NEPHROS INC
Form S-1/A
January 24, 2011

As filed with the Securities and Exchange Commission on January 24, 2011

Registration No. 333-169728

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

AMENDMENT NO. 3
TO
FORM S-1
REGISTRATION STATEMENT
UNDER THE SECURITIES ACT OF 1933

NEPHROS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	3841	13-3971809
(State or Other Jurisdiction of Incorporation or Organization)	*(Primary Standard Industrial Classification Code Number)*	*(I. R. S. Employer Identification No.)*

41 Grand Avenue
River Edge, New Jersey 07661
(201) 343-5202

(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant s Principal Executive Offices)

Paul A. Mieyal
Acting Chief Executive Officer
Nephros, Inc.
41 Grand Avenue
River Edge, New Jersey 07661
(201) 343-5202

(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

Copies to:

Alexander M. Donaldson, Esq.
Wyrick Robbins Yates & Ponton LLP
4101 Lake Boone Trail, Suite 300
Raleigh, North Carolina 27607
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Approximate date of commencement of proposed sale to the public: As promptly as practicable after this registration statement becomes effective and the satisfaction or waiver of certain other conditions described herein.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same

offering. o

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 o	Accelerated filer o
Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company x

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CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered[1][2]	Amount to be registered	Proposed maximum aggregate offering price per unit	Proposed maximum aggregate offering price	Amount of registration fee
Non-transferable subscription rights to purchase Units[3]				
Units underlying the subscription rights, each consisting of 4.185496618 shares of common stock, $0.001 par value per share, and a warrant to purchase 0.924532845 shares of our common stock	175,000,000			
Common stock, $0.001 par value per share[4]	175,000,000	$ 0.02	$ 3,500,000	$ 249.55
Warrants to purchase 161,793,248 shares of our common stock[5]	175,000,000			
Common stock, $0.001 par value per share, issuable upon exercise of the warrants[6]	161,793,248	$ 0.02	$ 3,235,865	$ 230.72
Total[7]			$ 6,735,865	$ 480.27

(1) Pursuant to Rule 416 under the Securities Act, the shares being registered hereunder include such indeterminate number of shares of common stock as may be issuable with respect to securities being registered hereunder as a result of stock splits, stock dividends, recapitalizations or similar transactions.

(2) This registration statement relates to (a) the subscription rights to purchase common stock, $0.001 par value per share, and warrants, (b) shares of common stock issuable upon the exercise of the subscription rights, (c) the warrants issuable upon exercise of the subscription rights, and (d) shares of our common stock that are issuable upon exercise of the warrants.

(3) The non-transferable subscription rights are being issued without consideration. Pursuant to Rule 457(g), no separate registration fee is payable with respect to the rights being offered hereby since the rights are being registered on the same registration statement as the securities offered pursuant thereto.

(4) Calculated pursuant to Rule 457(o) based on an estimate of the proposed maximum offering price of our common stock of $0.02.

(5) Pursuant to Rule 457(g), no separate registration fee is payable with respect to the warrants being offered hereby since the warrants are being registered on the same registration statement as the securities to be offered pursuant thereto.

(6) Calculated pursuant to Rule 457(o) based on an estimate of the proposed maximum exercise price of $0.02.

(7) The registration fee is being offset, pursuant to Rule 457(p) of the Securities Act, by the $959 of registration fees paid in connection with the registrant s filing of Registration Statement No. 333-167022 (initially filed on May 21, 2010, as amended on June 18, 2010, and withdrawn on October 1, 2010).

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration

statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities or the solicitation of an offer to buy these securities in any state in which such offer, solicitation or sale is not permitted.

PRELIMINARY PROSPECTUS **SUBJECT TO COMPLETION DATED JANUARY 24, 2011**

NEPHROS, INC.

