CYTODYN INC
Form 10-Q
November 22, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended August 31, 2011

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1933**

For the transition period from to

Commission File Number: 000-49908

CYTODYN INC.

(Exact name of registrant as specified in its charter)

Colorado	**75-3056237**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer or Identification No.)**
110 Crenshaw Lake Road, Lutz, Florida	**33548**
(Address of principal executive offices)	**(Zip Code)**

(Registrant s telephone number, including area code) (813) 527-6969

(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 x 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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No x

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

Large Accelerated Filer ¨	Accelerated Filer ¨
Non-accelerated Filer ¨	Smaller Reporting Company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes ¨ No x

On November 21, 2011, there were 22,290,982 shares outstanding of the registrant s no par common stock.

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PART I

Item 1. Financial Statements.

CytoDyn Inc.

(A Development Stage Company)

Condensed Consolidated Balance Sheet

	August 31, 2011 (unaudited)	May 31, 2011
Assets		
Current Assets:		
Cash	$ 492,569	$ 1,037,818
Prepaid expenses	51,979	59,275
Deferred Offering Costs	876,423	876,423
Total current assets	1,420,971	1,973,516
Furniture and equipment, net	1,100	5,374
Other Assets	48,313	15,748
	$ 1,470,384	$ 1,994,638
Liabilities and Shareholders (deficit)		
Current liabilities:		
Accounts payable	$ 1,327,749	$ 932,996
Accrued liabilities	756	756
Indebtedness to related parties - short-term portion	148,985	148,985
Accrued interest payable	30,898	26,696
Deposits on stock purchases	1,035,000	1,035,000
Stock rescission liability	4,848,000	4,851,000
Total current liabilities	7,391,388	6,995,433
Long-Term Liabilities		
Convertible notes payable, net	9,000	6,937
Total Liabilities	7,400,388	7,002,370
Shareholders (deficit):		
Series B Convertible preferred stock, no par value; 400,000 shares authorized, 311,800 and 311,800 shares issued and outstanding at August 31, 2011 and May 31, 2011, respectively	1,566,016	1,566,016
Common stock, no par value; 100,000,000 shares authorized, 22,290,982 and 22,290,982 outstanding at August 31, 2011 and May 31, 2011, respectively; 22,490,982 and 22,490,982 issued at August 31, 2011 and May 31, 2011, respectively	9,147,325	9,147,325
Additional paid-in capital	6,118,658	5,877,141
Common and Preferred stock subject to rescission	(4,848,000)	(4,851,000)
Treasury stock, at cost, 200,000 shares held at August 31, 2011 and May 31, 2011, respectively	(100,000)	(100,000)
Additional paid-in capital - treasury stock	313,080	313,080
Accumulated deficit on unrelated dormant operations	(1,601,912)	(1,601,912)
Accumulated deficit during development stage	(16,525,171)	(15,358,382)
Total shareholders (deficit)	(5,930,004)	(5,007,732)

	$ 1,470,384	$ 1,994,638

See accompanying notes to condensed consolidated financial statements.

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CytoDyn Inc.

(A Development Stage Company)

Condensed Consolidated Statements of Operations

(Unaudited)

	Three months ended		October 28, 2003 through
	8/31/2011	8/31/2010	8/31/2011
Operating expenses:			
General and administrative	$ 640,803	$ 511,630	$ 11,648,192
Amortization / depreciation	838	549	181,687
Research and development	173,460	27,250	2,402,928
Legal fees	343,523	4,436	1,765,050
Total operating expenses	1,158,624	543,865	15,997,857
Operating loss	(1,158,624)	(543,865)	(15,997,857)
Interest income			1,627
Extinguishment of debt			337,342
Interest expense:			
Interest on convertible debt	(2,063)		(736,926)
Interest on notes payable	(6,102)	(4,085)	(129,357)
Loss before income taxes	(1,166,789)	(547,950)	(16,525,171)
Income tax provision			
Net loss	$ (1,166,789)	$ (547,950)	$ (16,525,171)
Constructive preferred stock dividends	$	$	$ (6,000,000)
Convertible preferred stock dividends	$	$	$ (8,550)
Net loss applicable to common shareholders	$ (1,166,789)	$ (547,950)	$ (22,533,721)
Basic and diluted loss per share	$ (.05)	$ (0.03)	$ (1.72)
Basic and diluted weighted average common shares outstanding	22,290,982	19,975,112	13,132,704

See accompanying notes to condensed consolidated financial statements.

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CytoDyn Inc.

(A Development Stage Company)

Consolidated Statements of Cash Flows

(Unaudited)

	Three months ended		
	8/31/2011	8/31/2010	October 28, 2003 through 8/31/2011
Cash flows from operating activities			
Net loss	$ (1,166,789)	$ (547,950)	$ (16,525,171)
Adjustments to reconcile net loss to net cash used by operating activities:			
Amortization / depreciation	838	549	181,687
Loss on disposal furniture & equipment	3,436		3,436
Amortization of original issue discount	2,063		719,265
Extinguishment of debt			(337,342)
Purchased in process research and development			274,399
Stock-based compensation	241,517	262,841	5,961,642
Changes in current assets and liabilities:			
Accrued legal settlement			
Increase in prepaid expenses	(1,454)	(5,014)	(60,729)
Increase in other assets	(23,815)	1,875	(39,563)
Increase in accounts payable, accrued interest and accrued liabilities	398,955	(17,670)	2,693,859
Net cash used in operating activities	(545,249)	(305,369)	(7,128,517)
Cash flows from investing activities:			
Furniture and equipment purchases		(3,480)	(21,083)
Net cash used in investing activities		(3,480)	(21,083)
Cash flows from financing activities:			
Capital contributions by president			14,412
Proceeds from notes payable to related parties			705,649
Payments on notes payable to related parties			(165,498)
Proceeds from notes payable issued to individuals			145,000
Payments on notes payable issued to individuals			34,500
Proceeds from convertible notes payable			686,000
Proceeds from the sale of common stock		66,000	4,545,048
Proceeds from Series B preferred stock			2,009,000
Purchase of treasury stock			(436,000)
Proceeds from sale of treasury stock			559,210
Deferred offering costs		(45,800)	(1,029,940)
Proceeds from issuance of stock of AITI acquisition			512,200
Proceeds from issuance of stock of AGTI acquisition			100,000
Proceeds from exercise of warrants			28,350
Net cash provided by financing activities		20,200	7,638,931
Net change in cash	(545,249)	(288,649)	489,331

Cash, beginning of period	1,037,818	700,497	3,238
Cash, end of period	$ 492,569	$ 411,848	$ 492,569
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Income taxes	$	$	$
Interest	$ 6,102	$ 15,400	$ 30,266

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CytoDyn Inc.

(A Development Stage Company)

Consolidated Statements of Cash Flows

(Unaudited)

	Three months ended		October 28, 2003 through 8/31/2011
	8/31/2011	8/31/2010	
Non-cash investing and financing transactions:			
Net assets acquired in exchange for common stock in CytoDyn/Rexray business combination	$	$	$ 7,542
Common stock issued to former officer to repay working capital advance	$	$	$ 5,000
Common stock issued for convertible debt	$	$	$ 662,000
Common stock issued for debt	$	$	$ 245,582
Common stock issued for accrued interest payable	$	$	$ 20,956
Options to purchase common stock issued for debt	$	$	$ 62,341
Original issue discount and intrinsic value of beneficial conversion feature related to debt issued with warrants	$	$	$ 719,265
Common stock issued for preferred stock	$	$ 73,255	$ 167,500
Treasury stock issued for prepaid services	$	$	$ 118,291
Common Stock issued on payment of accounts payable	$	$	$ 49,000
Preferred and common stock subject to rescission	$ 3,000	$ 31,000	$ 4,848,000
Accrued stock incentive and deferred offering costs	$	$	$ 1,717,000
Common stock issued for Series B preferred stock	$	$	$ 442,984
Series B preferred stock dividends	$	$	$ 8,550
Accrued salaries related party contributed as capital	$	$ 229,500	$ 229,500
Reversal of accrued stock incentive and deferred offering costs	$	$	$ 1,717,000
Constructive dividend	$	$	$ 6,000,000

See accompanying notes to condensed consolidated financial statements.

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CYTODYN INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AS OF AUGUST 31, 2011

(UNAUDITED)

1 - Organization

CytoDyn Inc. (the Company) was incorporated under the laws of Colorado on May 2, 2002 under the name Rexray Corporation (Rexray). In October 2003, the Company (under its previous name RexRay Corporation) entered into an Acquisition Agreement with CytoDyn of New Mexico, Inc. Pursuant to the acquisition agreement, the Company acquired assets related to our leading drug candidate, Cytolin, including the assignment of the patent license agreement dated July 1, 1994 between CytoDyn of New Mexico, Inc. and Allen D. Allen covering three United States patents along with foreign counterpart patents which describe a method for treating Human Immunodeficiency Virus (HIV) disease with the use of monoclonal antibodies. This includes issued U.S. Patent Nos. 5,424,066; 5,651,970 and 6,534,057, as well as European Patent Nos. 0690725 and 1438970. In addition, Hong Kong Patent No. 1067958, Australian Patent No. 684074 and Canadian Patent No. 2156495 have been obtained as well. The Company also acquired the federally registered trademarks, CYTODYN (U.S. Registration No. 2095498) and CYTOLIN (U.S. Registration No. 2095497), and a related trademark symbol. The license acquired gives the Company the worldwide, exclusive right to develop, market and sell compounds disclosed by the patent claims, practice methods taught by the patent claims, and exploit specified technology related to the patents. The term of the license agreement is for the life of the patents of which the first will expire in 2013. The original expiration dates on the issued U.S. Patent Nos. 5,424,066; 5,651,970 and 6,534,057 are 2013, 2014 and 2013, respectively. As consideration for the intellectual property and trademarks the Company paid CytoDyn of New Mexico $10,000 in cash and issued 5,362,640 post-split shares of common stock to CytoDyn of New Mexico.

The Company entered the development stage effective October 28, 2003 upon the reverse merger and recapitalization of the Company and follows Financial Standard Accounting Codification No. 915, Development Stage Entities.

Advanced Genetic Technologies, Inc. (AGTI) was incorporated under the laws of Florida on December 18, 2006 pursuant to an acquisition during 2006.

CytoDyn Inc., discovered and is developing a class of therapeutic monoclonal antibodies to address significant unmet medical needs in the areas of HIV and Acquired Immune Deficiency Syndrome (AIDS).

On May 16, 2011, the Company formed a wholly owned subsidiary, CytoDyn Veterinary Medicine LLC (CVM), which will explore the possible application of the Company s existing proprietary monoclonal antibody technology to the treatment of Feline Immunodeficiency Virus (FIV). The Company views the formation of CVM and the exploration of the application of its existing proprietary monoclonal antibody technology to FIV as an effort to strategically diversify the use of its proprietary monoclonal antibody technology.

2 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and reflect all adjustments, consisting solely of normal recurring adjustments, needed to fairly present the financial results for these periods. The condensed consolidated financial statements and notes are presented as permitted by Form 10-Q. Accordingly, certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements should be read in conjunction with the financial statements for the years ended May 31, 2011 and 2010 and notes thereto in the Company s Annual Report on Form 10-K for the year ended May 31, 2011, filed with the Securities and Exchange Commission on November 3, 2011. Operating results for the three months ended August 31, 2011 and 2010 are not necessarily indicative of the results that may be expected for the entire year. In the

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opinion of management, all adjustments consisting only of normal recurring adjustments necessary for a fair statement of (a) the results of operations for the three month period ended August 31, 2011 and 2010 and the period October 28, 2003 through August 31, 2011, (b) the financial position at August 31, 2011, and (c) cash flows for the three month periods ended August 31, 2011 and 2010 and the period October 28, 2003 through August 31, have been made.

Principles of Consolidation

The consolidated financial statements include the accounts of CytoDyn Inc., and its wholly owned subsidiaries; AGTI and CVM. All intercompany transactions and balances are eliminated in consolidation.

Reclassifications

Certain prior year amounts shown in the accompanying consolidated financial statements have been reclassified to conform to the 2011 presentation. These reclassifications did not have any effect on total current assets, total assets, total current liabilities, total liabilities, total shareholders deficit, or net loss.

Going Concern

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the accompanying consolidated financial statements, the Company is currently in the development stage with losses for all periods presented. The Company incurred a net loss of $1,166,789 for the period ended August 31, 2011, has an accumulated deficit of $18,127,083, and a working capital deficit of $5,970,417 as of August 31, 2011. As of November 21, 2011, these factors, among others, raise substantial doubt about the Company s ability to continue as a going concern.

The consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company s continuation as a going concern is dependent upon its ability to obtain additional operating capital, complete development of its medical treatment, obtain U.S. Food & Drug Administration (the FDA) approval, outsource manufacturing of the treatment, and ultimately to attain profitability. The Company intends to seek additional funding through equity offerings to fund its business plan. There is no assurance that the Company will be successful in these endeavors.

Use of Estimates

The preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash

The Company considers all highly liquid debt instruments with original maturities of three months or less when acquired to be cash equivalents. The Company had no cash equivalents as of August 31, 2011 or May 31, 2011. Cash and cash equivalents are maintained at financial institutions, and, at times, balances may exceed federally insured limits. The Company has never experienced any losses related to these balances. All of the Company s non-interest bearing cash balances were fully insured at August 31, 2011 due to a temporary federal program in effect from December 31, 2010 through December 31, 2012. Under the program, there is no limit to the amount of insurance for eligible accounts. Beginning 2013, insurance coverage will revert to $250,000 per depositor at each financial institution, and our non-interest bearing cash balances may again exceed federally insured limits.

As of August 31, 2011, the Company had $492,569 in cash related to deposits received from common stock purchases as compared to $1,035,000 as of May 31, 2011. These deposits were received by the Company from prospective investors (the Prospective Investors) after the Company made an announcement on February 18, 2011 related to its potential rescission and other liabilities to investors who had made investments in the Company during the period beginning on April 15, 2008 end ending on February 18, 2011. The Company intends to send confirmations to the Prospective Investors asking them to either confirm their investment in the Company or request that their deposit be returned to them. During the three months ended August 31, 2011, the Company spent approximately $592,491 of the deposits received from the Prospective Investors to fund its working capital needs. Despite this fact, the Company still intends to return the deposit (or any portion thereof) received from the Prospective Investors if requested to do so by any of the Prospective Investors.

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Furniture and Equipment

Furniture and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets, generally three to seven years. Maintenance and repairs are charged to expense as incurred and major improvements or betterments are capitalized. Gains or losses on sales or retirements are included in the consolidated statements of operations in the year of disposition.

Impairment of Long-Lived Assets

The Company evaluates the carrying value of long-lived assets under U.S. GAAP, which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted future cash flows estimated to be generated by those assets are less than the assets carrying amount. If such assets are impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying value or fair value, less costs to sell. There were no impairment charges for the three months ended August 31, 2011 and 2010, and for the period October 28, 2003 through August 31, 2011.

Research and Development

Research and development costs are expensed as incurred.

Financial Instruments

At August 31, 2011 and May 31, 2011 the carrying value of the Company s financial instruments approximate fair value due to the short-term maturity of the instruments. The Company s notes payable have market rates of interest, and accordingly, the carrying values of the notes approximates the fair value.

Stock-Based Compensation

U.S. GAAP requires companies to measure the cost of employee services received in exchange for the award of equity instruments based on the fair value of the award at the date of grant. The expense is to be recognized over the period during which an employee is required to provide services in exchange for the award (requisite service period).

The Company accounts for common stock options, and common stock warrants granted based on the fair market value of the instrument using the Black-Scholes option pricing model utilizing certain weighted average assumptions such as expected stock price volatility, term of the options and warrants, risk-free interest rates, and expected dividend yield at the grant date. The risk-free interest rate assumption is based upon observed interest rates appropriate for the expected term of the stock options. The expected volatility is based on the historical volatility of the Company s common stock at consistent intervals. The Company has not paid any dividends on its common stock since its inception and does not anticipate paying dividends on its common stock in the foreseeable future. The computation of the expected option term is based on the simplified method as the Company s stock options are plain vanilla options and the Company has a limited history of exercise data. For common stock options and warrants with graded vesting, the Company recognizes the related compensation costs associated with these options and warrants on a straight-line basis over the requisite service period.

U.S. GAAP requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based on limited historical experience of forfeitures, the Company estimated future unvested option forfeitures at 0% for all periods presented.

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Deferred Offering Costs

In connection with a stock rescission liability as discussed at Note 3, the Company has recorded approximately $876,000 and $876,000 in deferred offering costs as of August 31, 2011 and May 31, 2011, respectively. These deferred offering costs have been recorded as a current asset for the respective periods. The asset will be offset against equity, and reduce equity in the period the investors described in Note 3 do not accept the rescission right and keep their shares. Conversely, if the investors accept the rescission right and forfeit their shares, the deferred offering costs will be expensed at that time.

Stock for Services

The Company issues common stock, warrants and common stock options to consultants for various services. Costs for these transactions are measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. The value of the common stock is measured at the earlier of (i) the date at which a firm commitment for performance by the counterparty to earn the equity instruments is reached or (ii) the date at which the counterparty s performance is complete.

Loss Per Common Share

Basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share is computed by dividing net loss by the weighted average common shares and potentially dilutive common share equivalents. The effects of potential common stock equivalents are not included in computations when their effect is anti-dilutive. Because of the net losses for all periods presented, the basic and diluted weighted average shares outstanding are the same since including the additional shares would have an anti-dilutive effect on the loss per share calculation. Common stock option and warrants to purchase 7,473,576 and 7,660,176 shares of common stock were not included in the computation of basic and diluted weighted average common shares outstanding for the three months ended August 31, 2011 and 2010, respectively, as inclusion would be anti-dilutive for these periods. Additionally, 311,800 shares of Series B convertible stock can potentially convert into 3,118,000 shares of common stock, and 1,035,000 shares of common stock will be issued related to deposits on common stock purchases if the Company is confirmed to do so by the Prospective Investors.

Income Taxes

Deferred taxes are provided on the asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carry forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Future tax benefits for net operating loss carryforwards are recognized to the extent that realization of these benefits is considered more likely than not. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Company follows the provisions of FASB ASC 740-10 Uncertainty in Income Taxes (ASC 740-10). A reconciliation of the beginning and ending amount of unrecognized tax benefits has not been provided since there are no unrecognized benefits at May 31, 2011 or 2010 and since the date of adoption. The Company has not recognized interest expense or penalties as a result of the implementation of ASC 740-10. If there were an unrecognized tax benefit, the Company would recognize interest accrued related to unrecognized tax benefit in interest expense and penalties in operating expenses. The Company is subject to examination by the Internal Revenue Service and state tax authorities for tax years ending after 2007.

3 - Rescission Liabilities and Accrued Stock Incentive Compensation

The Company s board of directors was advised by outside legal counsel that compensation the Company previously paid to an employee and certain other non-employees who were acting as unlicensed, non-exempt broker-dealers soliciting investors on behalf of the Company from April 15, 2008 to February 18, 2011 was a violation of certain state and possibly federal securities laws. As a result, such investors and potentially others have rescission or monetary claims (Claims) against the Company, and the Company s liability for these potential Claims is now being properly reflected in the Company s financial statements. On March 16, 2011, the Company filed a Current Report on Form 8-K disclosing the potential rescission liability (the Liability Disclosure). On July 21, 2011, the

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Company filed a Current Report on Form 8-K disclosing its receipt of an SEC letter of inquiry and request for voluntary assistance in discovering information related to the Liability Disclosure. We are cooperating with the SEC to provide all information required by this inquiry.

Rescission rights for individual investors and subscribers vary, based upon the laws of the states in which the investors or subscribers reside. Investments and subscriptions that are subject to rescission are recorded separately in our financial statements from stockholders deficiency in the Company s balance sheet. As the statute of limitations expire in the respective states, such amounts for those shares are reclassified to stockholders deficiency. Investors who have sold their shares of capital stock of the Company do not have rescission rights, but instead have claims for damages, to the extent their shares were sold at a net loss, which is determined by subtracting the purchase price plus statutory interest and costs (if any) from the sale price.

Based on the Company s ongoing investigation, assuming there are no affirmative defenses or exemptions available to the Company, investors may have up to approximately $6.4 million of federal and state Claims against the Company as of the date of filing this Form 10-Q. These investor Claims could include approximately $4.85 million of potential state or foreign jurisdiction Claims involving approximately 17 states and five foreign jurisdictions that may not be currently barred by the applicable statute of limitations or state law exemptions from broker-dealer registration requirements and these investors may also have overlapping federal Claims; the remainder could involve investors who do not have state law Claims but who may have federal rescission or damages rights if such rights can be proven to exist because of the Company s failure to disclose contingent liabilities related to the state and foreign jurisdiction Claims. The Company is continuing with its scientific and business plans in the ordinary course and is currently seeking to obtain a Letter of Credit to provide the Company the financial ability with respect to any potential Claims. As of the date of this Form 10-Q, the Company has been notified by one Investor regarding such investor s intent to seek rescission in the amount of $10,000.

The Company estimates an amount that is a probable indicator of the rescission liability and recorded rescission liabilities for August 31, 2011 and May 31, 2011 of $4,848,000 and $4,851,000, respectively. These amounts represent the believed potential rescission liability as of the dates presented, including any contingent interest payable to investors who accept the rescission right, and forfeit their shares. For the purpose of calculating and disclosing rescission liability, the Company has assumed that portions of the state claims are barred by the statutes of limitations of certain states based upon a literal interpretation of the applicable statute. Although the Company has assumed that affirmative defenses based upon the expiration of the statutes of limitations in these states may be generally available to bar these state claims, it has not had legal counsel undertake a detailed analysis of case law that might apply to defer or avoid application of a bar to such claims; thus, if rescission claims are made for those assumed to be barred by a statute of limitations and such claims are contested by the Company, until such affirmative defenses are ruled upon by judge in a proceeding adjudicating the rights at issue, no assurances can be made that, if asserted, such defenses would actually bar the rescission claims in these states.

The Company is considering methods to offer to rescind the previous investment purchase or subscription by persons who acquired or subscribed for such investments during the period April 15, 2008 to February 18, 2011. The Company may commence a rescission offer to give each investor the opportunity to rescind or not rescind their investment (if not already sold) or subscription agreements or by certain shareholders between April 15, 2008 to February 18, 2011. Any rescission offer could address all or part of the Company s rescission liability relating to its federal and state securities laws compliance issues by allowing the investors covered by the rescission offer to rescind the underlying securities transactions and sell those back to the Company or recover funding provided with subscription agreements, as the case may be.

The Company entered into a seven year Personal Services Agreement on August 4, 2008 (the Contract), with Nader Pourhassan pursuant to which compensation was paid or accrued in view of a subsequent determination that these payments violated applicable securities laws. Such violations gave rise to the Company s rescission obligation reflected in the Financial Statements. It was unclear whether the Company had any defenses to payment, whether the Company had any rights to recover payments made to Mr. Pourhassan or others at his direction or as contemplated in the Contract (including payments in the form of securities); or whether, even if the Company does have such rights, Mr. Pourhassan (and perhaps others) would have certain equitable remedies that would entitle Mr. Pourhassan (and perhaps others) to set off against the Company s rights or would obligate the Company to make compensatory payments for services performed by Mr. Pourhassan (and others under his direction).

The Contract provided for compensation to Dr. Pourhassan at an annual salary of $200,000. Additionally, as incentive compensation, Dr. Pourhassan s personal assistant and one additional person were to receive 50,000

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common shares each of Company stock for every $500,000 in capital received by the Company through Dr. Pourhassan s efforts. However, please see the Footnote 8 - Subsequent Events on page 13 for further information concerning the Company s obligations under the Contract.

In addition, costs of approximately $0, $46,000, and $876,000 which were originally reflected as consulting expenses and payroll costs during the three months ended August 31, 2011 and 2010, and the period October 28, 2003 through August 31, 2011, respectively, have been reclassed to deferred offering costs increasing current assets and decreasing expenses in these periods.

4 - Convertible Instruments

During fiscal year 2010 the Company issued 400,000 shares of Series B Convertible Preferred Stock (Series B) at $5.00 per share for cash proceeds totaling $2,009,000. The Series B is convertible into ten shares of the Company s common stock including any accrued dividend, with an effective fixed conversion price of $.50 per share. The holders of the Series B can only convert their shares to common shares provided the Company has sufficient authorized common shares at the time of conversion. Accordingly, the conversion option was contingent upon the Company increasing their authorized common shares, which occurred April 2010 when the Company s shareholders approved an increase to the authorized shares. At the commitment date, which occurred upon the shareholders approving the increase in the authorized shares, the conversion option related to the Series B was beneficial. The intrinsic value of the conversion option at the commitment date resulted in a constructive dividend to the Series B holders of approximately $6,000,000. The constructive dividend increased and decreased additional paid-in capital by the same amount. The Series B has liquidation preferences over the common share holders at $5.00 per share plus any accrued dividends. Dividends are payable to the Series B holders when declared by the board of directors at the rate of $.25 per share per annum. Such dividends are cumulative and accrue whether or not declared and whether or not there are any profits, surplus or other funds or assets of the Company legally available therefore. The Series B holders have no voting rights.

5 - Stock Options and Warrants

The Company has one stock-based equity plan at August 31, 2011. Pursuant to the 2004 Stock Incentive Plan as amended (the Plan), which was originally adopted by the Company s shareholders in 2005, the Company was authorized to issue options and warrants to purchase up to 7,600,000 shares of the Company s common stock. As of August 31, 2011 the Company had 3,425,500 shares available for future stock option grants under the Plan.

During the three months ended August 31, 2011, the Company granted 200,000 common stock options with an exercise price of $2.00, which vest ratably over one-year and have an expiration date of five years from the date of grant.

Net cash proceeds from the exercise of stock options and warrants were $-0- for the three months ended August 31, 2011 and 2010, respectively.

Compensation expense related to stock options and warrants was approximately $242,000, and $233,000 for the three months ended August 31, 2011 and 2010, respectively.

The grant date fair value of options and warrants vested during the three month periods ended August 31, 2011 and 2010 was approximately $190,000 and $233,000, respectively. The weighted average grant date fair value of options and warrants granted during the three month periods ended August 31, 2011 and 2010 was $1.25 and $0, respectively. As of August 31, 2011 there was approximately $1,568,000 of unrecognized compensation costs related to share-based payments for unvested options, which is expected to be recognized over a weighted average period of 1.91 years.

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The following table represents stock option and warrant activity as of and for the three months ended August 31, 2011:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options and warrants outstanding - May 31, 2011	7,473,576	$ 1.34	3.84	$ 10,495,913
Granted	200,000	$ 2.00		
Exercised				
Forfeited/expired/cancelled	83,000	$ 2.26		
Options and warrants outstanding - August 31, 2011	7,590,576	$ 1.34	3.67	$ 4,223,613
Outstanding exercisable - August 31, 2011	6,047,520	$ 1.25	3.34	$ 3,906,029

6 - Recent Accounting Pronouncements

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

7 - Related Party Transactions

A director provided legal services to the Company over the past several years. As of August 31, 2011 the Company owed the director $38,985 and it is included in the accompanying consolidated financial statements as indebtedness to related parties as of August 31, 2011. The amount has been classified as short-term, as the Company s intention is to pay the note completely in the next twelve months. As of August 31, 2011 the note is past due.

In May and July 2007, the Company issued $150,000 in promissory notes with a stated interest rate of 14% to a director of the Company. These notes are currently past due. As of August 31, 2011, the balance in the notes is $110,000. The Company has classified the balance as short-term obligation as of August 31, 2011, as the Company s intention is to pay the note completely in the next twelve months.

In July, 2010, three executives of the Company forgave approximately $230,000 in accrued salaries that are included as additional paid-in capital as of August 31, 2011.

We use on a month-to-month basis a portion of a building owned by Kenneth J. Van Ness, our President, Chief Executive Officer, and Chairman of the Board of Directors, our principal offices that are located at 110 Crenshaw Lake Road, Lutz, Florida 33548. We use approximately 1,600 square feet on a month-to-month basis which has been accruing at a cost of $1,650 per month since September 1, 2011.

8 - Subsequent Events

On September 8, 2011, the Company issued a press release announcing that it has entered into a consulting arrangement with SDG, LLC (SDG), a regulatory advisory service firm located in Cambridge, Massachusetts, for regulatory advice and strategic planning with the U.S. Food and Drug Administration (FDA). The Company intends to work in conjunction with the principals of SDG to organize, request, and participate in a planning meeting with the FDA and to prepare the filing of the Company s investigational new drug application to allow initiation of human trials for the humanized version of the Company s lead product Cytolin®.

On September 23, 2011, the Company announced that it has filed a provisional patent application for its humanized version of its lead product Cytolin®, a monoclonal antibody for the treatment of HIV Infection.

On October 11, 2011, Dr. Pourhassan and the Company entered into a Mutual Release and Personal Services Termination Agreement (the MRPSTA) which relieves the Company of liability for any claims of compensation under the Contract. Simultaneously, with the signing of the MRPSTA, Dr. Pourhassan and the Company entered into a new Employment and Non-Compete Agreement whereby Dr. Pourhassan will serve as Managing Director of Business Development at an annual salary of $200,000. See Footnote 3 of our Financial Statements on page 10 for further information. The Company had been accruing stock compensation and deferred offering costs related to the Contract as described at Note 3. Upon the signing of the MRPSTA, the Company at May 31, 2011 reversed all accrued stock compensation and deferring offering costs, as the

Company currently has no further obligations under the Contract.

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On November 16, 2011, the Company issued a press release announcing that the Company and The Scripps Research Institute, a nonprofit institution (Scripps Research) entered into a Research Funding and Option Agreement (the Agreement) that will enable Dr. John H. Elder, Professor in the Department of Immunology and Microbial Science at Scripps Research, to explore the potential application of the Company s recently provisionally patented technology as an effective therapy in the treatment of feline immunodeficiency virus**.** The Agreement requires that the Company pay Scripps Research $20,000 on the date of the Agreement, $20,000 on each of the second month and four month anniversary dates of the Agreement, and $20,000 upon the completion of Scripps Research s research and the Company s receipt of a final research report reflecting the results of the research. The Company has assigned the Agreement to its wholly-owned subsidiary, CytoDyn Veterinary Medicine LLC.

