HEAT BIOLOGICS, INC.
Form 10-Q
May 15, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2018

OR

o **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: 001-35994

Heat Biologics, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**26-2844103**
(State or Other Jurisdiction of	*(I.R.S. Employer*

Incorporation or Organization) *Identification No.)*

801 Capitola Drive

Durham, NC **27713**

(Address of Principal Executive Offices) *(Zip Code)*

(919) 240-7133

(Registrant s Telephone Number, including Area Code)

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 þ No o

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 (§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 þ No o

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	þ
(Do not check if smaller reporting company)		Emerging growth company	þ

If an emerging growth company indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. þ

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

As of May 11, 2018, there were 18,352,251 shares of Common Stock, $0.0002 par value per share, outstanding.

HEAT BIOLOGICS, INC.

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). All statements, other than statements of historical facts, contained in this Quarterly Report on Form 10-Q, including statements regarding our strategy, future operations, future financial position, future revenues, projected costs, prospects, plans and objectives of management, are forward-looking statements. The words anticipate, believe, estimate, expect, intend, may, plan, predict, project, target, potential, will continue and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words.

Forward-looking statements are not guarantees of future performance and our actual results could differ materially from the results discussed in the forward-looking statements. Factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to, our ability to raise additional capital to support our clinical development program and other operations, our ability to develop products of commercial value and to identify, discover and obtain rights to additional potential product candidates, our ability to protect and maintain our intellectual property and the ability of our licensors to obtain and maintain patent protection for the technology or products that we license from them, the outcome of research and development activities, our reliance on third-parties, competitive developments, the effect of current and future legislation and regulation and regulatory actions, as well as other risks described more fully in this Quarterly Report on Form 10-Q and our other filings with the Securities and Exchange Commission (the SEC). Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified below, under Part II, Item 1A. Risk Factors and elsewhere herein and those identified under Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 2, 2018. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

As a result of these and other factors, we may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make. We do not assume any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

NOTE REGARDING COMPANY REFERENCES

Throughout this Quarterly Report on Form 10-Q, Heat Biologics, the Company, we and our refer to Heat Biologics Inc.

i

PART I FINANCIAL INFORMATION

ITEM 1.

FINANCIAL STATEMENTS

HEAT BIOLOGICS, INC.

Consolidated Balance Sheets

	March 31, 2018 (unaudited)	December 31, 2017
Current Assets		
Cash and cash equivalents	$ 8,962,472	$ 9,763,067
Accounts receivable	5,399	14,833
Prepaid expenses and other current assets	1,652,740	1,967,257
Total Current Assets	10,620,611	11,745,157
Property and Equipment, net	661,957	286,891
Other Assets		
Restricted cash	1,170	2,292
In-process R&D	5,866,000	5,866,000
Goodwill	2,189,338	2,189,338
Deposits	79,219	69,798
Deferred financing costs	40,173	30,000
Total Other Assets	8,175,900	8,157,428
Total Assets	$ 19,458,468	$ 20,189,476
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts payable	$ 1,701,623	$ 1,033,680
Deferred revenue	6,273,861	7,026,388
Accrued expenses and other liabilities	1,558,661	2,276,431
Total Current Liabilities	9,534,145	10,336,499
Long Term Liabilities		
Other long term liabilities	160,942	160,559
Deferred tax liability	1,302,220	1,302,220
Contingent consideration	2,620,407	2,609,289
Total Liabilities	13,617,714	14,408,567

Commitments and Contingencies

Stockholders Equity				
Common stock, $.0002 par value; 100,000,000 shares authorized, 5,663,919 and 4,200,310 shares issued and outstanding at March 31, 2018 (unaudited) and December 31, 2017, respectively		1,133		840
Additional paid-in capital		80,153,716		76,382,262
Accumulated deficit		(72,373,092)		(68,846,326)
Accumulated other comprehensive loss		(144,700)		(166,025)
Total Stockholders Equity Heat Biologics, Inc.		7,637,057		7,370,751
Non-Controlling Interest		(1,796,303)		(1,589,842)
Total Stockholders Equity		5,840,754		5,780,909
Total Liabilities and Stockholders Equity	$	19,458,468	$	20,189,476

See Notes to Financial Statements

HEAT BIOLOGICS, INC.

Consolidated Statements of Operations and Comprehensive Loss

(Unaudited)

	Three Months Ended, March 31,	
	2018	**2017**
Revenue:		
Grant and licensing revenue	$ 752,527	$ 24,240
Operating expenses:		
Research and development	2,872,950	1,812,901
General and administrative	1,780,339	1,527,015
Change in fair value of contingent consideration	11,118	
Total operating expenses	4,664,407	3,339,916
Loss from operations	(3,911,880)	(3,315,676)
Interest income	3,633	5,221
Other income, net	175,020	69,727
Total non-operating income, net	178,653	74,948
Net loss	(3,733,227)	(3,240,728)
Net loss non-controlling interest	(206,461)	(50,791)
Net loss attributable to Heat Biologics, Inc.	$ (3,526,766)	$ (3,189,937)
Net loss per share attributable to Heat Biologics, Inc. basic and diluted	$ (0.75)	$ (1.18)
Weighted-average number of common shares used in net loss per share attributable to common stockholders basic and diluted	4,709,553	2,695,762
Other comprehensive loss:		
Net loss	(3,733,227)	(3,240,728)
Unrealized gain (loss) on foreign currency translation	21,325	(66,375)
Total other comprehensive loss	(3,711,902)	(3,307,103)
Comprehensive loss attributable to non-controlling interest	(206,461)	(50,791)
Comprehensive loss	$ (3,505,441)	$ (3,256,312)

See Notes to Financial Statements

HEAT BIOLOGICS INC.

Consolidated Statements of Stockholders Equity

(Unaudited)

	Common Stock	APIC	Accumulated Deficit	Accumulated Other Comprehensive Loss	Non-Controlling Interest	Total Stockholders Equity
Balance at December 31, 2017	$ 840	$ 76,382,262	$ (68,846,326)	$ (166,025)	$ (1,589,842)	$ 5,780,909
Issuance of common stock, 1,403,367 shares	281	3,573,099				3,573,380
Stock issuance costs		(173,526)				(173,526)
Stock-based compensation	12	371,881				371,893
Other comprehensive gain				21,325		21,325
Net loss			(3,526,766)		(206,461)	(3,733,227)
Balance at March 31, 2018	**$ 1,133**	**$ 80,153,716**	**$ (72,373,092)**	**$ (144,700)**	**$ (1,796,303)**	**$ 5,840,754**

See Notes to Financial Statements

HEAT BIOLOGICS, INC.

Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended March 31	
	2018	**2017**
Cash Flows from Operating Activities		
Net loss	$ (3,733,227)	$ (3,240,728)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	44,075	33,113
Stock-based compensation	371,893	248,745
Change in fair value of contingent consideration	11,118	
Increase (decrease) in cash arising from changes in assets and liabilities:		
Accounts receivable	9,422	80,555
Prepaid expenses and other current assets	305,097	61,611
Deferred financing costs	(10,173)	
Accounts payable	667,605	442,007
Deferred revenue	(752,527)	
Accrued expenses and other liabilities	(717,770)	(551,369)
Other long term liabilities	383	(39,920)
Net Cash Used in Operating Activities	(3,804,104)	(2,965,986)
Cash Flows from Investing Activities		
Purchase of property and equipment	(419,141)	(5,555)
Net Cash Used in Investing Activities	(419,141)	(5,555)
Cash Flows from Financing Activities		
Proceeds from public offering, net of underwriting discounts		4,183,000
Proceeds from the issuance of common stock, net of commissions	3,573,380	2,357,479
Stock issuance costs	(173,526)	(214,237)
Net Cash Provided by Financing Activities	3,399,854	6,326,242
Effect of exchange rate changes on cash, cash equivalents and restricted cash	21,674	(67,431)
Net (Decrease) Increase in Cash, Cash Equivalents and Restricted Cash	(801,717)	3,287,270

Cash, Cash Equivalents and Restricted Cash Beginning of Period		9,765,359		7,943,838
Cash, Cash Equivalents and Restricted Cash End of Period	$	8,963,642	$	11,231,108

