extent that (i) the employment thereof has been specifically authorized by the Company in writing, (ii) the Company has failed after a reasonable period of time to assume such defense and to employ counsel or (iii) in such action there is, in the reasonable opinion of counsel, a material conflict on any material issue between the position of the Company and the position of such Purchaser Party, in which case the Company shall be responsible for the reasonable fees and expenses of no more than one such separate counsel. The Company will not be liable to any Purchaser Party under this Agreement (y) for any settlement by a Purchaser Party effected without the Company's prior written consent, which shall not be unreasonably withheld or delayed; or (z) to the extent, but only to the extent that a loss, claim, damage or liability is attributable to any Purchaser Party's breach of any of the representations, warranties, covenants or agreements made by such Purchaser Party in this Agreement or in the other Transaction Documents. The indemnification required by this Section 4.10 shall be made by periodic payments of the amount thereof during the course of the investigation or defense, as and when bills are received or are incurred. The indemnity agreements contained herein shall be in addition to any cause of action or similar right of any Purchaser Party against the Company or others and any liabilities the Company may be subject to pursuant to law.

#### 4.11 Reservation and Listing of Securities.

(a) The Company shall maintain a reserve from its duly authorized shares of Common Stock for issuance pursuant to the Transaction Documents in such amount as may then be required to fulfill its obligations in full under the Transaction Documents.

(b) If, on any date, the number of authorized but unissued (and otherwise unreserved) shares of Common Stock is less than the Required Minimum on such date, then the Board of Directors shall use commercially reasonable efforts to amend the Company's certificate or articles of incorporation to increase the number of authorized but unissued shares of Common Stock to at least the Required Minimum at such time, as soon as possible and in any event not later than the 120th day after such date.

(c) The Company shall, if applicable: (i) in the time and manner required by the principal Trading Market, prepare and file with such Trading Market an additional shares listing application covering a number of shares of Common Stock at least equal to the Required Minimum on the date of such application, (ii) take all steps necessary to cause such shares of Common Stock to be approved for listing or quotation on such Trading Market as soon as commercially reasonable thereafter, (iii) provide to the Purchasers evidence of such listing or quotation and (iv) maintain the listing or quotation of such Common Stock on any date at least equal to the Required Minimum on such date on such Trading Market or another Trading Market.

#### 4.12 Participation in Future Financing.

(a) From the date hereof until July 1, 2014, upon any issuance by the Company or any of its Subsidiaries of Common Stock, Common Stock Equivalents for cash consideration, Indebtedness or a combination of units hereof (a "Subsequent Financing"), each Purchaser shall have the right to participate in up to an amount of the Subsequent Financing equal to 100% of the Purchaser's original Principal Amount (the "Participation Maximum") on the same terms, conditions and price provided for in the Subsequent Financing.

(b) At least five (5) Trading Days prior to the closing of the Subsequent Financing, the Company shall deliver to each Purchaser a written notice of its intention to effect a Subsequent Financing ("Pre-Notice"), which Pre-Notice shall ask such Purchaser if it wants to review the details of such financing (such additional notice, a "Subsequent Financing Notice"). Upon the request of a Purchaser, and only upon a request by such Purchaser, for a Subsequent Financing Notice, the Company shall promptly, but no later than one (1) Trading Day after such request, deliver a Subsequent Financing Notice to such Purchaser. The Subsequent Financing Notice shall describe in reasonable detail the proposed terms of such Subsequent Financing, the amount of proceeds intended to be raised thereunder and the Person or Persons through or with whom such Subsequent Financing is proposed to be effected and shall include a term sheet or similar document relating thereto as an attachment.

(c) Any Purchaser desiring to participate in such Subsequent Financing must provide written notice to the Company by not later than 5:30 p.m. (New York City time) on the fifth (5<sup>th</sup>) Trading Day after all of the Purchasers have received the Pre-Notice that such Purchaser is willing to participate in the Subsequent Financing, the amount of such Purchaser's participation, and representing and warranting that such Purchaser has such funds ready, willing, and available for investment on the terms set forth in the Subsequent Financing Notice. If the Company receives no such notice from a Purchaser as of such fifth (5<sup>th</sup>) Trading Day, such Purchaser shall be deemed to have notified the Company that it does not elect to participate.

(d) If by 5:30 p.m. (New York City time) on the fifth (5<sup>th</sup>) Trading Day after all of the Purchasers have received the Pre-Notice, notifications by the Purchasers of their willingness to participate in the Subsequent Financing (or to cause their designees to participate) is, in the aggregate, less than the total amount of the Subsequent Financing, then the Company may effect the remaining portion of such Subsequent Financing on the terms and with the Persons set forth in the Subsequent Financing Notice.