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

THROUGHOUT THIS FILING, WE MAKE FORWARD-LOOKING STATEMENTS. THE WORDS ANTICIPATE, BELIEVE, EXPECT, INTEND, PREDICT, PLAN, SEEK, ESTIMATE, PROJECT, WILL, CONTINUE, COULD, MAY, AND SIMILAR TERM EXPRESSIONS ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS. THESE STATEMENTS INCLUDE, AMONG OTHERS, INFORMATION REGARDING FUTURE OPERATIONS, FUTURE CAPITAL EXPENDITURES, AND FUTURE NET CASH FLOWS. SUCH STATEMENTS REFLECT THE COMPANY S CURRENT VIEWS WITH RESPECT TO FUTURE EVENTS AND FINANCIAL PERFORMANCE AND INVOLVE RISKS AND UNCERTAINTIES, INCLUDING, WITHOUT LIMITATION, GENERAL ECONOMIC AND BUSINESS CONDITIONS, CHANGES IN FOREIGN, POLITICAL, SOCIAL, AND ECONOMIC CONDITIONS, REGULATORY INITIATIVES AND COMPLIANCE WITH GOVERNMENTAL REGULATIONS, THE ABILITY TO ACHIEVE MARKET PENETRATION AND ATTRACT CUSTOMERS, AND VARIOUS OTHER MATTERS, MANY OF WHICH ARE BEYOND THE COMPANY S CONTROL. SHOULD ONE OR MORE OF THESE RISKS OR UNCERTAINTIES OCCUR, OR SHOULD UNDERLYING ASSUMPTIONS PROVE TO BE INCORRECT, ACTUAL RESULTS MAY VARY MATERIALLY AND ADVERSELY FROM THOSE ANTICIPATED, BELIEVED, ESTIMATED, OR OTHERWISE INDICATED. CONSEQUENTLY, ALL OF THE FORWARD-LOOKING STATEMENTS MADE IN THIS FILING ARE QUALIFIED BY THESE CAUTIONARY STATEMENTS AND THERE CAN BE NO ASSURANCE OF THE ACTUAL RESULTS OR DEVELOPMENTS.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the other sections of this Quarterly Report, including our financial statements and related notes appearing elsewhere herein. This discussion and analysis contains forward-looking statements including information about possible or assumed results of our financial conditions, operations, plans, objectives and performance that involve risk, uncertainties and assumptions. The actual results may differ materially from those anticipated and set forth in such forward-looking statements.

Results of Operations

Results of Operations for the three months ended August 31, 2011 and 2010 are as follows:

For the three months ended August 31, 2011 and 2010 we had no activities that produced revenues from operations.

For the three months ended August 31, 2011, we had a net loss of approximately $1,167,000 compared to a net loss of approximately $548,000 for the corresponding period in 2010. For the three months ended August 31, 2011 and 2010, we incurred operating expenses of approximately $1,159,000 and $544,000, respectively, consisting primarily of stock-based compensation, professional fees, research and development and salaries.

The increase in operating expenses of approximately $610,000 from the three-month period ended August 31, 2010 compared to the three months ended August 31, 2011 related primarily to increases in legal fees, and research and development expenses. Research and development expenses are associated with the development of our lead product, Cytolin ®. As discussed above, we are currently in clinical trials with our product. We expect the trend in research and development expenses to increase as our product progresses through clinical trials. Legal fees have increased during the current quarter compared to previous quarter as a result of the increase in our external filings and rescission liability. We expect the trend to stabilize, as our filings become more consistent. The trend in all of our expenses will depend on our ability to raise additional funds, including the increase in salary expense related to the hiring of our current CEO, CFO and controller.

Rescission Liability

We recorded rescission liabilities for August 31, 2011 and May 31, 2011 of $4,848,000 and $4,851,000, respectively. These amounts represent the believed potential rescission liability as of the dates presented, including any contingent interest payable to investors who accept the rescission right, and forfeit their shares. For the purpose of calculating and disclosing rescission liability, the Company has assumed that portions

of the state claims are barred by the statutes of limitations of certain states based upon a literal interpretation of the applicable statute. Although the Company has assumed that affirmative defenses based upon the expiration of the statutes of limitations in these states may be generally available to bar these state claims, it has not had legal counsel undertake a detailed analysis of case law that might apply to defer or avoid application of a bar to such claims; thus, if rescission claims are made for those assumed to be barred by a statute of limitations and such claims are contested by the Company,

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until such affirmative defenses are ruled upon by judge in a proceeding adjudicating the rights at issue, no assurances can be made that, if asserted, such defenses would actually bar the rescission claims in these states. See Footnote 3 of our Financial Statements on page 10 for further information regarding these rescission liabilities.

Accrued Incentive Stock Compensation

On August 4, 2008, we entered into a seven year Personal Services Agreement with Nader Pourhassan (the Contract). The Contract provides for compensation to Dr. Pourhassan at an annual salary of $200,000. Additionally, as incentive compensation, Dr. Pourhassan s personal assistant and one additional person are to receive 50,000 common shares each of our common stock for every $500,000 in capital received by the Company through Dr. Pourhassan s efforts. Subsequent to the three months ended August 31, 2011, Dr. Pourhassan and the Company entered into a Mutual Release and Personal Services Termination Agreement (the MRPSTA) which relieves the Company of liability for any claims of compensation under the Contract. Simultaneously, with the signing of the MRPSTA, Dr. Pourhassan and the Company entered into a new Employment and Non-Compete Agreement whereby Dr. Pourhassan will serve as Managing Director of Business Development at an annual salary of $200,000. See Footnote 3 of our Financial Statements on page 10 for further information.

The Company had been accruing stock compensation and deferred offering costs related to the Contract as described at Note 3. Upon the signing of the MRPSTA, the Company at May 31, 2011 reversed all accrued stock compensation and deferring offering costs, as the Company currently has no further obligations under the Contract.

Liquidity and Capital Resources

On August 31, 2011, we had negative working capital of approximately $(5,970,000) as compared to a negative working capital of approximately $(5,022,000) on May 31, 2011.

Cash Flows

Net cash used in operating activities was approximately $545,000 during the three months ended August 31, 2011, which reflects an increase of approximately $240,000 from net cash used in operating activities of approximately $305,000 for the three months ended August 31, 2010. The increase in the net cash used in operating activities for the above periods was primarily attributable to the increase in the net loss, off-set by the increase in accounts payable.

There were no significant changes in cash used in investing activities from the three months ended August 31, 2011.

There were no material changes in cash flows from financing activities from the three months ended August 31, 2011.

As shown in the accompanying Financial Statements, for the three months ended August 31, 2011 and 2010, and since October 28, 2003 through August 31, 2011 we incurred net losses of approximately $1,167,000 and $548,000 and $(16,525,000), respectively. As of August 31, 2011, we have not emerged from the development stage. In view of these matters, our ability to continue as a going concern is dependent upon our ability to begin operations and to achieve a level of profitability. Since inception, we have financed our activities principally from the sale of public and private equity securities and proceeds from notes payable. We intend to finance our future development activities and our working capital needs largely from the sale of equity securities with some additional funding from other traditional financing sources.

As previously mentioned, since October 28, 2003, we have financed our operations largely from the sale of common stock and preferred stock and proceeds from notes payable. From October 28, 2003 through August 31, 2011 we raised cash of approximately $6,083,000 (net of offering costs) through private placements of common and preferred stock financings and approximately $1,537,000 through the issuance related party notes payable and convertible notes. Additionally, the Company has raised approximately $612,000 from the issuance of common stock and preferred stock in conjunction with certain acquisitions in prior years. In April 2010, our shareholders voted to amend our Articles of Incorporation to increase the number of authorized shares of common stock to 100,000,000 shares; accordingly, we intend to continue to finance our operations through the sale of our shares.

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Since October 28, 2003 through August 31, 2011, we have incurred approximately $2,403,000 of research and development costs and approximately $15,998,000 in operating expenses. We have incurred significant net losses and negative cash flows from operations since our inception. As of August 31, 2011, we had an accumulated deficit of approximately $18,127,000 and negative working capital of approximately $5,970,000.

We anticipate that cash used in product development and operations, especially in the marketing, production and sale of our products will increase significantly in the future. We currently do not have any significant material commitments related to capital expenditures. As described above, we do have material commitments related to our current study of our product with MGH, and have potential obligations under our contracts with Vista.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Not applicable.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

As of August 31, 2011, under the supervision and with the participation of the Company s Chief Executive Officer and Chief Financial Officer, management has evaluated the effectiveness of the design and operations of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of August 31, 2011. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were not effective as of August 31, 2011 as a result of the material weakness in internal control over financial reporting because of inadequate segregation of duties over authorization, review and recording of transactions as well as the financial reporting of such transactions. Management is attempting to develop a plan to mitigate the above material weaknesses. Despite the existence of these material weaknesses, we believe the financial information presented herein is materially correct and in accordance with generally accepted accounting principles.

Internal Control Over Financial Reporting

Changes in Control Over Financial Reporting

No change in the Company s internal control over financial reporting occurred during the quarter ended August 31, 2011, other than those described above that materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

Not Applicable.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Removed and Reserved.

Not Applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

(a) Exhibits:

3.1	Articles of Incorporation (incorporated herein by reference to Exhibit 3.1 on Form 10SB12G Registration of Securities for Small Business Issuers filed July 11, 2002).
3.2	Amendment to the Articles of Incorporation dated October 28, 2003 (incorporated herein by reference to filed Exhibit 3.3 on Form 8-K filed November 12, 2003).
3.3	Amendment to Articles of Incorporation dated September 2009 (incorporated herein by reference to Exhibit 3.4 to Form 10-K filed March 12, 2010).
3.4	Amendment to Articles of Incorporation dated April 29, 2010 (incorporated herein by reference to Exhibit 3.5 to Form 8-K filed April 29, 2010).
3.5	Amended and Restated Bylaws, as amended on November 8, 2011 (incorporated by reference herein to Exhibit 3.1 filed with Form 8-K Current Report filed November 10, 2011).
31.1	Rule 13a-14(a)/15d-14(a) Certification by the CEO of the Registrant.
31.2.	Rule 13a-14(a)/15d-14(a) Certification by the CFO of the Registrant.
32.1.	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the CEO of the Registrant.
32.2.	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of the CFO of the Registrant.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CYTODYN INC.
(Registrant)

DATE: November 21, 2011

BY: /s/ Kenneth J. Van Ness
Kenneth J. Van Ness
President and Chief Executive Officer

BY: /s/ Andrew T. Libby, Jr.
Andrew T. Libby, Jr.
Chief Financial Officer and Corporate Secretary

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EXHIBIT INDEX

Exhibit No.	Description
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