See Notes to Financial Statements

HEAT BIOLOGICS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

On January 19, 2018, the Company announced a reverse stock split of its shares of common stock at a ratio of one-for-ten. The reverse stock split took effect at 11 p.m. ET on January 19, 2018, and the Company s common stock began to trade on a post-split basis at the market open on January 22, 2018. During the Company s annual stockholders meeting held June 29, 2017, shareholders approved the Company s reverse stock split, and granted the board of directors the authority to implement and determine the exact split ratio. When the reverse stock split became effective, every 10 shares of our issued and outstanding common stock were combined into one share of common stock. Effecting the reverse stock split reduced the number of issued and outstanding common stock from approximately 42 million shares to approximately 4.2 million. It also subsequently adjusted outstanding options issued under the Company s equity incentive plan and outstanding warrants to purchase common stock.

The accompanying unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q have been prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial reporting. However, certain information or footnote disclosures normally included in complete financial statements prepared in accordance with U.S. GAAP have been condensed, or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). In the opinion of the Company s management, the unaudited consolidated financial statements in this Quarterly Report on Form 10-Q include all normal and recurring adjustments necessary for the fair statement of the results for the interim periods presented. The results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2018.

The consolidated financial statements as of and for the three months ended March 31, 2018 and 2017 included in this Quarterly Report on Form 10-Q are unaudited. The balance sheet as of December 31, 2017 is derived from the audited consolidated financial statements as of that date. The accompanying unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes, together with Management s Discussion and Analysis of Financial Condition and Results of Operations, contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 2, 2018 (the 2017 Annual Report).

On April 28, 2017, the Company completed the acquisition of an 80% controlling interest in Pelican Therapeutics, Inc. (Pelican), a related party prior to acquisition. Operations of Pelican are included in the consolidated statement of operations and comprehensive loss from the acquisition date.

The accompanying consolidated financial statements as of and for the three months ended March 31, 2018 and 2017 include the accounts of Heat Biologics, Inc. (the Company), and its subsidiaries, Heat Biologics I, Inc. (Heat I), Heat Biologics III, Inc. (Heat III), Heat Biologics IV, Inc. (Heat IV), Heat Biologics GmbH, Heat Biologics Australia Pty Ltd. and Zolovax. Additionally, as of the three months ended March 31, 2018 the accompanying consolidated financials include Pelican. The functional currency of the entities located outside the United States is the applicable local currency (the foreign entities). Assets and liabilities of the foreign entities are translated at period-end exchange rates. Statement of operations accounts are translated at the average exchange rate during the period. The effects of foreign currency translation adjustments are included in other comprehensive loss, which is a component of accumulated other comprehensive loss in stockholders equity. All significant intercompany accounts and transactions have been eliminated in consolidation. At December 31, 2017 and March 31, 2018, the Company held a 92.5% controlling interest in Heat I and an 80% controlling interest in Pelican. All other subsidiaries are wholly owned. For the three months ended March 31, 2018 the Company recognized $92,323 in non-controlling interest for Heat I and $114,138 in non-controlling interest for Pelican. The Company accounts for its less than 100% interest in these subsidiaries in the consolidated financial statements in accordance with U.S. GAAP. Accordingly, the Company presents non-controlling interests as a component of stockholders equity on its consolidated balance sheets and reports non-controlling interest net loss under the heading net loss non-controlling interest in the consolidated statements of operations and comprehensive loss.

HEAT BIOLOGICS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The Company has an accumulated deficit of approximately $72.4 million as of March 31, 2018 and a net loss of approximately $3.7 million for the three months ended March 31, 2018, and has not generated significant revenue or positive cash flows from operations. In May 2018 the Company raised approximately $18.6 million on a public offering. On April 28, 2017, the acquisition of an 80% controlling interest in Pelican, a related party prior to acquisition, was completed. Pelican has been awarded a $15.2 million grant to fund preclinical and some clinical activities from the Cancer Prevention and Research Institute of Texas (CPRIT). The CPRIT grant is subject to customary CPRIT funding conditions. The Company believes the acquisition aligns its strategic focus and strengthens its position in the T-cell activation arena.