(e) If by 5:30 p.m. (New York City time) on the fifth (5<sup>th</sup>) Trading Day after all of the Purchasers have received the Pre-Notice, the Company receives responses to a Subsequent Financing Notice from Purchasers seeking to purchase more than the aggregate amount of the Participation Maximum, each such Purchaser shall have the right to purchase its Pro Rata Portion (as defined below) of the Participation Maximum. “Pro Rata Portion” means the ratio of (x) the Subscription Amount of Securities purchased on the Closing Date by a Purchaser participating under this Section 4.12 and (y) the sum of the aggregate Subscription Amounts of Securities purchased on the Closing Date by all Purchasers participating under this Section 4.12.

(f) The Company must provide the Purchasers with a second Subsequent Financing Notice, and the Purchasers will again have the right of participation set forth above in this Section 4.12, if the Subsequent Financing subject to the initial Subsequent Financing Notice is not consummated for any reason on the terms set forth in such Subsequent Financing Notice within thirty (30) Trading Days after the date of the initial Subsequent Financing Notice.

(g) The Company and each Purchaser agree that if any Purchaser elects to participate in the Subsequent Financing, the transaction documents related to the Subsequent Financing shall not include any term or provision whereby such Purchaser shall be required to agree to any restrictions on trading as to any of the Securities purchased hereunder or be required to consent to any amendment to or termination of, or grant any waiver, release or the like under or in connection with, this Agreement, without the prior written consent of such Purchaser.

(h) Notwithstanding anything to the contrary in this Section 4.12 and unless otherwise agreed to by such Purchaser, the Company shall either confirm in writing to such Purchaser that the transaction with respect to the Subsequent Financing has been abandoned or shall publicly disclose its intention to issue the securities in the Subsequent Financing, in either case in such a manner such that such Purchaser will not be in possession of any material, non-public information, by the tenth (10th) Business Day following delivery of the Subsequent Financing Notice. If by such tenth (10th) Business Day, no public disclosure regarding a transaction with respect to the Subsequent Financing has been made, and no notice regarding the abandonment of such transaction has been received by such Purchaser, such transaction shall be deemed to have been abandoned and such Purchaser shall not be deemed to be in possession of any material, non-public information with respect to the Company or any of its Subsidiaries.

(i) Notwithstanding the foregoing, this Section 4.12 shall not apply in respect of (i) an Exempt Issuance, or (ii) an underwritten public offering of Common Stock.

4.13 Subsequent Equity Sales.

(a) From the date hereof until 180 days after the Closing Date, neither the Company nor any Subsidiary shall issue, enter into any agreement to issue or announce the issuance or proposed issuance of any shares of Common Stock or Common Stock Equivalents, except in connection with the transactions otherwise permitted under the Transaction Documents.

(b) From the date hereof until such time as no Purchaser holds any of the Warrants, the Company shall be prohibited from effecting or entering into an agreement to effect any issuance by the Company or any of its Subsidiaries of Common Stock or Common Stock Equivalents (or a combination of units thereof) involving a Variable Rate Transaction. “Variable Rate Transaction” means a transaction in which the Company (i) issues or sells any debt or equity securities that are convertible into, exchangeable or exercisable for, or include the right to receive, additional shares of Common Stock either (A) at a conversion price, exercise price or exchange rate or other price that is based upon, and/or varies with, the trading prices of or quotations for the shares of Common Stock at any time after the initial issuance of such debt or equity securities or (B) with a conversion, exercise or exchange price that is subject to being reset at some future date after the initial issuance of such debt or equity security or upon the occurrence of specified or contingent events directly or indirectly related to the business of the Company or the market for the Common Stock or (ii) enters into any agreement, including, but not limited to, an equity line of credit, whereby the Company may issue securities at a future determined price. Any Purchaser shall be entitled to obtain injunctive relief against the Company to preclude any such issuance, which remedy shall be in addition to any right to collect damages.

(c) Notwithstanding the foregoing, this Section 4.13 shall not apply in respect of an Exempt Issuance, except that no Variable Rate Transaction shall be an Exempt Issuance.

4.14 Equal Treatment of Purchasers. No consideration (including any modification of any Transaction Document) shall be offered or paid to any Person to amend or consent to a waiver or modification of any provision of this Agreement unless the same consideration is also offered to all of the parties to this Agreement. Further, the Company shall not make any payment of principal or interest on the Debentures in amounts which are disproportionate to the respective principal amounts outstanding on the Debentures at any applicable time. For clarification purposes, this provision constitutes a separate right granted to each Purchaser by the Company and negotiated separately by each Purchaser, and is intended for the Company to treat the Purchasers as a class and shall not in any way be construed as the Purchasers acting in concert or as a group with respect to the purchase, disposition or voting of Securities or otherwise.

4.15 Certain Transactions and Confidentiality. Each Purchaser, severally and not jointly with the other Purchasers, covenants that neither it, nor any Affiliate acting on its behalf or pursuant to any understanding with it will execute any purchases or sales, including Short Sales, of any of the Company's securities during the period commencing with the execution of this Agreement and ending at such time that the transactions contemplated by this Agreement are first publicly announced pursuant to the initial press release as described in Section 4.6. Each Purchaser, severally and not jointly with the other Purchasers, covenants that until such time as the transactions contemplated by this Agreement are publicly disclosed by the Company pursuant to the initial press release as described in Section 4.6, such Purchaser will maintain the confidentiality of the existence and terms of this transaction and the information included in the Transaction Documents and the Disclosure Schedules. Notwithstanding the foregoing, no Purchaser makes any representation, warranty or covenant hereby that it will not engage in Short Sales in the securities of the Company after the time that the transactions contemplated by this Agreement are first publicly announced as described in Section 4.6; provided, however, each Purchaser agrees, severally and not jointly with any other Purchasers, that such Purchaser will not enter into any Net Short Sales (as hereinafter defined) from the period commencing on the Closing Date and ending on the date that such Purchaser no longer holds any Debentures or Warrants. For purposes of this Section 4.15, a "Net Short Sale" by any Purchaser shall mean a sale of Common Stock by such Purchaser that is marked as a short sale and that is made at a time where there is no equivalent offsetting long position in Common Stock held by such Purchaser. For purposes of determining whether there is an equivalent offsetting long position in Common Stock held by the Purchaser, Underlying Shares that have not yet been converted pursuant to the Debentures and Warrant Shares that have not yet been exercised pursuant to the Warrants shall be deemed to be held long by the Purchaser, and the amount of shares of Common Stock held in a long position shall be all unconverted Underlying Shares and unexercised Warrant Shares (ignoring any exercise limitations included therein) issuable to such Purchaser on such date, plus any shares of Common Stock or Common Stock Equivalents otherwise then held by such Purchaser. Notwithstanding the foregoing, in the case of a Purchaser that is a multi-managed investment vehicle whereby separate portfolio managers manage separate portions of such Purchaser's assets and the portfolio managers have no direct knowledge of the investment decisions made by the portfolio managers managing other portions of such Purchaser's assets, the covenant set forth above shall only apply with respect to the portion of assets managed by the portfolio manager that made the investment decision to purchase the Securities covered by this Agreement.

4.16 Form D; Blue Sky Filings. The Company agrees to timely file a Form D with respect to the Securities as required under Regulation D and to provide a copy thereof, promptly upon request of any Purchaser. The Company shall take such action as the Company shall reasonably determine is necessary in order to obtain an exemption for, or to qualify the Securities for, sale to the Purchasers at the Closing under applicable securities or "Blue Sky" laws of the states of the United States, and shall provide evidence of such actions promptly upon request of any Purchaser.

4.17 Capital Changes. Until the one year anniversary of the Closing Date, except in the context of a Qualified Public Offering, the Company shall not undertake a reverse or forward stock split or reclassification of the Common Stock without the prior written consent of the Purchasers holding a majority in principal amount outstanding of the Debentures.

**ARTICLE V.  
MISCELLANEOUS**

5.1 Termination. This Agreement may be terminated by any Purchaser, as to such Purchaser's obligations hereunder only and without any effect whatsoever on the obligations between the Company and the other Purchasers, by written notice to the other parties, if the Closing has not been consummated on or before December 31, 2012 provided, however, that such termination will not affect the right of any party to sue for any breach by any other party (or parties).

5.2 Fees and Expenses. At the Closing, the Company has agreed to reimburse Hillair Capital Management LLC ("Hillair") the non-accountable sum of \$40,000 for its due diligence expense, \$20,000 of which has been paid prior to the Closing Date plus \$35,000 for its legal fees and expenses, \$15,000 of which has been paid prior to the Closing. Accordingly, in lieu of the foregoing payments, the aggregate amount that Hillair's fund is to pay for the Securities at the Closing shall be reduced by \$40,000 in lieu thereof. Except as expressly set forth in the Transaction Documents to the contrary, each party shall pay the fees and expenses of its advisers, counsel, accountants and other experts, if any, and all other expenses incurred by such party incident to the negotiation, preparation, execution, delivery and performance of this Agreement. The Company shall pay all Transfer Agent fees (including, without limitation, any fees required for same-day processing of any instruction letter delivered by the Company and any conversion or exercise notice delivered by a Purchaser), stamp taxes and other taxes and duties levied in connection with the delivery of any Securities to the Purchasers.

