SKINVISIBLE INC
Form 10-Q
November 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

[X] Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended **September 30, 2018**

[ ] Transition Report pursuant to 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from __________ to __________

Commission File Number: **000-25911**

Skinvisible, Inc.

(Exact name of Registrant as specified in its charter)

Nevada	**88-0344219**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6320 South Sandhill Road, Suite 10, Las Vegas, NV 89120
(Address of principal executive offices)

702.433.7154
(Registrant's telephone number)

____

(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

[X] Yes [ ] No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 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 [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company.

[ ] Large accelerated filer	[ ] Accelerated filer
[ ] Non-accelerated filer	[X] Smaller reporting company
	[ ] Emerging growth company

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. [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 144,830,920 common shares as of November 14, 2018

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Our consolidated financial statements included in this Form 10-Q are as follows:

F-1 Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017 (unaudited);

F-2 Consolidated Statements of Operations for the three and nine months ended September 30, 2018 and 2017 (unaudited);

F-3 Consolidated Statements of Cash Flow for the nine months ended September 30, 2018 and 2017 (unaudited);

F-4 Notes to Consolidated Financial Statements.

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the SEC instructions to Form 10-Q. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the interim period ended September 30, 2018 are not necessarily indicative of the results that can be expected for the full year.

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SKINVISIBLE, INC.

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	September 30, 2018	**December 31, 2017**
ASSETS		
Current assets		
Cash	$8,285	$23,318
Accounts receivable	11,401	9,905
Inventory	17,649	26,023
Due from related party	1,145	1,436
Promissory note due from Ovation Science Inc.	—	245,193
Prepaid expense and other current assets	2,500	10,000
Total current assets	40,980	315,875
Equity method investment in Ovation Inc.	—	109,968
Fixed assets, net of accumulated depreciation of $327,373 and $327,191, respectively	177	359
Intangible and other assets:		
Patents and trademarks, net of accumulated amortization of $484,151 and $455,187, respectively	186,919	205,987
Total assets	$228,076	$632,189
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LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities		
Accounts payable and accrued liabilities	$839,402	$612,783
Accounts payable related party	6,166	34,883
Accrued interest payable	1,227,280	1,674,346
Loans from related party	—	17,260
Loans payable	992,000	2,301,875
Convertible notes payable, net of unamortized debt discount of $348 and $6,551, respectively	434,152	1,173,449
Convertible notes payable related party, net of unamortized discount of $884,176 and $1,413,576 respectively	1,804,367	1,577,215
Total current liabilities	5,303,367	7,391,811
Total liabilities	5,303,367	7,391,811
Stockholders' deficit		
Common stock; $0.001 par value; 200,000,000 shares authorized; 144,830,920 and 136,864,035 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	144,832	136,865
Shares payable	1,519,963	61,976
Additional paid-in capital	24,632,952	24,750,544
Accumulated deficit	(31,373,038)	(31,709,007)
Total stockholders' deficit	(5,075,291)	(6,759,622)
Total liabilities and stockholders' deficit	$228,076	$632,189

See Accompanying Notes to Consolidated Financial Statements.

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SKINVISIBLE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ending		Nine Months Ending	
	September 30, 2018	**September 30, 2017**	**September 30, 2018**	**September 30, 2017**
Revenues	$18,675	$61,423	$56,591	$115,679
Cost of revenues	3,550	4,996	20,470	48,457
Gross profit	15,125	56,427	36,121	67,222
Operating expenses				
Depreciation and amortization	9,983	14,520	29,147	42,798
Selling general and administrative	143,778	183,522	451,485	633,970
Total operating expenses	153,761	198,042	480,632	676,768
Loss from operations	(138,636)	(141,615)	(444,511)	(609,546)
Other income and (expense)				
Other income	—	—	4,807	4
Interest expense	(251,417)	(410,654)	(797,002)	(1,093,967)
Gain on sale of Ovation Science Inc.	—	—	595,127	—
Loss on equity method investment	—	—	(21,810)	—
Gain (loss) on extinguishment of debt	1,026,156	—	999,358	—
Total other expense	774,739	(410,654)	780,480	(1,093,963)
Net income (loss)	$636,103	$(552,269)	$335,969	$(1,703,509)
Net income (loss) attributable to noncontrolling interest	$—	$(280)	$—	$(280)
Net income (loss) Skinvisible	$636,103	$(551,989)	$335,969	$(1,703,229)
Basic loss per common share	$0.00	$(0.00)	$0.00	$(0.01)
Basic weighted average common shares outstanding	144,830,920	130,493,434	143,154,712	126,067,878

See Accompanying Notes to Consolidated Financial Statements.

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SKINVISIBLE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Nine Months Ended	
	September 30, 2018	September 30, 2017
Cash flows from operating activities:		
Net loss	$335,969	$(1,703,509)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	29,146	42,798
Stock-based compensation	—	162,634
Gain on sale of Ovation Science Inc.	(595,127)	—
Amortization of debt discount	368,696	614,753
Loss on equity method investment	21,810	—
Imputed interest on Ovation Science loan	4,807	—
Gain on extinguishment of debt	(999,358)	—
Changes in operating assets and liabilities:		
Decrease in inventory	8,374	17,201
Decrease in prepaid assets	7,500	—
Decrease (increase) in accounts receivable	(1,496)	1,912
Increase in accounts payable and accrued liabilities	267,411	497,962
Decrease in due from related party	291	—
Decrease in promissory note from Ovation Science Inc.	245,193	—
Increase in accrued interest	316,647	237,909
Net cash used in operating activities	9,863	(128,340)
Cash flows from investing activities:		
Purchase of fixed and intangible assets	(9,896)	(13,937)
Net cash used in investing activities	(9,896)	(13,937)
Cash flows from financing activities:		
Proceeds from related party loans, net of payments	(10,000)	(49,120)
Proceeds from investments in subsidiary	—	89,545
Payments on notes payable	(5,000)	(28,025)
Proceeds from notes payable	—	15,000
Payments on convertible notes payable		(17,000)
Proceeds from convertible notes payable	—	220,000
Net cash provided by (used in) financing activities	(15,000)	230,400
Net change in cash	(15,033)	88,123
Cash, beginning of period	23,318	3,019
Cash, end of period	$8,285	$91,142
Supplemental disclosure of cash flow information:		
Cash paid for interest	$102,187	$6,175
Cash paid for tax	$—	$—

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Non-cash investing and financing activities:		
Beneficial conversion feature	$—	$571,402
Accrued expenses converted to notes	$—	$178,439
Common stock payable on extinguishment of debts	$1,519,963	$—
Common stock issued on extinguishment of debts	$74,486	$—

See Accompanying Notes to Consolidated Financial Statements.

SKINVISIBLE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. DESCRIPTION OF BUSINESS AND HISTORY

Description of business – Skinvisible, Inc., (referred to as the “Company”) is focused on the development and manufacture and sales of innovative topical, transdermal and mucosal polymer-based delivery system technologies and formulations incorporating its patent-pending formula/process for combining hydrophilic and hydrophobic polymer emulsions. The technologies and formulations have broad industry applications within the pharmaceutical, over-the-counter, personal skincare and cosmetic arenas. Additionally, the Company’s non-dermatological formulations, offer solutions for a broad spectrum of markets women’s health, pain management, and others. The Company maintains executive and sales offices in Las Vegas, