

**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 **March 31, 2015**

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**

**95-4463937**

(State or other jurisdiction of  
incorporation or organization)

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

**115 W 18<sup>th</sup> Street, New York, NY**

**10011**

(Address of principal executive offices)

(Zip Code)

**(212) 520-6218**

(Registrant's telephone number, including area code)

**3 Columbus Circle, 16th Floor New York, NY 10016**

(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 | <input type="checkbox"/> | Accelerated filer         | <input type="checkbox"/>            |
| Non-accelerated filer   | <input type="checkbox"/> | Smaller reporting company | <input checked="" type="checkbox"/> |

(Do not check if a 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 May 8, 2015, there were 42,918,927 shares of the registrant's common stock, \$0.01 par value, outstanding.

**SG BLOCKS, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2015**

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

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

|  | <u>March 31,</u><br><u>2015</u> | <u>December 31,</u><br><u>2014</u> |
|--|---------------------------------|------------------------------------|
|  | <i>(Unaudited)</i>              |                                    |
| <b>Assets</b>  |                                 |                                    |
| Current assets:  |                                 |                                    |
| Cash and cash equivalents  | \$ 578,592                      | \$ 884,188                         |
| Short-term investment  | 39,405                          | 39,399                             |
| Accounts receivable, net   | 339,622                         | 165,933                            |
| Inventory  | 561,826                         | 198,970                            |
| Prepaid expenses and other current assets  | 17,717                          | 7,717                              |
| Total current assets   | <u>1,537,162</u>                | <u>1,296,207</u>                   |
| Equipment, net   | 10,013                          | 10,957                             |
| Security deposit   | 15,900                          | 15,900                             |
| Debt issuance costs, net   | 20,815                          | 26,019                             |
| Totals   | <u>\$ 1,583,890</u>             | <u>\$ 1,349,083</u>                |
| <b>Liabilities and Stockholders' Deficiency</b>  |                                 |                                    |
| Current liabilities:   |                                 |                                    |
| Accounts payable and accrued expenses  | \$ 342,691                      | \$ 279,066                         |
| Accrued interest, related party  | 38,854                          | 36,833                             |
| Accrued interest   | 79,914                          | -                                  |
| Related party accounts payable and accrued expenses  | 297,580                         | 132,481                            |
| Related party notes payable  | 73,500                          | 73,500                             |
| Convertible debentures, net of discounts of \$691,590 and \$198,200  | 3,304,110                       | 800,726                            |
| Billings in excess of costs and estimated earnings on uncompleted contracts  | 2,579                           | 3,500                              |
| Deferred revenue   | 822,109                         | 303,427                            |
| Conversion option liabilities  | 7,991                           | 110,000                            |
| Warrant liabilities  | 252,789                         | 536,671                            |
| Total current liabilities  | <u>5,222,117</u>                | <u>2,276,204</u>                   |
| Convertible debentures, net of discounts of \$594,598  | -                               | 2,402,176                          |
| Total liabilities  | <u>5,222,117</u>                | <u>4,678,380</u>                   |
| <b>Commitments</b>   |                                 |                                    |
| Stockholders' deficiency:  |                                 |                                    |
| Preferred stock, \$0.01 par value, 5,000,000 shares authorized; 0 issued and outstanding at March 31, 2015 and December 31, 2014         | -                               | -                                  |
| Common stock, \$0.01 par value, 300,000,000 shares authorized; 42,918,927 issued and outstanding at March 31, 2015 and December 31, 2014 | 429,189                         | 429,189                            |
| Additional paid-in capital   | 7,027,022                       | 6,978,907                          |
| Accumulated deficiency   | (11,094,438)                    | (10,737,393)                       |
| Total stockholders' deficiency   | <u>(3,638,227)</u>              | <u>(3,329,297)</u>                 |
| Totals   | <u>\$ 1,583,890</u>             | <u>\$ 1,349,083</u>                |

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

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

|  | <i>For the Three Months Ended</i> |                     |
|--|-----------------------------------|---------------------|
|  | <i>March 31,</i>                  |                     |
|  | <u>2015</u>                       | <u>2014</u>         |
|  | <i>(Unaudited)</i>                | <i>(Unaudited)</i>  |
| <b>Revenue:</b>                                |                                   |                     |
| SG Block sales                                 | \$ 376,513                        | \$ 1,008,646        |
| Engineering services                           | 25,526                            | 23,890              |
| Project management                             | -                                 | 1,734               |
|  | <u>402,039</u>                    | <u>1,034,270</u>    |
| <b>Cost of revenue:</b>                        |                                   |                     |
| SG Block sales                                 | 337,155                           | 778,645             |
| Engineering services                           | 22,768                            | 8,044               |
| Project management                             | -                                 | 13,449              |
|  | <u>359,923</u>                    | <u>800,138</u>      |
| <b>Gross profit</b>                            | 42,116                            | 234,132             |
| <b>Operating expenses:</b>                     |                                   |                     |
| Payroll and related expenses                   | 311,223                           | 240,313             |
| General and administrative expenses            | 218,020                           | 220,002             |
| Marketing and business development expense     | 58,739                            | 14,155              |
| Pre-project expenses                           | 8,729                             | 14,070              |
| Total  | <u>596,711</u>                    | <u>488,540</u>      |
| <b>Operating loss</b>                          | (554,595)                         | (254,408)           |
| <b>Other income (expense):</b>                 |                                   |                     |
| Interest expense                               | (188,347)                         | (183,599)           |
| Interest income                                | 6                                 | 8                   |
| Change in fair value of financial instruments  | 385,891                           | (80,215)            |
| Total  | <u>197,550</u>                    | <u>(263,806)</u>    |
| <b>Net loss</b>                                | <u>\$ (357,045)</u>               | <u>\$ (518,214)</u> |
| <b>Net loss per share - basic and diluted:</b> |                                   |                     |
| Basic and diluted                              | <u>\$ (0.01)</u>                  | <u>\$ (0.01)</u>    |
| <b>Weighted average shares outstanding:</b>    |                                   |                     |
| Basic and diluted                              | <u>42,918,927</u>                 | <u>42,746,480</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**

| <i>For the Three Months Ended March 31, 2015</i><br><i>(Unaudited)</i> | <b>\$0.01 Par Value<br/>Common Stock</b> |                   | <b>Additional<br/>Paid-in</b> | <b>Accumulated</b>     | <b>Total</b>          |
|--|--|-------------------|-------------------------------|------------------------|-----------------------|
|  | <b>Shares</b>                            | <b>Amount</b>     | <b>Capital</b>                | <b>Deficiency</b>      |                       |
| <b>Balance - December 31, 2014</b>                                     | 42,918,927                               | \$ 429,189        | \$ 6,978,907                  | \$ (10,737,393)        | \$ (3,329,297)        |
| Stock-based compensation   | -  | -                 | 48,115                        | -                      | 48,115                |
| Net loss   | -  | -                 | -                             | (357,045)              | (357,045)             |
| <b>Balance – March 31, 2015</b>  | <u>42,918,927</u>                        | <u>\$ 429,189</u> | <u>\$ 7,027,022</u>           | <u>\$ (11,094,438)</u> | <u>\$ (3,638,227)</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 Three Months Ended March 31,*

|  | <b>2015</b>              | <b>2014</b>             |
|--|--------------------------|-------------------------|
|  | <i>(Unaudited)</i>       | <i>(Unaudited)</i>      |
| <b>Cash flows from operating activities:</b>                                 |                          |                         |
| Net loss   | \$ (357,045)             | \$ (518,214)            |
| Adjustments to reconcile net loss to net cash used in operating activities:  |                          |                         |
| Depreciation expense   | 944                      | 886                     |
| Amortization of debt issuance costs  | 5,204                    | 22,415                  |
| Accretion of discount on convertible debentures                              | 101,208                  | 117,723                 |
| Interest income on short-term investment                                     | (6)                      | (8)                     |
| Change in fair value of financial instruments                                | (385,891)                | 80,215                  |
| Stock-based compensation   | 48,115                   | 30,695                  |
| Vesting of consultant stock  | -                        | 62,143                  |
| Changes in operating assets and liabilities:                                 |                          |                         |
| Accounts receivable  | (173,689)                | 7,888                   |
| Inventory  | (362,856)                | 5,602                   |
| Prepaid expenses and other current assets                                    | (10,000)                 | 1,776                   |
| Accounts payable and accrued expenses  | 63,625                   | (48,814)                |
| Accrued interest, related party  | 2,021                    | 2,021                   |
| Accrued interest   | 79,914                   | 41,440                  |
| Related party accounts payable and accrued expenses                          | 165,099                  | (108,243)               |
| Billings in excess of costs and estimated earnings -on uncompleted contracts | (921)                    | (1,734)                 |
| Deferred revenue   | 518,682                  | (202,759)               |
| Net cash used in operating activities  | <u>(305,596)</u>         | <u>(506,968)</u>        |
| <b>Cash flows used in investing activities</b>                               |                          |                         |
| Purchase of equipment  | -                        | (607)                   |
| Net cash used in investing activities  | <u>-</u>                 | <u>(607)</u>            |
| <b>Cash flows from financing activities:</b>                                 |                          |                         |
| Expenditures on debt issuance costs  | -                        | (20,000)                |
| Proceeds from exercise of stock options                                      | -                        | 10,000                  |
| Net cash provided by financing activities                                    | <u>-</u>                 | <u>(10,000)</u>         |
| <b>Net decrease in cash and cash equivalents</b>                             | <b>(305,596)</b>         | <b>(517,575)</b>        |
| <b>Cash and cash equivalents - beginning of period</b>                       | <b>884,188</b>           | <b>594,248</b>          |
| <b>Cash and cash equivalents - end of period</b>                             | <b><u>\$ 578,592</u></b> | <b><u>\$ 76,673</u></b> |
| <b>Supplemental disclosure of cash flow information:</b>                     |                          |                         |
| Cash paid during the period for:   |                          |                         |
| Interest   | <u>\$ -</u>              | <u>\$ -</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

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 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.

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 March 31, 2015, the Company has incurred an accumulated deficiency since inception of \$11,094,438. At March 31, 2015, the Company had a cash balance of \$578,592.

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

Between October 1, 2015 and April 1, 2016, the Company's convertible debentures (as disclosed in Note 6), in the amount of \$3,995,700 will mature. Also, in June 2015 the Company's related party revolving credit promissory matures (as disclosed in Note 11). In April 2015, the Company entered into a license agreement (the "License Agreement") with Red Cardinal Holdings, Inc. ("Red Cardinal") pursuant to which the Company granted Red Cardinal a 15 year world-wide non-exclusive license to use the Company's proprietary methods and technology to develop, manufacture, advance and promote code-engineered containers for safe and sustainable construction of buildings (the "License"). In consideration for the License, the Company will receive a royalty of 10% of actual revenues collected by Red Cardinal in connection with manufacturing, distributing and selling of buildings using the License. Under the terms of License Agreement, Red Cardinal will, within ninety days of the execution of the License Agreement, enter into a contract in the amount of no less than \$10,000,000 for the manufacture of buildings under the License Agreement. In addition, Red Cardinal has also agreed to pay in full, assume or otherwise satisfy, to the holders of the Company's debentures, described herein, all amounts as and when due under such debentures. The Company will provide consulting services to Red Cardinal in connection with which Red Cardinal may provide an advance to the 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. At May 7, 2015, the Company had a cash balance of approximately \$299,000.

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 any proceeds of any other issuances of senior convertible debt 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 expected operating costs. Accordingly, the Company requires further external funding to sustain operations and to follow through on the execution of its business plan. There is 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 additional 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.

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

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 3. Summary of Significant Accounting Policies

**Interim financial information** - The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“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 notes required by GAAP 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 three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

The condensed consolidated financial statements and notes should be read in conjunction with the financial statements and notes for the year ended December 31, 2014 included in the Company’s Annual Report on Form 10-K, as amended, filed with the Securities and Exchange Commission on March 31, 2015.

**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, allowance for doubtful accounts and a valuation for deferred tax assets. 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

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 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. For the three months ended March 31, 2015 and 2014, the Company recognized \$1,494 and \$1,275, respectively, in warrant claims. The Company does not anticipate that any additional 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 receiving point. The title and risk of loss passes to the customer at the customer's receiving 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.

**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 March 31, 2015 and December 31, 2014, work-in-process inventory amounted to \$561,826 and \$198,970, respectively.