5.3 Entire Agreement. The Transaction Documents, together with the exhibits and schedules thereto, contain the entire understanding of the parties with respect to the subject matter hereof and thereof and supersede all prior agreements and understandings, oral or written, with respect to such matters, which the parties acknowledge have been merged into such documents, exhibits and schedules.

5.4 Notices. Any and all notices or other communications or deliveries required or permitted to be provided hereunder shall be in writing and shall be deemed given and effective on the earliest of: (a) the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number set forth on the signature pages attached hereto at or prior to 5:30 p.m. (New York City time) on a Trading Day, (b) the next Trading Day after the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number set forth on the signature pages attached hereto on a day that is not a Trading Day or later than 5:30 p.m. (New York City time) on any Trading Day, (c) the second (2<sup>nd</sup>) Trading Day following the date of mailing, if sent by U.S. nationally recognized overnight courier service or (d) upon actual receipt by the party to whom such notice is required to be given. The address for such notices and communications shall be as set forth on the signature pages attached hereto.

5.5 Amendments; Waivers. No provision of this Agreement may be waived, modified, supplemented or amended except in a written instrument signed, in the case of an amendment, by the Company and the Purchasers holding at least 50.1% in interest of the Securities then outstanding or, in the case of a waiver, by the party against whom enforcement of any such waived provision is sought. No waiver of any default with respect to any provision, condition or requirement of this Agreement shall be deemed to be a continuing waiver in the future or a waiver of any subsequent default or a waiver of any other provision, condition or requirement hereof, nor shall any delay or omission of any party to exercise any right hereunder in any manner impair the exercise of any such right.

5.6 Headings. The headings herein are for convenience only, do not constitute a part of this Agreement and shall not be deemed to limit or affect any of the provisions hereof.

5.7 Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the parties and their successors and permitted assigns. The Company may not assign this Agreement or any rights or obligations hereunder without the prior written consent of each Purchaser (other than by merger). Any Purchaser may assign any or all of its rights under this Agreement to any Person to whom such Purchaser assigns or transfers any Securities, provided that such transferee agrees in writing to be bound, with respect to the transferred Securities, by the provisions of the Transaction Documents that apply to the "Purchasers."

5.8 No Third-Party Beneficiaries. This Agreement is intended for the benefit of the parties hereto and their respective successors and permitted assigns and is not for the benefit of, nor may any provision hereof be enforced by, any other Person, except as otherwise set forth in Section 4.10 and this Section 5.8.

5.9 Governing Law. All questions concerning the construction, validity, enforcement and interpretation of the Transaction Documents shall be governed by and construed and enforced in accordance with the internal laws of the State of New York, without regard to the principles of conflicts of law thereof. Each party agrees that all legal proceedings concerning the interpretations, enforcement and defense of the transactions contemplated by this Agreement and any other Transaction Documents (whether brought against a party hereto or its respective affiliates, directors, officers, shareholders, partners, members, employees or agents) shall be commenced exclusively in the state and federal courts sitting in the City of New York. Each party hereby irrevocably submits to the exclusive jurisdiction of the state and federal courts sitting in the City of New York, Borough of Manhattan for the adjudication of any dispute hereunder or in connection herewith or with any transaction contemplated hereby or discussed herein (including with respect to the enforcement of any of the Transaction Documents), and hereby irrevocably waives, and agrees not to assert in any suit, action or proceeding, any claim that it is not personally subject to the jurisdiction of any such court, that such suit, action or proceeding is improper or is an inconvenient venue for such proceeding. Each party hereby irrevocably waives personal service of process and consents to process being served in any such suit, action or proceeding by mailing a copy thereof via registered or certified mail or overnight delivery (with evidence of delivery) to such party at the address in effect for notices to it under this Agreement and agrees that such service shall constitute good and sufficient service of process and notice thereof. Nothing contained herein shall be deemed to limit in any way any right to serve process in any other manner permitted by law. If either party shall commence an action, suit or proceeding to enforce any provisions of the Transaction Documents, then, in addition to the obligations of the Company under Section 4.10, the prevailing party in such action, suit or proceeding shall be reimbursed by the other party for its reasonable attorneys' fees and other costs and expenses incurred with the investigation, preparation and prosecution of such action or proceeding.