Up to 175,000,000 Shares of Common Stock and
Warrants to Purchase up to 161,793,248 Shares of Common Stock
Issuable upon Exercise of Non-transferrable Rights to Subscribe
for such Shares and Warrants

We are distributing, at no charge, to holders of our common stock, non-transferable subscription rights to purchase up to 175,000,000 Units. We refer to this offering as the rights offering. In this rights offering, you will receive one non-transferrable subscription right for each share of common stock owned by you at 5:00 p.m., Eastern Time, on [ ], 2011, which we refer to as the record date. Each non-transferable subscription right will entitle you to purchase 4.185496618 Units at a subscription price of $0.02 per Unit, which we refer to as the basic subscription privilege. Each Unit consists of one share of our common stock and a warrant to purchase 0.924532845 shares of our common stock at the exercise price of $0.02 per share for a period of five years following [ ], 2011.

There is no minimum number of Units you must purchase, but you may not purchase fractional Units. To determine the number of Units you may purchase under your basic subscription privilege, multiply the number of shares of our common stock you own by 4.185496618 and round down to the nearest whole number. For example, if you own 100 shares of our common stock, you will be entitled to subscribe for up to 418 Units (100 shares × 4.185496618 = 418.5496618, rounded down to 418, the nearest whole number) under your basic subscription privilege. Similarly, the warrant to purchase 0.924532845 shares of our common stock included with each Unit you purchase will only be exercisable for a number of shares rounded down to the nearest whole number. For example, if you purchase 418 Units, the warrants included with those Units would be exercisable for up to 386 shares (418 Units × 0.924532845 = 386.4547292, rounded down to 386, the nearest whole number).

If you exercise your basic subscription privilege in full, you may also exercise an over-subscription privilege to subscribe for additional Units not subscribed for by other rights holders in the offering at the same subscription price of $0.02 per Unit, subject to certain limitations. If an insufficient number of Units is available to fully satisfy all over-subscription privilege requests, the available Units will be allocated proportionately among rights holders who exercise their over-subscription privileges based on the number of Units each such holder subscribed for under the basic subscription privilege. To the extent you properly exercise your over-subscription privilege for an amount of Units that exceeds the number of unsubscribed Units available to you, any excess subscription payment received by the subscription agent will be promptly returned to you, without interest or deduction.

There is no certainty that any Units will be purchased pursuant to the rights offering, and there is no minimum purchase requirement as a condition to our accepting subscriptions. We are not entering into any standby purchase agreement or similar agreement with respect to the purchase of Units not subscribed for through the exercise of subscription privileges by our stockholders, except that our largest stockholder, Lambda Investors LLC, has committed to purchase, through a private placement evidenced by a purchase agreement, 60,194,226 Units, which

amount equals the number of Units that would otherwise be available for purchase by Lambda Investors pursuant to the exercise of its basic subscription privilege, at the rights offering subscription price of $0.02 per Unit, so long as certain conditions are met, including that stockholders not affiliated with Lambda Investors subscribe for at least 87,500,000 of the Units offered in the rights offering. In addition, under the purchase agreement, Lambda Investors has the right to purchase, at the rights offering subscription price, that number of Units that would otherwise be available for purchase by Lambda Investors pursuant to its over-subscription privilege in the event our other stockholders do not exercise their basic subscription privileges in full and Lambda Investors purchases 60,194,266 Units under the purchase agreement. See The Rights Offering Background of the Rights Offering Purchase Agreement with Lambda Investors. Lambda Investors is not receiving any compensation for its purchase commitment. Any Units purchased by Lambda Investors

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and the shares and warrants to purchase shares of our common stock underlying them are not being registered pursuant to the registration statement of which this prospectus is a part, and thus may not be offered or sold except pursuant to an effective registration statement under, or an exemption from the registration requirements of, the Securities Act of 1933, as amended. See Plan of Distribution.

The subscription rights will expire if they are not exercised by 5:00 p.m., Eastern Time, on [ ], 2011, unless we extend the subscription period in our sole discretion. However, our board of directors reserves the right to cancel the rights offering at any time, for any reason. If the rights offering is cancelled, all subscription payments received by the subscription agent will be returned promptly.

Shares of our common stock are quoted on the OTC Bulletin Board under the ticker symbol NEPH. On January 21, 2011, the closing sales price for our common stock was $0.09 per share. The shares of common stock issued in the rights offering will also be quoted on the OTC Bulletin Board under the same ticker symbol. Neither the warrants nor the subscription rights will be listed for trading on any stock exchange or market or quoted on the OTC Bulletin Board.

This is not an underwritten offering. The Units are being offered directly by us without the services of an underwriter or selling agent.