## SG BLOCKS, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

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

**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 Three Months Ended March 31, 2015 and 2014 (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:

|                               | <b>March 31,<br/>2015</b> | <b>Quoted<br/>prices in<br/>active market<br/>for identical<br/>assets<br/>(Level 1)</b> | <b>Significant<br/>other<br/>observable<br/>inputs<br/>(Level 2)</b> | <b>Significant<br/>unobservable<br/>inputs<br/>(Level 3)</b> |
|-------------------------------|---------------------------|--|--|--|
| Warrant Liabilities           | \$ 252,789                | \$ -   | \$ -   | \$ 252,789   |
| Conversion Option Liabilities | \$ 7,991                  | \$ -   | \$ -   | \$ 7,991   |

|                               | <b>December<br/>31,<br/>2014</b> | <b>Quoted<br/>prices in<br/>active market<br/>for identical<br/>assets<br/>(Level 1)</b> | <b>Significant<br/>other<br/>observable<br/>inputs<br/>(Level 2)</b> | <b>Significant<br/>unobservable<br/>inputs<br/>(Level 3)</b> |
|-------------------------------|----------------------------------|--|--|--|
| Warrant Liabilities           | \$ 536,671                       | \$ -   | \$ -   | \$ 536,671   |
| Conversion Option Liabilities | \$ 110,000                       | \$ -   | \$ -   | \$ 110,000   |

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:

|   | <b>For the<br/>three months<br/>ended<br/>March 31,<br/>2015</b> | <b>For the<br/>three<br/>months<br/>ended<br/>March 31,<br/>2014</b> |
|---|--|--|
| Beginning balance   | \$ 646,671   | \$ 217,611   |
| Aggregate fair value of conversion option liabilities and warrants issued | -  | -  |
| Change in fair value of conversion option liabilities and warrants        | (385,891)  | 80,215   |
| Ending balance  | <u>\$ 260,780</u>  | <u>\$ 297,826</u>  |

## SG BLOCKS, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 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 6 and 8.

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 6 and 8, the Company computed the fair value of the warrant and conversion option liability at the date of issuance and the reporting dates of March 31, 2015 and December 31, 2014 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 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 publicly quoted prices. 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.

## SG BLOCKS, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 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 March 31, 2015 and December 31, 2014, 93% and 85%, respectively, of the Company's accounts receivable were due from four and two customers, respectively.

Revenue relating to two customers represented approximately 44% and 40%, respectively, of the Company's total revenue for the three months ended March 31, 2015. Also, revenue relating to two customers represented approximately 22% and 66%, respectively, of the Company's total revenue for the three months ended March 31, 2014. One customer is included in both the three months ended March 31, 2015 and 2014.

Costs of revenue relating to one vendor, who is a related party and disclosed in Note 11, represented approximately 57% and 23% of the Company's total cost of revenue for the three months ended March 31, 2015 and 2014. Costs of revenue relating to one unrelated vendors, represented approximately 67%, of the Company's total cost of revenue for the three months ended March 31, 2014. The Company believes it has access to alternative suppliers, with limited disruption to the business, should circumstances change with its existing suppliers.

**Recent accounting pronouncements** - In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09 ("ASU 2014-09"), which creates Topic 606, *Revenue from Contracts with Customers*, and supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. In addition, ASU 2014-09 supersedes the cost guidance in Subtopic 605-35, Revenue Recognition --Construction-Type and Production-Type Contracts, and creates new Subtopic 340-40, Other Assets and Deferred Costs -- Contracts with Customers. In summary, the core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additionally, ASU 2014-09 requires enhanced financial statement disclosures over revenue recognition as part of the new accounting guidance. The amendments in ASU 2014-09 are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, and early application is not permitted. The Company is currently evaluating the provisions of ASU 2014-09 and assessing the impact, if any, it may have on its financial position and results of operations.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements - Going Concern*. The Update provides U.S. GAAP guidance on management's responsibility in evaluating whether there is substantial doubt about a company's ability to continue as a going concern and about related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company's ability to continue as a going concern within one year from the date the financial statements are issued. This Accounting Standards Update is the final version of Proposed Accounting Standards Update 2013-300 --Presentation of Financial Statements (Topic 205): Disclosure of Uncertainties about an Entity's Going Concern Presumption, which has been deleted. The Company is currently evaluating the effects of ASU 2014-15 on the financial statements.

In April 2015, the FASB issued ASU No. 2015-03, *Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. The update requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability instead of being presented as an asset. Debt disclosures will include the face amount of the debt liability and the effective interest rate. The update requires retrospective application and represents a change in accounting principle. The update is effective for fiscal years beginning after December 15, 2015. Early adoption permitted for financial statements that have not been previously issued. The adoption of this statement will impact future presentation and disclosures of the financial statements.

Management does not believe that these or any other recently issued, but not yet effective accounting pronouncements, if adopted, would have a material effect on the accompanying condensed consolidated financial statements.

## SG BLOCKS, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 4. Accounts Receivable

At March 31, 2015 and December 31, 2014, the Company's accounts receivable consisted of the following:

|                                       | <u>2015</u>       | <u>2014</u>       |
|---------------------------------------|-------------------|-------------------|
| Billed:                               |                   |                   |
| SG Block sales                        | \$ 348,526        | \$ 172,837        |
| Engineering services                  | -                 | 2,000             |
| Project management                    | 15,842            | 15,842            |
| Total gross receivables               | 364,368           | 190,679           |
| Less: allowance for doubtful accounts | (24,746)          | (24,746)          |
| Total net receivables                 | <u>\$ 339,622</u> | <u>\$ 165,933</u> |

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

Costs and estimated earnings on uncompleted contracts consist of the following at March 31, 2015 and December 31, 2014:

|   | <u>2015</u>       | <u>2014</u>       |
|---|-------------------|-------------------|
| Costs incurred on uncompleted contracts     | \$ 768            | \$ -              |
| Provision for loss on uncompleted contracts | -                 | -                 |
| Estimated income (loss)                     | 153               | -                 |
|   | 921               | -                 |
| Less: billings to date                      | (3,500)           | (3,500)           |
|   | <u>\$ (2,579)</u> | <u>\$ (3,500)</u> |

The above amounts are included in the accompanying condensed consolidated balance sheets under the following captions at March 31, 2015 and December 31, 2014.

|   | <u>2015</u>       | <u>2014</u>       |
|---|-------------------|-------------------|
| Costs and estimated earnings in excess of billings on uncompleted contracts | \$ -              | \$ -              |
| Billings in excess of cost and estimated earnings on uncompleted contracts  | (2,579)           | (3,500)           |
|   | <u>\$ (2,579)</u> | <u>\$ (3,500)</u> |

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.