Cash Equivalents and Restricted Cash

The Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents. Restricted cash consists of deposits held by the US Patent and Trademark Office.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Estimates are used for, but not limited to, useful lives of fixed assets, income taxes and stock-based compensation. Actual results may differ from those estimates.

Segments

The Company has one reportable segment - the development of immunotherapies designed to activate and expand a patient's T-cell mediated immune system against cancer.

Business Combinations

We account for acquisitions using the acquisition method of accounting, which requires that all identifiable assets acquired and liabilities assumed be recorded at their estimated fair values. The excess of the fair value of purchase consideration over the fair values of identifiable assets and liabilities is recorded as goodwill. When determining the fair values of assets acquired and liabilities assumed, management makes significant estimates and assumptions.

Critical estimates in valuing certain intangible assets include but are not limited to future expected cash flows from acquired patented technology. Management s estimates of fair value are based upon assumptions believed to be reasonable, but are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. Other estimates associated with the accounting for acquisitions may change as additional information becomes available regarding the assets acquired and liabilities assumed (see Note 2).

Goodwill and In-Process Research and Development

We classify intangible assets into three categories: (1) intangible assets with definite lives subject to amortization, (2) intangible assets with indefinite lives not subject to amortization and (3) goodwill. We determine the useful lives of definite-lived intangible assets after considering specific facts and circumstances related to each intangible asset. Factors we consider when determining useful lives include the contractual term of any agreement related to the asset, the historical performance of the asset, and other economic facts; including competition and specific market conditions. Intangible assets that are deemed to have definite lives are amortized, primarily on a straight-line basis, over their estimated useful lives.

Intangible assets that are deemed to have indefinite lives, including goodwill, are reviewed for impairment annually on the anniversary of the acquisition, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test for indefinite-lived intangibles, other than goodwill, consists of a comparison of the fair value of the intangible asset with its carrying amount. If the carrying amount exceeds the fair value, an impairment charge is recognized in an amount equal to that excess. Indefinite-lived intangible assets, such as goodwill, are not amortized. The Company will qualitatively test the carrying amounts of goodwill for recoverability on an annual basis or when events or changes in circumstances indicate evidence a potential impairment exists, using a fair value-based test. No impairment existed at March 31, 2018.

HEAT BIOLOGICS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

In-process research and development, or IPR&D, assets are considered to be indefinite-lived until the completion or abandonment of the associated research and development projects. IPR&D assets represent the fair value assigned to technologies that we acquire, which at the time of acquisition have not reached technological feasibility and have no alternative future use. During the period that the assets are considered indefinite-lived, they are tested for impairment on an annual basis, or more frequently if we become aware of any events occurring or changes in circumstances that indicate that the fair value of the IPR&D assets are less than their carrying amounts. If and when development is complete, which generally occurs upon regulatory approval and the ability to commercialize products associated with the IPR&D assets, these assets are then deemed definite-lived and are amortized based on their estimated useful lives at that point in time. If development is terminated or abandoned, we may have a full or partial impairment charge related to the IPR&D assets, calculated as the excess of carrying value of the IPR&D assets over fair value.

Contingent Consideration

Consideration paid in a business combination may include potential future payments that are contingent upon the acquired business achieving certain milestones in the future (contingent consideration). Contingent consideration liabilities are measured at their estimated fair value as of the date of acquisition, with subsequent changes in fair value recorded in the consolidated statements of operations. The Company estimates the fair value of the contingent consideration as of the acquisition date using the estimated future cash outflows based on the probability of meeting future milestones. The milestone payments will be made upon the achievement of clinical and commercialization milestones as well as single low digit royalty payments and payments upon receipt of sublicensing income. Subsequent to the date of acquisition, the Company will reassess the actual consideration earned and the probability-weighted future earn-out payments at each balance sheet date. Any adjustment to the contingent consideration liability will be recorded in the consolidated statements of operations. Contingent consideration liabilities are presented in long-term liabilities in the consolidated balance sheets (see Note 2).

Revenue Recognition

Effective January 1, 2018, the Company has adopted on a modified retrospective basis Accounting Standards Codification (ASC) Topic 606.