The purchase of Units involves substantial risks. See Risk Factors beginning on page 19 of this prospectus to read about important factors you should consider before subscribing for Units.

Neither the SEC nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is [ ], 2011.

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NEPHROS, INC.

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OLpur™ and H_2H™ are among our trademarks for which U.S. registrations are pending. H_2H is a registered European Union trademark. We have assumed that the reader understands that these terms are source-indicating. Accordingly, such terms appear throughout the remainder of this prospectus without trademark notices for convenience only and should not be construed as being used in a descriptive or generic sense.

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission, which we refer to as the SEC or the Commission, utilizing a registration process. It is important for you to read and consider all of the information contained in this prospectus and any applicable prospectus before making a decision whether to invest in the common stock. You should also read and consider the information contained in the exhibits filed with our registration statement, of which this prospectus is a part, as described in Where You Can Find More Information in this prospectus.

You should rely only on the information contained in this prospectus and any applicable prospectus supplement, including the information incorporated by reference. We have not authorized anyone to provide you with different information. We are not offering to sell or soliciting offers to buy, and will not sell, any securities in any jurisdiction where it is unlawful. You should assume that the information contained in this prospectus or any prospectus supplement, as well as information contained in a document that we have previously filed or in the future will file with the SEC is accurate only as of the date of this prospectus, the applicable prospectus supplement or the document containing that information, as the case may be.

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PROSPECTUS SUMMARY

This summary highlights information contained in other parts of this prospectus. Because it is a summary, it does not contain all of the information that is important to you. You should carefully read the more detailed information contained in this prospectus, including the section entitled Risk Factors beginning on page 19 and our financial statements for the years ended December 31, 2008 and 2009, and the nine months ended September 30, 2010, and related notes appearing elsewhere in this prospectus. We refer to Nephros, Inc. and its consolidated subsidiary as Nephros , the Company , we , our , and us .

About the Company

We are a medical device company developing and marketing filtration products for therapeutic applications, infection control, and water purification.

Our hemodiafiltration, or HDF, system is designed to improve the quality of life for the End-Stage Renal Disease, or ESRD, patient while addressing the critical financial and clinical needs of the care provider. ESRD is a disease state characterized by the irreversible loss of kidney function. The Nephros HDF system removes a range of harmful substances more effectively, and with greater capacity, than existing ESRD treatment methods, particularly with respect to substances known collectively as middle molecules. These molecules have been found to contribute to such conditions as dialysis-related amyloidosis, carpal tunnel syndrome, degenerative bone disease and, ultimately, mortality in the ESRD patient. Nephros ESRD products are sold and distributed throughout Europe and are currently being used in over 50 clinics in Europe.

We currently have three HDF products in various stages of development to deliver improved therapy to ESRD patients:

OLpur MDHDF filter series (which we sell in various countries in Europe and currently consists of our MD190 and MD220 diafilters), which is, to our knowledge, the only filter designed expressly for HDF therapy and employing our proprietary Mid-Dilution Diafiltration technology;
OLpur H_2H, our add-on module designed to allow the most common types of hemodialysis machines to be used for HDF therapy; and
OLpur NS2000 system, our stand-alone HDF machine and associated filter technology.

We have also developed our OLpur HD 190 high-flux dialyzer cartridge, which incorporates the same materials as our OLpur MD series, but does not employ our proprietary Mid-Dilution Diafiltration technology. Our OLpur HD190 was designed for use with either hemodialysis or hemodiafiltration machines, and received its approval in June 2005 from the U.S. Food and Drug Administration, or FDA, under Section 510(k) of the Food, Drug and Cosmetic Act, or the FDC Act.

We believe that products in our OLpur MDHDF filter series are more effective than any products currently available for ESRD therapy because they are better at removing certain larger toxins (known in the industry as middle molecules because of their heavier molecular weight) from blood. The accumulation of middle molecules in the blood has been related to such conditions as malnutrition, impaired cardiac function, carpal tunnel syndrome, and degenerative bone disease in the ESRD patient. We also believe that OLpur H_2H will, upon introduction, expand the use of HDF as a cost-effective and attractive alternative for ESRD therapy, and that, if approved, our OLpur H_2H and MDHDF filters will be the first, and only, HDF therapy available in the United States at that time.

On June 30, 2010, we received a final decision letter from the FDA for our 510(k) submission, which stated that the FDA could not reach a substantial equivalence determination for our OLpur MDHDF filter system. An in-person meeting with the FDA took place on September 10, 2010 to discuss the issues raised in the FDA letter. We are evaluating our future course of action. The current decision by the U.S. FDA with regard to our HDF system does not impact our ability to market and sell our mid-dilution (MD) filters for hemodiafiltration procedures outside of the U.S.

We believe that our products will reduce hospitalization, medication and care costs as well as improve patient health (including reduced drug requirements and improved blood pressure profiles), and therefore, quality of life, by removing a broad range of toxins through a more patient-friendly, better-tolerated process.

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In addition, independent studies in Europe have indicated that, when compared with dialysis as it is currently offered in the United States, HDF can reduce the patient s mortality risk by up to 35%. We believe that the OLpur MDHDF filter series and the OLpur H_2H will provide these benefits to ESRD patients at competitive costs and without the need for ESRD treatment providers to make significant capital expenditures in order to use our products. We also believe that the OLpur NS2000 system, if successfully developed, will be the most cost-effective stand-alone hemodiafiltration system available.

In January 2006, we introduced our new Dual Stage Ultrafilter, or DSU, water filtration system. Our DSU represents a new and complementary product line to our existing ESRD therapy business. The DSU incorporates our unique and proprietary dual stage filter architecture and is, to our knowledge, the only water filter that allows the user to sight-verify that the filter is properly performing its cleansing function. Our research and development work on the OLpur H_2H and MD Mid-Dilution filter technologies for ESRD therapy provided the foundation for a proprietary multi-stage water filter that we believe is cost effective, reliable, and long-lasting. We believe our DSU can offer a robust solution to a broad range of contaminated water and disease prevention issues. Hospitals are particularly stringent in their water quality requirements; transplant patients and other individuals whose immune systems are compromised can face a substantial infection risk in drinking or bathing with standard tap water that would generally not present a danger to individuals with normal immune function. The DSU is designed to remove a broad range of bacteria, viral agents and toxic substances, including salmonella, hepatitis, cholera, HIV, Ebola virus, ricin toxin, legionella, fungi and e-coli. With over 5,000 registered hospitals in the United States alone (as reported by the American Hospital Association in Fast Facts of October 20, 2006), we believe the hospital shower and faucet market can offer us a valuable opportunity as a first step in water filtration.

Due to the ongoing concerns of maintaining water quality, on October 7, 2008, we filed a 510(k) application for approval to market our DSU to dialysis clinics for in-line purification of dialysate water. On July 1, 2009, the FDA approved the DSU to be used to filter biological contaminants from water and dialysate concentrate used in hemodialysis procedures.

In March 2007, we received full approval on our IDE application from the FDA to begin human clinical trials of our OLpur H_2H hemodiafiltration module and OLpur MD220 hemodiafilter. We obtained approval from the IRBs and completed the clinical trial near the end of the second quarter in 2008. The clinical data was compiled, analyzed, summarized and submitted with our FDA 510(k) in November 2008. Following its review of the application, the FDA has requested additional information from us. We replied to the FDA inquiries on March 13, 2009. On June 30, 2010, we received a final decision letter from the FDA for our 510(k) submission, which stated that the FDA could not reach a substantial equivalence determination for our hemodiafiltration, or HDF, system. An in-person meeting with the FDA took place on September 10, 2010 to discuss the issues raised in the FDA letter. We are evaluating our future course of action. The current decision by the U.S. FDA with regard to our HDF system does not impact our ability to market and sell our mid-dilution (MD) filters for hemodiafiltration procedures outside of the U.S.