## SG BLOCKS, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 6. Convertible Debentures

On April 10, 2014, the Company entered into a Securities Exchange Agreement (the "Exchange Agreement") with Hillair Capital Investments L.P. ("Hillair"), Frank Casano ("Casano") and Scott Masterson ("Masterson") who held certain existing Senior Convertible Debentures (the "Existing Debentures"). Existing Debentures consisted of: (a) debentures issued and sold to Hillair in December 2012 (the "2012 Hillair Debentures") and (b) debentures issued and sold to Casano and Masterson in April 2013 (the "April 2013 Debentures"). Under the terms of the Exchange Agreement, Existing Debentures with a stated maturity value of \$1,680,000 were surrendered in exchange for (i) new Senior Convertible Debentures with a stated interest rate of eight percent (8%) per year, a stated maturity value of \$1,915,200, a conversion price of \$0.25 per share, subject to adjustment, with a final maturity date of April 1, 2016 (the "2014 Exchange Debentures"), and (ii) a five (5) year Common Stock purchase warrant to purchase up to 7,660,800 shares of the Company's common stock at an exercise price of \$0.275 (110% of the conversion price), subject to adjustment (the "2014 Exchange Warrants"). At April 10, 2014, the carrying value of Existing Debentures was \$1,680,000 and the fair value of the conversion option liability was \$2,366. The fair value of the conversion option liability of the 2014 Exchange Debentures was determined to be \$380,744 and the fair value of the warrants issued was determined to be \$490,601. The Company recognized a loss of \$1,104,179 on this exchange transaction. In connection with the Exchange Agreement, the Company incurred \$20,763 in legal fees which are included in debt issuance costs in the accompanying condensed consolidated balance sheets at March 31, 2015 and December 31, 2014.

On April 10, 2014, the Company entered into a Securities Purchase Agreement (the "2014 SPA") with four investors, including Hillair pursuant to which the Company issued and sold (i) \$2,080,500 in 8% Original Discount Senior Secured Convertible Debentures, for \$1,825,000, with a conversion price of \$0.25 per share, subject to adjustment, with a final maturity date of April 1, 2016 (the "2014 New Debentures" together with the 2014 Exchange Debentures, the "2014 Debentures"), and (ii) a five (5) year Common Stock purchase warrant to purchase up to 8,322,000 shares of the Company's common stock at an exercise price of \$0.275 (110% of the conversion price), subject to adjustment with a fair value of \$532,944 at issuance, which has been recorded as a discount to the 2014 New Debentures. (As disclosed in Note 8) The Company recorded a discount of \$255,500, which is being amortized over the term of the 2014 New Debentures, using the effective interest method. The initial conversion price for the 2014 New Debentures is \$0.25 per share, subject to adjustments upon certain events, as set forth in the 2014 New Debentures. At the date of issuance the fair value of the conversion option liability was determined to be \$413,606, which has been recorded as a discount to the 2014 New Debentures. In connection with the 2014 New Debentures, the Company incurred \$20,000 in legal fees which are included in debt issuance costs in the accompanying condensed consolidated balance sheets at March 31, 2015 and December 31, 2014. As of March 31, 2015 and December 31, 2014, the discount related to the 2014 New Debentures amounted to \$691,590 and \$792,798, respectively.

## SG BLOCKS, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 6. Convertible Debentures (continued)

The Exchange Agreement and the 2014 SPA triggered anti-dilution adjustments to the warrants issued on the Existing Debentures based on a \$0.25 per share conversion price (adjusted from the original stated conversion price of \$0.43 per share), which reduces the exercise price to \$0.25 per share and increases the number of shares issuable upon the exercise of the Existing Warrants from 4,818,605 to 8,288,000 shares.

At any time after April 10, 2014, (the "Original Issue Date") until the 2014 Debentures are no longer outstanding, the 2014 Debentures are convertible, in whole or in part, into shares of Common Stock at the option of the 2014 Debenture holders, subject to certain conversion limitations set forth in the 2014 Debentures. The initial conversion price for the 2014 Debentures is \$0.25 per share, subject to adjustments upon certain events, as set forth in the 2014 Debentures. The Company will pay interest on the aggregate unconverted and then outstanding principal amount of the 2014 Debentures at the rate of 8% per annum, payable quarterly on January 1, April 1, July 1 and October 1, beginning on October 1, 2014. Interest is payable in cash or at the Company's option in shares of Common Stock, provided certain terms and conditions are met as more fully described in the 2014 Debentures. On each of October 1, 2015 and January 1, 2016, the Company is obligated to redeem an amount equal to \$998,925 and on April 1, 2016, an amount equal to \$1,997,850, plus accrued but unpaid interest, liquidated damages and any other amounts then owing in respect of the 2014 Debentures (as to each of the forgoing periodic redemptions, each a "Periodic Redemption Amount"). In lieu of a cash redemption and subject to the Company meeting certain equity conditions described in the 2014 Debentures, the Company may elect to pay the Periodic Redemption Amount in shares on the terms set forth in the 2014 Debentures.

Upon any Event of Default (as defined in the 2014 Debentures), the outstanding principal amount of the 2014 Debentures, plus liquidated damages, interest, a premium of 30% and other amounts owing in respect thereof through the date of acceleration, shall become, at the debenture holders' election, immediately due and payable in cash. Commencing five days after the occurrence of any Event of Default, the interest rate on the 2014 Debentures shall accrue at an interest rate equal to the lesser of 18% per annum or the maximum rate permitted under applicable law. The 2014 Debentures contain anti-dilution protective provisions as described therein. The Company is subject to compliance with certain covenants under the 2014 Debentures as set forth therein.

The 2014 Warrants may be exercised at any time on or after April 10, 2014 and on or prior to the close of business on April 10, 2019, at an exercise price of \$0.275 per share, subject to adjustment upon certain events. The 2014 Warrants contain anti-dilution protective provisions and limitations on exercise as described therein.

To secure the Company's obligations under the 2014 Debentures, SG Building entered into a Subsidiary Guarantee, dated as of April 10, 2014 (the "Guarantee"), pursuant to which it unconditionally and irrevocably guaranteed the prompt and complete payment and performance when due of the obligations arising from the 2014 Debentures. The Company and SG Building have each granted the debenture holders a security interest in their assets to secure the payment, performance and discharge in full of all of the Company's obligations under the 2014 Debentures and the guarantor's obligations under the Guarantee, in accordance with that certain Security Agreement, dated as of April 10, 2014.