The Company s sole source of revenue is grant revenue related to the CPRIT contract, which is being accounted for under ASC 606. ASC 606 introduces a new framework for analyzing potential revenue transactions by identifying the contract with a customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction price to the performance obligations in the contract, and recognizing revenue when (or as) the Company satisfies a performance obligation.

The performance obligations of the Contract include developing a human TNFRSF25 agonist antibody for use in cancer patients through research and development efforts and a noncommercial license from CPRIT-funded research to CPRIT and other government agencies and institutions of higher education in Texas.

Management has concluded that the license and R&D services should be combined into a single performance obligation as both are highly interdependent - a license cannot be effectively granted without the corresponding research basis and CPRIT cannot benefit from the license without the R&D services and are therefore not capable of being distinct.

The CPRIT grant covers a three-year period from June 1, 2017 through May 31, 2019, for a total grant award of up to $15.2 million. CPRIT advances grant funds upon request by the Company consistent with the agreed upon amounts and schedules as provided in the contract. The first tranche of funding of $1.8 million was received in May 2017, and a second tranche of funding of $6.5 million was received in October 2017. The next tranche of funding is expected to be requested and received in late 2018. Funds received are reflected in deferred revenue as a liability until revenue is earned. Grant revenue is recognized when qualifying costs are incurred. As of March 31, 2018, the deferred revenue balance was $6.3 million with $2.2 million recognized as revenue since contract inception.

Prepaid Expenses and Other Current Assets

The Company s prepaid expenses and other current assets consists primarily of the amount paid in advance for cGMP production of our PTX-35 antibody and PTX-15 fusion protein for Pelican, as well as Chemistry Manufacturing and Control (CMC) material for our clinical trial studies for HS-110.

HEAT BIOLOGICS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Income Taxes

We account for income taxes using the asset and liability method, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to the extent that utilization is not presently more likely than not.

Significant Accounting Policies

The significant accounting policies used in preparation of these interim financial statements are disclosed in the Company's Form 10-K and have not changed significantly since such filing.

Recently Issued Accounting Pronouncements

In January 2017, the FASB issued ASU No. 2018-01, *Business Combinations (Topic 805)* to clarify the definition of a business, which is fundamental in the determination of whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses combinations. The updated guidance requires that in order to be considered a business the integrated set of assets and activities acquired must include, at a minimum, an input and process that contribute to the ability to create output. If substantially all of the fair value of the assets acquired is concentrated in a single identifiable asset or group of similar assets, it is not considered a business, and therefore would not be considered a business combination. The update is effective for fiscal years beginning after December 15, 2018, and interim periods with fiscal years beginning after December 15, 2019, with early adoption permitted. The Company has not determined the impact of this standard and does not plan early adoption of this standard.

In August 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230) Restricted Cash. ASU 2016-18 requires the statement of cash flows to be a reconciliation between beginning and ending cash balances inclusive of restricted cash balances. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017 and is to be

applied using a retrospective transition method to each period presented. The Company adopted this ASU for the year ending December 31, 2018. The adoption of this standard resulted in the removal of changes in Restricted Cash from the Consolidated Statements of Cash Flows of $1,170 and $101,176 for the quarters ended March 31, 2018 and 2017, respectively and inclusion of these amounts as part of the starting and ending cash balances.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, requiring lessees to recognize for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee s obligation to make lease payments arising from a lease, measured on a discounted basis, and (2) a right-of-use (ROU) asset, which is an asset that represents the lessee s right to use, or control the use of, a specified asset for the lease term. The update is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2020. The Company currently anticipates that upon adoption of the new standard, ROU assets and lease liabilities will be recognized in amounts that will be immaterial to the consolidated balance sheets.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (ASU 2014-09),* which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in U.S. GAAP. In July 2015, the FASB voted to defer the effective date of the new standard until fiscal years beginning after December 15, 2017 with early application permitted for fiscal years beginning after December 15, 2016. The Company s adoption of this standard in the first quarter of 2018 did not have a significant impact to the Company s consolidated financial statements.