5.10 Survival. The representations and warranties contained herein shall survive the Closing and the delivery of the Securities.

5.11 Execution. This Agreement may be executed in two or more counterparts, all of which when taken together shall be considered one and the same agreement and shall become effective when counterparts have been signed by each party and delivered to each other party, it being understood that the parties need not sign the same counterpart. In the event that any signature is delivered by facsimile transmission or by e-mail delivery of a “.pdf” format data file, such signature shall create a valid and binding obligation of the party executing (or on whose behalf such signature is executed) with the same force and effect as if such facsimile or “.pdf” signature page were an original thereof.

5.12 Severability. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction to be invalid, illegal, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions set forth herein shall remain in full force and effect and shall in no way be affected, impaired or invalidated, and the parties hereto shall use their commercially reasonable efforts to find and employ an alternative means to achieve the same or substantially the same result as that contemplated by such term, provision, covenant or restriction. It is hereby stipulated and declared to be the intention of the parties that they would have executed the remaining terms, provisions, covenants and restrictions without including any of such that may be hereafter declared invalid, illegal, void or unenforceable.

5.13 Rescission and Withdrawal Right. Notwithstanding anything to the contrary contained in (and without limiting any similar provisions of) any of the other Transaction Documents, whenever any Purchaser exercises a right, election, demand or option under a Transaction Document and the Company does not timely perform its related obligations within the periods therein provided, then such Purchaser may rescind or withdraw, in its sole discretion from time to time upon written notice to the Company, any relevant notice, demand or election in whole or in part without prejudice to its future actions and rights; provided, however, that in the case of a rescission of a conversion of a Debenture or exercise of a Warrant, the applicable Purchaser shall be required to return any shares of Common Stock subject to any such rescinded conversion or exercise notice concurrently with the return to such Purchaser of the aggregate exercise price paid to the Company for such shares and the restoration of such Purchaser’s right to acquire such shares pursuant to such Purchaser’s Warrant (including, issuance of a replacement warrant certificate evidencing such restored right).

5.14 Replacement of Securities. If any certificate or instrument evidencing any Securities is mutilated, lost, stolen or destroyed, the Company shall issue or cause to be issued in exchange and substitution for and upon cancellation thereof (in the case of mutilation), or in lieu of and substitution therefor, a new certificate or instrument, but only upon receipt of evidence reasonably satisfactory to the Company of such loss, theft or destruction. The applicant for a new certificate or instrument under such circumstances shall also pay any reasonable third-party costs (including customary indemnity) associated with the issuance of such replacement Securities.

5.15 Remedies. In addition to being entitled to exercise all rights provided herein or granted by law, including recovery of damages, each of the Purchasers and the Company will be entitled to specific performance under the Transaction Documents. The parties agree that monetary damages may not be adequate compensation for any loss incurred by reason of any breach of obligations contained in the Transaction Documents and hereby agree to waive and not to assert in any action for specific performance of any such obligation the defense that a remedy at law would be adequate.

5.16 Payment Set Aside. To the extent that the Company makes a payment or payments to any Purchaser pursuant to any Transaction Document or a Purchaser enforces or exercises its rights thereunder, and such payment or payments or the proceeds of such enforcement or exercise or any part thereof are subsequently invalidated, declared to be fraudulent or preferential, set aside, recovered from, disgorged by or are required to be refunded, repaid or otherwise restored to the Company, a trustee, receiver or any other Person under any law (including, without limitation, any bankruptcy law, state or federal law, common law or equitable cause of action), then to the extent of any such restoration the obligation or part thereof originally intended to be satisfied shall be revived and continued in full force and effect as if such payment had not been made or such enforcement or setoff had not occurred.