**SG BLOCKS, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

*For the Three Months Ended March 31, 2015 and 2014 (Unaudited)*

**6. Convertible Debentures (continued)**

A summary of the Company's convertible debentures as of March 31, 2015 and December 31, 2014 is as follows:

|  | <u>2015</u>      | <u>2014</u>         |
|--|------------------|---------------------|
| 2014 Exchange Debentures                                     | \$ 1,915,200     | \$ 1,915,200        |
| 2014 New Debentures, net of \$691,590 and \$792,798 discount | <u>1,388,910</u> | <u>1,287,702</u>    |
| Total debt   | 3,304,110        | 3,202,902           |
| Less current portion   | <u>3,304,110</u> | <u>800,726</u>      |
| Long-term debt   | <u>\$ -</u>      | <u>\$ 2,402,176</u> |

For the three months ended March 31, 2015 and 2014, interest expense on the convertible debentures amounted to \$79,914 and \$41,440, respectively, and is included on the accompanying condensed consolidated statements of operations. For the three months ended March 31, 2015 and 2014, total amortization relating to the discount amounted to \$101,208 and \$117,723, respectively, and is included in interest expense on the accompanying condensed consolidated statements of operations.

## SG BLOCKS, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 6. Convertible Debentures (continued)

The Company bifurcated the conversion option from its debt host. The fair value of the conversion option liabilities as of March 31, 2015 and December 31, 2014 was \$7,991 and \$110,000, respectively. The significant assumptions which the Company used to measure the fair value at the date of issuance and March 31, 2015 of the conversion option liability are as follows:

|                         | March 31,<br>2015 | December 31,<br>2014 |
|-------------------------|-------------------|----------------------|
| Stock price             | \$ 0.09           | \$ 0.14              |
| Term                    | 0.50 – 1 year     | 0.75 – 1.25 years    |
| Volatility              | 50%               | 50%                  |
| Risk-free interest rate | 0.14 – 0.26%      | 0.25%                |
| Exercise price          | \$ 0.25           | \$ 0.25              |

In connection with the 2014 SPA, 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 debenture 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 debentures 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 debentures, 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 debenture holder for a Buy-In (as defined in the debentures) of securities previously sold by the debenture holder on a failure to timely deliver certificates upon conversion by the debenture holder. If the holder is subject to a Buy-In, then the Company will (A) pay in cash to the debenture holder (in addition to any other remedies available to or elected by the debenture holder) the amount, if any, by which (x) the debenture 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 debenture 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 debenture 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 debenture 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 Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 7. 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. Diluted income per share includes the dilution that would occur upon the exercise or conversion of all potentially dilutive securities into common stock using the "treasury stock" and/or "if converted" method as applicable. At March 31, 2015, there were options and warrants to purchase 15,425,001 and 25,572,059 shares of common stock, respectively, outstanding which could potentially dilute future net income (loss) per share. At March 31, 2015 the Company also has outstanding convertible debt which is initially convertible into 15,982,800 shares of common stock that could potentially dilute future net income (loss) per share. The number of shares the convertible debt could be converted into could potentially increase under certain circumstances related to the market price of the Company's common stock at the time of conversion. At March 31, 2014, there were options and warrants to purchase 10,330,001 and 6,119,864 shares of common stock, respectively, outstanding which could potentially dilute future net income (loss) per share. At March 31, 2014 the Company also had outstanding convertible debt which was initially convertible into 4,818,605 shares of common stock, which could potentially dilute future net income (loss) per share.

#### 8. 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 March 31, 2015 and December 31, 2014 was \$0 and \$3,476, respectively.

## SG BLOCKS, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 8. 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. These 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 were 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 Placements warrants as of March 31, 2015 and December 31, 2014 was \$146 and \$750, respectively.

In connection with the issuance of the 2012 Hillair Debenture disclosed in Note 6, the Company issued warrants to Hillair (the "2012 Hillair Warrants"). The 2012 Hillair Warrants originally entitled Hillair to purchase up to 2,604,651 shares of Common Stock for \$0.4488 per share, subject to adjustments upon certain events. The 2012 Hillair Warrants may be exercised at any time on or after June 27, 2013 and expire on June 27, 2018. As a result of the transactions consummated pursuant to the Exchange Agreement and the 2014 SPA as disclosed in Note 6, the number of shares of Common Stock Hillair is entitled to purchase under the 2012 Hillair Warrants has increased to 4,480,000 and can be purchased for \$0.25 per share. The fair value of the 2012 Hillair Warrants was calculated utilizing the lattice method. The 2012 Hillair Warrants 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 2012 Hillair Warrants as of the date of issuance has been classified as liabilities and has been included as a debt discount of the 2012 Hillair Debenture described in Note 6. The fair value of the 2012 Hillair Warrants as of March 31, 2015 and December 31, 2014 was \$40,320 and \$96,931, respectively.

In connection, with the issuance of the 2012 Hillair Debenture, 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 condensed consolidated balance sheets. The fair value of the Merriman warrants as of the date of issuance was \$8,166.

As part of the issuance and sale of convertible debentures to Next View Capital LP ("Next View") and another investor in January 2013 (the "January 2013 Debentures"), which have since been fully repaid in accordance with their terms, the Company issued warrants to Next View and another investor (the "January 2013 Warrants"). The January 2013 Warrants originally entitled Next View and the other 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 January 2013 Warrants issued to Next View and the other investor contain substantially all of the same terms as the 2012 Hillair Warrants. As a result of the transactions consummated pursuant to the Exchange Agreement and the 2014 SPA as disclosed in Note 6, the number of shares of Common Stock Next View and the other investor are entitled to purchase has increased to 1,120,000 and 448,000, respectively, and can be purchased for \$0.25 per share. The fair value of the January 2013 Warrants as of the date of issuance has been classified as liabilities and has been included as a debt discount of the January 2013 Debentures described in Note 6. The fair value of the January 2013 Warrants issued to Next View and another investor warrants as of March 31, 2015 and December 31, 2014 was \$14,112 and \$33,926, respectively.