HEAT BIOLOGICS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. Acquisition of Pelican Therapeutics

On April 28, 2017, the Company consummated the acquisition of 80% of the outstanding equity of Pelican, a related party, and Pelican became a majority owned subsidiary of the Company. Operations of Pelican are included in the consolidated statements of operations and comprehensive loss from the acquisition date. Pelican is a biotechnology company focused on the development and commercialization of monoclonal antibody and fusion protein-based therapies that are designed to activate the immune system. In exchange for 80% of the outstanding capital stock of Pelican on a fully diluted basis, the Company paid to the Pelican Stockholders that executed the Stock Purchase Agreement (the Participating Pelican Stockholders) an aggregate of $0.5 million minus certain liabilities (the Cash Consideration), and issued to the Participating Pelican Stockholders 133,106 shares of the Company s restricted common stock representing 4.99% of the outstanding shares of our common stock on the date of the initial execution of the Purchase Agreement (the Stock Consideration). As of March 31, 2018, the Cash Consideration of approximately $0.3 million was distributed to the Participating Pelican Stockholders and the remainder of approximately $0.2 million for certain Pelican liabilities not satisfied was recognized as other income in the Consolidated Statements of Operations and Comprehensive Loss.

Under the agreement, the Company is also obligated to make future payments based on the achievement of certain clinical and commercialization milestones, as well as low single digit royalty payments and payments upon receipt of sublicensing income:

(1)

$2,000,000 upon Pelican s dosing of the first patient in its first Phase 1 trial for an oncology indication;

(2)

$1,500,000 upon Pelican s dosing of the first patient in its first Phase 2 trial for an oncology indication;

(3)

$3,000,000 upon successful outcome of the first Phase 2 trial for an oncology indication;

(4)

$6,000,000 upon Pelican s dosing of the first patient in its first Phase 3 trial for an oncology indication;

(5)

$3,000,000 upon Pelican s dosing of the first patient in its first Phase 3 trial for a non- oncology indication;

(6)

$7,500,000 upon successful outcome of the first Phase 3 trial for an oncology indication;

(7)

$3,000,000 upon successful outcome of the first Phase 3 trial for a non-oncology indication;

(8)

$7,500,000 upon acceptance of a Biologics License Application (BLA) submission for an oncology indication;

(9)

$3,000,000 upon acceptance of a BLA submission for a non-oncology indication;

(10)

$7,500,000 upon first product indication approval in the United States or Europe for an oncology indication;

(11)

$3,000,000 upon first product indication approval in the United States or Europe for a non-oncology indication.

The fair value of these future milestone payments are reflected in the contingent consideration account under long term liabilities on the balance sheet. The estimated fair value of the contingent consideration was determined using a probability-weighted income approach, at a discount of 7.68% based on the median yield of publicly traded non-investment grade debt of companies in the pharmaceutical industry. The Company performs an analysis on a quarterly basis and as of March 31, 2018, the Company determined the change in the estimated fair value of the contingent consideration was $11,118 for the quarter ended March 31, 2018.

We have recorded the assets purchased and liabilities assumed at their estimated fair value in accordance with FASB ASC Topic 805: *Business Combinations*. The purchase price exceeded the fair value of the net assets acquired resulting in goodwill of approximately $2.2 million. The identifiable indefinite-lived intangible asset consists of in-process R&D of approximately $5.9 million. The estimated fair value of the IPR&D was determined using a probability-weighted income approach, which discounts expected future cash flows to present value. The projected cash flows were based on certain key assumptions, including estimates of future revenue and expenses, taking into account the stage of development of the technology at the acquisition date and the time and resources needed to complete development. The Company utilized corporate bond yield data observed in the bond market to develop the discount rate utilized in the cash flows that have been probability adjusted to reflect the risks of product commercialization, which the Company believes are appropriate and representative of market participant assumptions. Operations of the acquired entity are included in the consolidated statements of operations from the acquisition date.