5.17 Usury. To the extent it may lawfully do so, the Company hereby agrees not to insist upon or plead or in any manner whatsoever claim, and will resist any and all efforts to be compelled to take the benefit or advantage of, usury laws wherever enacted, now or at any time hereafter in force, in connection with any claim, action or proceeding that may be brought by any Purchaser in order to enforce any right or remedy under any Transaction Document. Notwithstanding any provision to the contrary contained in any Transaction Document, it is expressly agreed and provided that the total liability of the Company under the Transaction Documents for payments in the nature of interest shall not exceed the maximum lawful rate authorized under applicable law (the "Maximum Rate"), and, without limiting the foregoing, in no event shall any rate of interest or default interest, or both of them, when aggregated with any other sums in the nature of interest that the Company may be obligated to pay under the Transaction Documents exceed such Maximum Rate. It is agreed that if the maximum contract rate of interest allowed by law and applicable to the Transaction Documents is increased or decreased by statute or any official governmental action subsequent to the date hereof, the new maximum contract rate of interest allowed by law will be the Maximum Rate applicable to the Transaction Documents from the effective date thereof forward, unless such application is precluded by applicable law. If under any circumstances whatsoever, interest in excess of the Maximum Rate is paid by the Company to any Purchaser with respect to indebtedness evidenced by the Transaction Documents, such excess shall be applied by such Purchaser to the unpaid principal balance of any such indebtedness or be refunded to the Company, the manner of handling such excess to be at such Purchaser's election.

5.18 Independent Nature of Purchasers' Obligations and Rights. The obligations of each Purchaser under any Transaction Document are several and not joint with the obligations of any other Purchaser, and no Purchaser shall be responsible in any way for the performance or non-performance of the obligations of any other Purchaser under any Transaction Document. Nothing contained herein or in any other Transaction Document, and no action taken by any Purchaser pursuant hereto or thereto, shall be deemed to constitute the Purchasers as a partnership, an association, a joint venture or any other kind of entity, or create a presumption that the Purchasers are in any way acting in concert or as a group with respect to such obligations or the transactions contemplated by the Transaction Documents. Each Purchaser shall be entitled to independently protect and enforce its rights, including, without limitation, the rights arising out of this Agreement or out of the other Transaction Documents, and it shall not be necessary for any other Purchaser to be joined as an additional party in any proceeding for such purpose. Each Purchaser has been represented by its own separate legal counsel in its review and negotiation of the Transaction Documents. For reasons of administrative convenience only, each Purchaser and its respective counsel have chosen to communicate with the Company through EGS. EGS does not represent any of the Purchasers and only represents Hillair. The Company has elected to provide all Purchasers with the same terms and Transaction Documents for the convenience of the Company and not because it was required or requested to do so by any of the Purchasers.

5.19 Liquidated Damages. The Company's obligations to pay any partial liquidated damages or other amounts owing under the Transaction Documents is a continuing obligation of the Company and shall not terminate until all unpaid partial liquidated damages and other amounts have been paid notwithstanding the fact that the instrument or security pursuant to which such partial liquidated damages or other amounts are due and payable shall have been canceled.

5.20 Saturdays, Sundays, Holidays, etc. If the last or appointed day for the taking of any action or the expiration of any right required or granted herein shall not be a Business Day, then such action may be taken or such right may be exercised on the next succeeding Business Day.

5.21 Construction. The parties agree that each of them and/or their respective counsel have reviewed and had an opportunity to revise the Transaction Documents and, therefore, the normal rule of construction to the effect that any ambiguities are to be resolved against the drafting party shall not be employed in the interpretation of the Transaction Documents or any amendments thereto. In addition, each and every reference to share prices and shares of Common Stock in any Transaction Document shall be subject to adjustment for reverse and forward stock splits, stock dividends, stock combinations and other similar transactions of the Common Stock that occur after the date of this Agreement.

5.22 **WAIVER OF JURY TRIAL. IN ANY ACTION, SUIT, OR PROCEEDING IN ANY JURISDICTION BROUGHT BY ANY PARTY AGAINST ANY OTHER PARTY, THE PARTIES EACH KNOWINGLY AND INTENTIONALLY, TO THE GREATEST EXTENT PERMITTED BY APPLICABLE LAW, HEREBY ABSOLUTELY, UNCONDITIONALLY, IRREVOCABLY AND EXPRESSLY WAIVES FOREVER TRIAL BY JURY.**

*(Signature Pages Follow)*

IN WITNESS WHEREOF, the parties hereto have caused this Securities Purchase Agreement to be duly executed by their respective authorized signatories as of the date first indicated above.

**SG BLOCKS, INC.**

Address for Notice:  
400 Madison Avenue, Suite 16C  
New York, NY 10017

By: /s/ Paul M. Galvin  
\_\_\_\_\_

Fax:  
(646) 747-2438

Name: Paul M. Galvin  
Title: Chief Executive Officer

With a copy to (which shall not constitute notice):

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK  
SIGNATURE PAGE FOR PURCHASER FOLLOWS]

[PURCHASER SIGNATURE PAGES TO SGBX SECURITIES PURCHASE AGREEMENT]

IN WITNESS WHEREOF, the undersigned have caused this Securities Purchase Agreement to be duly executed by their respective authorized signatories as of the date first indicated above.