In connection with the issuance of the January 2013 Debentures, 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 the April 2013 Debentures to Casano and Masterson as disclosed in Note 6, the Company issued the April 2013 Warrants to Casano and Masterson. The April 2013 Warrants originally entitled 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 April 2013 Warrants issued to Casano and Masterson contain substantially all of the same terms as the 2012 Hillair Warrants. As a result of the transactions consummated pursuant to the Exchange Agreement and the 2014 SPA as disclosed in Note 6, the number of shares of Common Stock Casano and Masterson are entitled to purchase has increased to 1,792,000 and 448,000, respectively and can be purchased for \$0.25 per share. The fair value of the April 2013 Warrants as of the date of issuance has been classified as liabilities and has been included as a debt discount of the April 2013 Debentures described in Note 6. The fair value of the April 2013 Warrants issued to Casano and Masterson as of March 31, 2015 and December 31, 2014 was \$22,400 and \$51,153, respectively.

**SG BLOCKS, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

*For the Three Months Ended March 31, 2015 and 2014 (Unaudited)*

**8. Warrants (continued)**

Pursuant to the Exchange Agreement disclosed in Note 6, the Company issued 2014 Exchange Warrants to Hillair, Casano and Masterson. The 2014 Exchange Warrants entitle Hillair, Casano and Masterson to purchase up to 5,107,200, 2,042,880, and 510,720, respectively, shares of Common Stock at \$0.275 per share, subject to adjustments upon certain events. The 2014 Exchange Warrants may be exercised at any time after April 10, 2014 and expire on April 10, 2019. The fair value of the 2014 Exchange Warrants issued to Hillair, Casano and Masterson was calculated utilizing the lattice method. The 2014 Exchange Warrants 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 value of the 2014 Exchange Warrants as of the date of issuance has been classified as liabilities and has been included in the loss on extinguishment of debt on the accompanying condensed consolidated statements of operations. The fair value of these warrants as of March 31, 2015 and December 31, 2014 was \$84,269 and \$167,969, respectively.

As part of the issuance of the 2014 New Debentures as disclosed in Note 6, the Company issued warrants to purchase up to 8,322,000 shares of Common Stock at \$0.275 per share (the "2014 New Warrants"), subject to adjustments upon certain events. The 2014 New Warrants contain substantially all of the same terms as the 2014 Exchange Warrants. The fair value of the 2014 New Warrants as of the date of issuance has been classified as liabilities and has been included as a debt discount of the 2014 New Debentures described in Note 6. The fair value of the 2014 New Warrants as of March 31, 2015 and December 31, 2014 was \$91,542 and \$182,466, respectively.

A summary of warrant activity as of March 31, 2015 and changes during the three months ended are presented below:

|                                 | Number of<br>Warrants | Weighted<br>Average<br>Exercise Price<br>Per Share | Weighted<br>Average<br>Remaining<br>Terms<br>(in years) | Aggregate<br>Intrinsic Value |
|---------------------------------|-----------------------|--|---|------------------------------|
| Outstanding - December 31, 2014 | 25,572,059            | \$ 0.27  | 3.89  | -                            |
| Issued                          | -                     | -  |   |                              |
| Exercised                       | -                     | -  |   |                              |
| Forfeited                       | -                     | -  |   |                              |
| Outstanding – March 31, 2015    | <u>25,572,059</u>     | <u>\$ 0.27</u>                                     | <u>3.65</u>   | <u>\$ -</u>                  |
| Exercisable –March 31, 2015     | <u>25,572,059</u>     | <u>\$ 0.27</u>                                     | <u>3.65</u>   | <u>\$ -</u>                  |

The change in fair value of all of the Company's outstanding warrants of \$283,882 and \$80,598 is included in the accompanying condensed consolidated statements of operations for the three months ended March 31, 2015 and 2014, respectively.

The significant assumptions which the Company used to measure the fair value of warrants at March 31, 2015 and December 31, 2014 is as follows:

|                         | 2015           | 2014              |
|-------------------------|----------------|-------------------|
| Stock price             | \$ 0.09        | \$ 0.14           |
|                         | 0.58 –         |                   |
| Term                    | 4.03 Years     | 0.83 - 4.28 Years |
| Volatility              | 50%            | 50%               |
| Risk-free interest rate | 0.14 – 1.37%   | 0.25 - 1.38%      |
| Exercise prices         | \$ 0.25-0.4488 | \$ 0.25-0.4488    |
| Dividend yield          | 0.00%          | 0.00%             |

## SG BLOCKS, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 9. 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 March 31, 2015, there were 3,928 shares of common stock available for issuance under the 2011 Plan.

**2012 Board Equity Authorization** - 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 (the "2012 Board Equity Authorization"). 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 2012 Board Equity Authorization has not been approved by the Company's stockholders. The issuance of these options will be approved by the Company's board of directors on a case-by-case basis. As of March 31, 2015, there were 66,071 shares of common stock available for issuance under this approval.

**2013 Plan** - During November 2013, the Company's board of directors approved the issuance of up to 2,000,000 shares of the Company's Common Stock in the form of restricted stock or options ("2013 Stock Plan"). The options granted under the 2013 Stock Plan have generally the same terms and conditions as those provided under the 2011 Plan. The 2013 Plan has not been approved by the Company's stockholders. The Stock Plan is administered by the Company's board of directors. As of March 31, 2015, there were 1,600,000 shares of common stock available for issuance under the 2013 Stock Plan.

**2014 Plan** - On July 15, 2014, at the annual meeting of the Company's shareholders, the shareholders holding a majority of the Company's outstanding common stock voted to approve the 2014 Incentive Stock Plan ("2014 Stock Plan"). The 2014 Stock Plan contains 12,000,000 shares of the Company's Common Stock, which is available for grant to directors, officers and employees of, and consultants and advisors to, the Company or any subsidiary of the Company; provided that incentive stock options may only be granted to employees of the Company and its subsidiaries. An incentive stock option may be granted under the 2014 Plan only to a person who, at the time of the grant, is an employee of the Company or its subsidiaries. Grants under the 2014 Stock Plan may take the form of options, stock appreciation rights, restricted stock and other equity incentives. The 2014 Plan expires on July 14, 2024, and is administered by a committee consisting of two or more directors appointed by the Company's Board. As of March 31, 2015, there were 6,792,500 shares of common stock available for issuance under the 2014 Stock Plan.