In 2006, the U.S. Defense Department budget included an appropriation for the U.S. Marine Corps for development of a dual stage water ultra filter. In connection with this Federal appropriation of approximately $1 million, we worked on the development of a personal potable water purification system for use by warfighters. Work on this project was completed in August 2009 and we have billed approximately $900,000 during the twenty months ended August 2009. In August 2009, we were awarded a new $1.8 million research contract from the Office of Naval Research (ONR) for development of a potable dual-stage military water purifying filter. The research contract is an expansion of our former ONR contract which is being performed as part of the Marine Corps Advanced Technology Demonstration (ATD) project. The primary objective of this expanded research program is to select concepts and functional prototype filter/pump units which were developed during the first phase of the project, and further develop them into smaller field-testable devices that can be used for military evaluation purposes. An advantage of our ultrafilter is the removal

of viruses which are not removed with commercially available off-the-shelf microfilter devices. Such devices generally rely on a secondary chemical disinfection step to make the water safe to drink. The expanded contract also includes research geared toward improving membrane performance, improving device durability, developing larger squad-level water purifier devices, and investigating desalination filter/pump devices for emergency-use

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purposes. Approximately $1,178,000 of revenue has been recognized on this new project since September 2009 of which approximately $755,000 was recognized on this new project during the nine months ended September 30, 2010.

Immediate Need for Capital and Recent Loan from Lambda Investors LLC

At September 30, 2010, we had cash and cash equivalents totaling approximately $421,000 and tangible assets of approximately $1,682,000. At that time, we estimated that these funds would allow us to keep operating into the fourth quarter of 2010. On June 30, 2010, we received a final decision letter from the FDA for our 510(k) submission, which stated that the FDA could not reach a substantial equivalence determination for our hemodiafiltration, or HDF, system. The receipt of this letter had a detrimental impact on our ongoing capital raising efforts. As a result, we determined, in consultation with the investment banking firm we had engaged, Dawson James Securities, Inc. (Dawson James), that raising capital through conventional sources was no longer feasible. We subsequently terminated our engagement of Dawson James on September 16, 2010.

After having considered all possible financing alternatives, on October 1, 2010, with the unanimous approval of our independent directors who are unaffiliated with Lambda Investors LLC (Lambda Investors), we issued a six-month senior secured note to Lambda Investors in the principal amount of $500,000. We expect that the proceeds from the note will allow us to fund our operations into February 2011. The terms of the Lambda Investors note are discussed in more detail under the heading The Rights Offering Background of the Rights Offering Loan from Lambda Investors.

As required under the terms of the note, we are conducting this rights offering to raise up to $3,500,000 from our existing stockholders. If we complete the rights offering, we must repay the principal and accrued interest on the note as well as fees and expenses associated with the note with the proceeds from the rights offering.

To effect the rights offering, we must amend our certificate of incorporation to increase the number of authorized shares of common stock. At our annual meeting of stockholders held on January 10, 2011, our stockholders approved, among other proposals, the increase in our authorized shares of common stock. The increase in our authorized shares of common stock is a condition to the closing of the rights offering. We intend to file a certificate of amendment to our certificate of incorporation providing for such share increase immediately prior to the closing of the rights offering. Other conditions to the closing of the rights offering are discussed under the heading The Rights Offering Conditions to the Rights Offering.

Lambda Investors is our largest stockholder and as of the record date beneficially owned approximately 43.9% of our outstanding common stock, including warrants to purchase an aggregate of 7,190,811 shares of our common stock.

Proposed Reverse Stock Split

If the rights offering is completed, we intend to effect, subject to approval by our stockholders, a 1-for-20 reverse stock split immediately after the completion of the rights offering. Our stockholders approved a proposal to effect the reverse stock split at our annual meeting of stockholders held on January 10, 2011. In the 1-for-20 reverse stock split, our board of directors intends to cash out fractional shares at a price equal to the average closing sale price of shares of common stock for the ten trading days immediately prior to the date the 1-for-20 reverse stock split becomes effective, or, if no such sale takes place on such days, the average of the closing bid and ask prices for such days, in each case as officially reported by the OTC Bulletin Board, which we refer to as the cash out price. If the shares currently held by

you and the shares purchased by you in this offering result in a fractional interest following the 1-for-20 reverse stock split, then such fractional interests will be cashed out at the cash out price, which may be less than or greater than the $0.02 per Unit subscription price.

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Corporate Information

We are incorporated in Delaware and our principal executive offices are located at 41 Grand Avenue, River Edge, New Jersey 07661. Our telephone number is (201) 343-5202 and our website address is *www.nephros.com*. Information contained in, or accessible through, our website does not constitute part of this prospectus.