Name of Purchaser: \_\_\_\_\_

*Signature of Authorized Signatory of Purchaser:* \_\_\_\_\_

Name of Authorized Signatory: \_\_\_\_\_

Title of Authorized Signatory: \_\_\_\_\_

Email Address of Authorized Signatory: \_\_\_\_\_

Facsimile Number of Authorized Signatory: \_\_\_\_\_

Address for Notice to Purchaser:

Address for Delivery of Securities to Purchaser (if not same as address for notice):

Subscription Amount: \_\_\_\_\_

Principal Amount (*1.12 x Subscription Amount*): \_\_\_\_\_

Warrant Shares: \_\_\_\_\_

EIN Number: \_\_\_\_\_

[SIGNATURE PAGES CONTINUE]

## Disclosure Schedules

### SG Blocks, Inc.

These Disclosure Schedules are being furnished by SG Blocks, Inc., a Delaware corporation (the “Company” or “SGB”) in connection with the Securities Purchase Agreement between the Company and certain Purchasers identified on the signature pages thereto (the “Agreement”). Unless the context otherwise requires, all capitalized terms used in these Disclosure Schedules shall have the respective meanings assigned to them in the Agreement.

No reference to or disclosure of any item or other matter in these Disclosure Schedules shall be construed as an admission or indication that such item or other matter is material or that such item or other matter is required to be referred to or disclosed in these Disclosure Schedules. No reference in these Disclosure Schedules to any agreement or document shall be construed as an admission or indication that such agreement or document is enforceable or currently in effect or that there are any obligations remaining to be performed or any rights that may be exercised under such agreement or document. No disclosure in these Disclosure Schedules relating to any possible breach or violation of any agreement, law or regulation shall be construed as an admission or indication that any such breach or violation exists or has occurred.

These Disclosure Schedules are qualified in their entirety by reference to specific provisions of the Agreement, and are not intended to constitute, and shall not be construed as constituting, any representation or warranties of the Company, except as and to the extent provided in the Agreement, subject to the limitations therein. These Disclosure Schedules and the information and disclosures contained in these Disclosure Schedules are intended only to qualify and limit the representations, warranties and covenants of the Company contained in the Agreement and shall not be deemed to expand in any way the scope or effect of any such representations, warranties or covenants.

Notwithstanding anything to the contrary contained in these Disclosure Schedules or in the Agreement, the information and disclosures contained in each section of these Disclosure Schedules shall be deemed to be disclosed and incorporated by reference to each of the other sections (whether or not specific cross-references are made), and shall be deemed to qualify and limit all representations, warranties and covenants of Company contained in the Agreement.

The bold-faced headings contained in these Disclosure Schedules are included for convenience only, and are not intended to limit the effect of the disclosures contained in these Disclosure Schedules or to expand the scope of the information required to be disclosed in these Disclosure Schedules.

**Schedule 3.1(a)**

**Subsidiaries**

1. SG Building, Inc., a Delaware corporation.
2. SG Blocks Sistema De Constucao Brasileiro LTDA, a company organized under the laws of Brazil.

**Schedule 3.1(d)**

**Conflicts**

Schedule 3.1(e) is incorporated by reference.

**Schedule 3.1(e)**

**Filings, Consents and Approvals**

Consent of Prestige Capital Corporation (“Prestige”) is required, or order to create the security interest agreed to in the Transaction Documents. The Company has not factored under the Factoring Agreement with Prestige since October 26, 2010.

**Schedule 3.1(g)**

**Capitalization**

1. Shares not yet issued by American Stock Transfer:

Scott Smith – 40,000 (July 19)  
Richard Lampen – 30,000  
Two Lake, LLC (Scott Magrane – BOD) - 28,571  
J. Bryant Kirkland – 28,572  
Christopher Melton – 85,000

Admiral Edmund P. Giambastiani, Jr. U.S. Navy (ret) - Options to purchase 20,000 shares. For each month during term of Mr. Giambastiani consulting agreement with the Company, Mr. Giambastiani is granted options to purchase 10,000 shares of Company common stock, which are priced at the closing price on the night before the date of the grant. The 20,000 options noted above reflect monthly grants for October and November 2012.

2. The Company issued approximately 2,206,444 shares at \$0.35 per share during 2012. All of these shares are subject to reset at Conversion Price.