A summary of stock option activity as of March 31, 2015 and changes during the three months then ended are presented below:

|                                 | Shares            | Weighted<br>Average Fair<br>Value Per<br>Share | Weighted<br>Average<br>Exercise Price<br>Per Share | Weighted<br>Average<br>Remaining<br>Terms<br>(in years) | Aggregate<br>Intrinsic<br>Value |
|---------------------------------|-------------------|--|--|---|---------------------------------|
| Outstanding - December 31, 2014 | 15,425,001        | \$ 0.11  | \$ 0.30  | 8.00  | 112,500                         |
| Granted                         | -                 | -  | -  | -   | -                               |
| Exercised                       | -                 | -  | -  | -   | -                               |
| Cancelled                       | -                 | -  | -  | -   | -                               |
| Outstanding - March 31, 2015    | <u>15,425,001</u> | <u>\$ 0.11</u>                                 | <u>\$ 0.30</u>                                     | <u>7.76</u>   | <u>\$ -</u>                     |
| Exercisable - December 31, 2014 | 11,625,835        | \$ 0.09  | \$ 0.33  | 7.50  | \$ 37,500                       |
| Exercisable - March 31, 2015    | <u>11,806,668</u> | <u>\$ 0.11</u>                                 | <u>\$ 0.33</u>                                     | <u>7.27</u>   | <u>\$ -</u>                     |

For the three months ended March 31, 2015 and 2014, the Company recognized stock-based compensation expense of \$48,115 and \$30,695, respectively, which is included in payroll and related expenses in the accompanying condensed consolidated statements of operations.

As of March 31, 2015, there was \$267,318 of total unrecognized compensation costs related to non-vested stock options, which will be expensed over a weighted average period of 1.33 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 March 31, 2015 and December 31, 2014 was \$0.09 and \$0.14 per share, respectively, as determined by using the weighted average bulletin board price.

## SG BLOCKS, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 10. Commitments

The Company is subject to periodic lawsuits, investigations and claims during the ordinary course of business. The Company is not a party to any material litigation as of March 31, 2015.

**Operating lease** - The Company leases office space in New York City to conduct its business. The Company's previous lease began October 1, 2013 and expired March 31, 2015. Non-contingent rent increases were being amortized over the life of the lease on a straight line basis. Subsequent to March 31, 2015, the Company entered into a month-to-month lease for office space. The rental expense charged to operations for the three months ended March 31, 2015 and 2014 amounted to \$18,347 and \$14,400, respectively.

#### 11. Related Party Transactions

On March 26, 2009, the Company entered into a \$50,000 revolving credit promissory note (the "Revolver") with Vector Group Ltd. ("Vector"), the former controlling stockholder of the Company. On January 26, 2011, the Company and Vector entered into an amendment to the Revolver increasing the amount that the Company may borrow from \$50,000 to \$100,000. The loan bears interest at 11% per annum and was due on December 31, 2013. During January 2014, the Revolver was extended from December 31, 2013 to June 30, 2015. As of March 31, 2015 and December 31, 2014, the balance due to Vector amounted to \$73,500. As of March 31, 2015 and December 31, 2014, accrued interest related to the Revolver amounted to \$38,854 and \$36,833, respectively, and is included in accrued interest, related party on the accompanying condensed consolidated balance sheets. Interest expense for other related party notes payable amounted to \$2,021 and \$2,021 for the three months ended March 31, 2015 and 2014, respectively.

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 \$206,449 and \$186,012, for services ConGlobal Industries, Inc. rendered during the three months ended March 31, 2015 and 2014, respectively. As of March 31, 2015 and December 31, 2014, \$222,953 and \$92,792, 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

For the Three Months Ended March 31, 2015 and 2014 (Unaudited)

#### 11. 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 \$4,760 for services The Lawrence Group rendered during the three months ended March 31, 2014. As of March 31, 2015 and December 31, 2014, \$32,389, of expenses were included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets.

An affiliated accounting firm of the Company's Chief Financial Officer provided accounting and consulting services to the Company. The Company recognized General and Administrative expenses in the amount of \$32,000 and \$10,000 for the three months ended March 31, 2015 and 2014, respectively. As of March 31, 2015 and December 31, 2014, \$32,000 and \$7,300, respectively, of expenses were included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets.

As of March 31, 2015, an aggregate of \$10,237 is due to the Company's Chief Financial Officer for consulting fees and reimbursable expenses, and is included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets.

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

### **Introduction and Certain Cautionary Statements**

*The following discussion and analysis of the financial condition and results of our operations should be read in conjunction with our condensed consolidated financial statements and related notes and schedules included elsewhere in this Quarterly Report on Form 10-Q. The unaudited condensed consolidated financial statements and notes included herein should be read in conjunction with our audited consolidated financial statements and notes for the year ended December 31, 2014, which were included in our Annual Report on Form 10-K, as amended, filed with the Securities and Exchange Commission. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. Factors that could cause or contribute to such differences include, but are not limited to, intensified competition and/or operating problems in its operating business projects and their impact on revenues and profit margins or additional factors, and those discussed in Part II, Item 1A “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. In addition, certain information presented below is based on unaudited financial information. There can be no assurance that there will not be changes to this information once audited financial information is available.*

### **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. SG Brazil is currently inactive.

## Results of Operations

### Three Months Ended March 31, 2015 and 2014:

|                        | <u>2015</u>      | <u>2014</u>      |
|------------------------|------------------|------------------|
| Loss from operations   | (554,595)        | (254,408)        |
| Other income (expense) | 197,550          | (263,806)        |
| Net Income (loss)      | <u>(357,045)</u> | <u>(518,214)</u> |

### Revenue

Revenue for the three months ended March 31, 2015 was \$402,039 compared to \$1,034,270 for the three months ended March 31, 2014. This decrease of \$632,231 resulted mainly from a decrease of revenue from block “green steel” jobs. Revenue recognized from block “green steel” jobs decreased by \$632,133 for the three months ended March 31, 2015 compared to the three months ended March 31, 2014. Revenue from block “green steel” jobs decreased primarily due to one job in the amount of \$675,885 being recognized during the three months ended March 31, 2014.

### Cost of Revenue and Gross Profit

Cost of revenue decreased by \$440,215 to \$359,923 for the three months ended March 31, 2015 from \$800,138 for the three months ended March 31, 2014. The decrease in cost of revenue resulted primarily from a decrease in costs from block “green steel” jobs. Costs recognized from block “green steel” jobs decreased by \$441,490, for the three months ended March 31, 2015 compared to the three months ended March 31, 2014. Gross profit decreased by \$192,016 to \$42,116 for the three months ended March 31, 2015 compared to \$234,132 for the three months ended March 31, 2014. Gross profit percentage decreased to 11% for the three months ended March 31, 2015 compared to 23% for the three months ended March 31, 2014. This decrease results primarily a block “green steel” job being recognized during the three months March 31, 2014 at a gross profit percentage of 23%.