9

HEAT BIOLOGICS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The purchase price has been allocated to the assets and liabilities as follows:

Aggregate consideration:		
Cash consideration	$	500,000
Stock consideration	$	1,052,000
Contingent consideration	$	2,385,000
Total Consideration	**$**	**3,937,000**
Purchase price allocation:		
Cash acquired	$	31,199
In-process R&D	$	5,866,000
Goodwill	$	2,189,338
Deferred tax liability	$	(2,111,760)
Net liabilities assumed	$	(1,102,777)
Fair value of non-controlling interest	$	(935,000)
Total purchase price	**$**	**3,937,000**

Goodwill is calculated as the difference between the acquisition-date fair value of the consideration transferred and the fair values of the assets acquired and liabilities assumed. The goodwill resulting from this acquisition arises largely from synergies expected from combining the operations. The goodwill is not deductible for income tax purposes.

In-process R&D assets are treated as indefinite-lived until the completion or abandonment of the associated R&D program, at which time the appropriate useful lives will be determined.

The Company calculated the fair value of the non-controlling interest acquired in the acquisition as 20% of the equity interest of Pelican, adjusted for a minority interest discount.

In May 2016, Pelican was awarded a $15.2 million CPRIT Grant from CPRIT for development of Pelican s lead product candidate, PTX-35. The CPRIT Grant is expected to allow Pelican to develop PTX-35 through a 70-patient Phase 1 clinical trial. The Phase 1 clinical trial will be designed to evaluate PTX-35 in combination with other immunotherapies. The CPRIT Grant is subject to customary CPRIT funding conditions including a matching funds

requirement where Pelican will match $0.50 for every $1.00 from CPRIT. Consequently, Pelican is required to raise $7.6 million in matching funds over the three year project.

Pelican has contributed net revenue and net loss of $0.8 million and $0.6 million, respectively, which are included in the Company s consolidated statement of operations for the three months ended March 31, 2018.

HEAT BIOLOGICS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following unaudited pro forma information presents the combined results of operations for the three months ended March 31, 2018 and 2017, as if we had completed the Pelican acquisition at the beginning of fiscal 2017. The pro forma financial information is provided for comparative purposes only and is not necessarily indicative of what actual results would have been had the acquisition occurred on the date indicated, nor does it give effect to synergies, cost savings, fair market value adjustments, immaterial amortization expense and other changes expected to result from the acquisition. Accordingly, the pro forma financial results do not purport to be indicative of consolidated results of operations as of the date hereof, for any period ended on the date hereof, or for any other future date or period.

	Three Months Ended March 31,	
	2018	**2017**
Revenue	$ 752,527	$ 24,240
Net loss	(3,733,227)	(3,629,944)
Net loss: Non-controlling interest	(206,461)	(128,634)
Net loss attributable to Heat Biologics, Inc.	$ (3,526,766)	$ (3,501,310)
Net loss per share attributable to Heat Biologics, Inc. basic and diluted	$ (0.75)	$ (1.24)

3. Fair Value of Financial Instruments

The carrying amount of certain of the Company s financial instruments, including cash and cash equivalents, restricted cash, accounts payable and accrued expenses and other payables approximate fair value due to their short maturities.

As a basis for determining the fair value of certain of the Company s financial instruments, the Company utilizes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level I Observable inputs such as quoted prices in active markets for identical assets or liabilities.

Level II Observable inputs, other than Level I prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level III Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the entire fair value measurement requires management to make judgments and consider factors specific to the asset or liability. The Company's cash equivalents are classified within Level I of the fair value hierarchy.

The following table provides a rollforward of the Company s Level 3 fair value measurements:

	Contingent Consideration
Balance at December 31, 2017	$ 2,609,289
Change in fair value	11,118
Balance at March 31, 2018	$ 2,620,407

HEAT BIOLOGICS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following at:

	March 31, 2018	December 31, 2017
Prepaid manufacturing expense	$ 1,433,010	$ 1,551,597
Prepaid insurance	125,000	218,750
Other prepaid expenses	94,730	87,937
Other current assets		108,973
	$ 1,652,740	$ 1,967,257

5. Property and Equipment

Property and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives, ranging generally from five to seven years. Expenditures for maintenance and repairs are charged to expense as incurred.

Property and equipment consisted of the following:

	March 31, 2018	December 31, 2017
Furniture and fixtures	$ 55,883	$ 55,883
Computers	42,323	41,333