**Schedule 3.1(h)**

**SEC Reports; Financial Statements**

None

**Schedule 3.1(i)**

**Material Changes**

None

**Schedule 3.1(j)**

**Litigation**

Lorlee Inc. D/B/A Hunter & Hunter Transport V. Amagansett Beach Box LLC, SG Blocks, Inc., Paul M. Galvin, Steven Armstrong, and J. Bryant Kirkland (File No. 5001-0001) filed on December 18, 2012, in the State Supreme Court of the State of New York, County of Suffolk.

**Schedule 3.1(n)**

**Title to Assets**

**Liens**

In connection with that certain Purchase and Sale Agreement between the Company and Prestige, dated January 4, 2010, as supplemented or amended from time to time (the "Factoring Agreement"), Prestige has a security interest in all assets of the Company. This interest is reflected in the UCC File No. 20103763848, filed in Delaware on October 27, 2010.

### Schedule 3.1(v)

#### Registration Rights

1. Agreements entered into in connection the Company's private placement / financings that closed on October 29, 2010 and December 23, 2010.
2. Stock Purchase Agreement, dated March 11, 2011, between the Company and Gunther Bacher for 10,000 shares of Common Stock.
3. Stock Purchase Agreement, dated March 9, 2011, between the Company and Franz Burda for 40,000 shares of Common Stock.
4. Stock Purchase Agreement, dated February 28, 2011, between the Company and Eric Freymond for 50,000 shares of Common Stock.
5. Stock Purchase Agreement, dated March 28, 2011, between the Company and Pro-Mall International Ltd. for 100,000 shares of Common Stock.
6. Stock Purchase Agreement, dated June 21, 2011, between the Company and Ben Lambert for 40,000 shares of SGB Common Stock.
7. Warrant to Ladenburg Thalmann & Co. Inc. ("Ladenburg") on November 4, 2011. Warrant grants the same registration rights as the Company granted to investors in the private placement of the Company's shares of Common Stock for which Ladenburg acted as placement agent.
8. Letter Agreement between certain shareholders of the Company and Plaza Construction Corp. ("Plaza"), dated September 1, 2010. These registration rights granted to Plaza "piggy back" off on the registration rights granted to certain members of management.
9. Agreements entered into in connection the Company's private placement / financings that closed on March 27, 2012 and May 24, 2012.
10. Warrant issued by SG Blocks, Inc. to Ladenburg on March 28, 2012. Warrant grants the same registration rights as the Company granted to investors in the private placement of the Company's shares of Common Stock for which Ladenburg acted as placement agent.
11. Agreements entered into in connection the Company's private placement / financings that closed on November 14, 2012 and November 19, 2012.

NOTE: With respect to agreements 1 through 7 above, all shares have been registered pursuant to that Registration Statement on Form S-1, File No. 333-178321.

**Schedule 3.1(aa)**

**Solvency**

1. The Factoring Agreement with Prestige. No amounts are currently outstanding pursuant to this agreement. The Company has not factored under the Factoring Agreement with Prestige since October 26, 2010.

2. On March 26, 2009, the Company entered into a \$50,000 revolving credit promissory note (the “Revolver”) with Vector Group Ltd. (the “Revolver”). On January 26, 2011, the Company and Vector entered into an amendment to the Revolver increasing the amount that it may borrow thereunder from \$50,000 to \$100,000. As of September 30, 2012, the Revolver had \$73,500 of principal and \$18,373 of interest outstanding.

**Schedule 3.1 (ee)**

**Accountants**

Marcum LLP

CERTIFICATION OF THE PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Paul M. Galvin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SG Blocks, Inc.;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer(s) 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 Rules 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 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 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(s) 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.

November 14, 2013

/s/ Paul M. Galvin

Name: Paul M. Galvin

Title: Chief Executive Officer

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CERTIFICATION OF THE PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Brian Wasserman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SG Blocks, Inc.;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer(s) 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 Rules 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 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 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(s) 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.

November 14, 2013

/s/ Brian Wasserman

Name: Brian Wasserman

Title: Chief Financial Officer

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CERTIFICATION PURSUANT TO 18 U.S.C. §1350,  
AS ADOPTED PURSUANT TO SECTION 906 OF THE  
SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of SG Blocks, Inc., (the “Company”) on Form 10-Q for the period ended September 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Paul M. Galvin, the Chief Executive Officer of the Company, and I, Brian Wasserman, the Chief Financial Officer of the Company, do hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief that:

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

November 14, 2013

/s/ Paul M. Galvin  
Name: Paul M. Galvin  
Title: Chief Executive Officer

November 14, 2013

/s/ Brian Wasserman  
Name: Brian Wasserman  
Title: Chief Financial Officer

This certification accompanies each Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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