Where You Can Find More Information

We make available on our website, *www.nephros.com*, our annual reports, quarterly reports, proxy statements and other filings made with the SEC. The registration statement on Form S-1, of which this prospectus is a part, and its exhibits, as well as our other reports filed with the SEC, can be inspected and copied at the SEC s public reference room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information about the operation of the public reference room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains a web site at *www.sec.gov* which contains our registration statement on Form S-1 and any amendments thereto and other reports, proxy and information statements and information regarding us that we file electronically with the SEC.

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The Rights Offering

The following summary describes the principal terms of the rights offering, but is not intended to be complete. See the information under the heading The Rights Offering in this prospectus for a more detailed description of the terms and conditions of the rights offering.

Securities Offered

We are distributing to holders of our common stock, at no charge, one non-transferable subscription right for each share of our common stock owned as of 5:00 p.m., Eastern Time, on the record date, either as a holder of record or, in the case of shares held of record by brokers, dealers, custodian banks or other nominees on a stockholder s behalf, as a beneficial owner of such shares. Each subscription right entitles you to purchase 4.185496618 Units, each consisting of one share of our common stock and a warrant to purchase 0.92453 shares of our common stock at an exercise price of $0.02 per share for a period of five years following [ ], 2011.

Basic Subscription Privilege

For each share that you own, you will have a basic subscription privilege to buy from us 4.185496618 Units at a subscription price of $0.02 per Unit. You may exercise your basic subscription privilege for some or all of your rights, or you may choose not to exercise your rights. If you choose to exercise your rights, there is no minimum number of Units you must purchase, but you may not purchase fractional Units. To determine the number of Units you may purchase under your basic subscription privilege, multiply the number of shares of our common stock you own by 4.185496618 and round down to the nearest whole number. For example, if you own 100 shares of our common stock, you will be entitled to subscribe for up to 418 Units (100 shares × 4.185496618 = 418.5496618, rounded down to 418, the nearest whole number) under your basic subscription privilege. Similarly, the warrant to purchase 0.92453 shares of our common stock included with each Unit you purchase will only be exercisable for a number of shares rounded down to the nearest whole number. For example, if you purchase 418 Units, the warrants included with those Units would be exercisable for up to 386 shares (418 Units × 0.924532845 = 386.4547292, rounded down to 386, the nearest whole number).

Over-Subscription Privilege

If you exercise your basic subscription privilege in full, you may also exercise an over-subscription privilege to subscribe for additional Units not subscribed for by other rights holders in the offering at the same subscription price of $0.02 per Unit. If an insufficient number of Units is available to fully satisfy all over-subscription privilege requests, the available Units will be allocated proportionately among rights holders who exercise their over-subscription privileges based on the number of Units each such holder subscribed for under the basic subscription privilege. The subscription agent will return

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any excess payments by mail without interest or deduction promptly after expiration of the subscription period.

Subscription Price

$0.02 per Unit, payable in cash. To be effective, any payment related to the exercise of a right must clear prior to the expiration of the subscription period.

Record Date

5:00 p.m., Eastern Time, on [ ], 2011.

Expiration Date

5:00 p.m., Eastern Time, on [ ], 2011, subject to extension or earlier termination at our sole discretion. We may extend the expiration date by giving oral or written notice to our subscription agent on or before the expiration date, followed by a press release no later than 9:00 a.m, Eastern Time, on the next business day after the previously scheduled expiration date.

Non-Transferability of Rights

The subscription rights are not transferrable, other than by operation of law, and will not be quoted or listed for trading, as applicable, on the OTC Bulletin Board or on any stock exchange or trading markets.

No Board Recommendation

Our board of directors is making no recommendation regarding your exercise of the subscription rights. You are urged to make your decision based on your own assessment of our business and the rights offering. Please see Risk Factors for a discussion of the risks involved in investing in our common stock.

Purchase Commitment of Lambda Investors

Our largest stockholder, Lambda Investors LLC, has committed to purchase, through a private placement evidenced by a purchase agreement, 60,194,226 Units, which amount equals the number of Units that would otherwise be available for purchase by Lambda Investors pursuant to the exercise of its basic subscription privilege, at the