### Payroll and Related Expense

Payroll and related expense for the three months ended March 31, 2015 was \$311,223 compared to \$240,313 for the three months ended March 31, 2014. This increase is primarily caused by an increase in salaries during the three months ended March 31, 2015 compared to the three months ended March 31, 2014. The increase mainly resulted from salary increases to the Company’s Chief Executive Officer and Chief Operating Officer.

**Other Operating Expenses**

Other operating expense for the three months ended March 31, 2015 was \$285,488 compared to \$248,227 for the three months ended March 31, 2014. The change results primarily from an increase of \$44,584 in marketing and business development expense for the three months ended March 31, 2015 compared to the three months ended March 31, 2014.

**Interest Expense**

Interest expense for the three months ended March 31, 2015 was \$188,347 compared to \$183,599 for the three months ended March 31, 2014.

**Other income (expense)**

During the three months ended March 31, 2015 and 2014, there was other (income) expense recognized due to a change in fair value of financial instruments of (\$385,891) and \$80,215, respectively.

**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 March 31, 2015 and December 31, 2014, the Company's stockholders' deficiency was approximately \$3,638,000 and \$3,300,000, respectively. The Company's net loss from operations for the three months ended March 31, 2015 was \$357,045. Net cash used in operating activities was \$305,596 for the three months ended March 31, 2015.

Through March 31, 2015, the Company has incurred an accumulated deficiency since inception of \$11,094,438. At March 31, 2015, the Company had a cash balance of \$578,592.

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 any proceeds of any other issuances of senior convertible debt 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 expected operating costs. Accordingly, the Company requires further 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.

The Company intends to raise additional funds in the future through either the issuance of equity or debt. The additional capital would be used to fund the Company's operations. Between October 1, 2015 and April 1, 2016, the Company's convertible debentures, in the amount of \$3,995,700 will mature. Also, in June 2015 the Company's related party revolving credit promissory matures. In April 2015, the Company entered into the License Agreement with Red Cardinal pursuant to which the Company granted Red Cardinal a 15 year worldwide non-exclusive license to use the Company's proprietary methods and technology to develop, manufacture, advance and promote code-engineered containers for safe and sustainable construction of buildings. In consideration for the License, the Company will receive a royalty of 10% of actual revenues collected by Red Cardinal in connection with manufacturing, distributing and selling of buildings using the License. Under the terms of License Agreement, Red Cardinal will, within ninety days of the execution of the License Agreement, enter into a contract in the amount of not less than \$10,000,000 for the manufacture of buildings under the License Agreement. In addition, Red Cardinal has also agrees to pay in full, assume or otherwise satisfy, to the holders the Company's debentures described herein all amounts as and when due under such debentures. The Company will provide consulting services to Red Cardinal in connection with which Red Cardinal may provide an advance to the 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. 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. To the extent that the Company raises capital through the issuance of equity securities, it would cause dilution to the Company's stockholders and could also trigger the anti-dilution provisions in the 2014 Debentures and the Company's outstanding warrants which would also cause dilution to the Company's stockholders. In addition, 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 March 31, 2015 and December 31, 2014, 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 March 31, 2015.

## **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, as amended, for the year ended December 31, 2014. There have been no material changes to the policies noted above as of the Quarterly Report on Form 10-Q for the period ended March 31, 2015.

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

#### *Transactions with Vector*

On March 26, 2009, the Company entered into a \$50,000 revolving credit promissory note (the “Revolver”) with Vector Group Ltd. (“Vector”), the former controlling stockholder of the Company. On January 26, 2011, the Company and Vector entered into an amendment to the Revolver increasing the amount that the Company may borrow from \$50,000 to \$100,000. The loan bears interest at 11% per annum and was due on December 31, 2013. During January 2014, the Revolver was extended from December 31, 2013 to June 30, 2015. As of March 31, 2015 and December 31, 2014, the balance due to Vector amounted to \$73,500. As of March 31, 2015 and December 31, 2014, accrued interest related to the Revolver amounted to \$38,854 and \$36,833, respectively, and is included in accrued interest, related party on the accompanying condensed consolidated balance sheets. Interest expense for other related party notes payable amounted to \$2,021 and \$2,021 for the three months ended March 31, 2015 and 2014, respectively.

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 \$206,449 and \$186,012, for services ConGlobal Industries, Inc. rendered during the three months ended March 31, 2015 and 2014, respectively. As of March 31, 2015 and December 31, 2014, \$222,953 and \$97,792, 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 \$4,760 for services The Lawrence Group rendered during the three months ended March 31, 2014. As of March 31, 2015 and December 31, 2014, \$32,389, of expenses were included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets.

An affiliated accounting firm of the Company's Chief Financial Officer provided accounting and consulting services to the Company. The Company recognized General and Administrative expenses in the amount of \$32,000 and \$10,000 for the three months ended March 31, 2015 and 2014, respectively. As of March 31, 2015 and December 31, 2014, \$32,000 and \$7,300, respectively, of expenses were included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets.

As of March 31, 2015, an aggregate of \$10,237 is due to the Company's Chief Financial Officer for consulting fees and reimbursable expenses, and is included in related party accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets.

**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 2014 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.

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 SG Building is a relatively small company with few employees. 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, there was no change in our internal control over financial reporting that occurred during the first quarter of 2015 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**

The Company is involved in legal proceedings from time to time in the ordinary course of its business. As of the date of this filing, the Company is not a party to any legal proceeding that requires disclosure hereunder.

### **Item 1A. Risk Factors**

There have been no material changes from the risk factors disclosed in Part 1, Item 1A, of our Annual Report on Form 10-K, as amended, for the year ended December 31, 2014.

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

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

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- 10.1 License Agreement. Incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed April 21, 2015.
- 31.1+ 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: May 8, 2015

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

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.

May 8, 2015

/s/ Paul M. Galvin

Name: Paul M. Galvin

Title: Chief Executive Officer

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.

May 8, 2015

/s/ Brian Wasserman

Name: Brian Wasserman

Title: Chief Financial Officer

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 March 31, 2015 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.

May 8, 2015

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

May 8, 2015

/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.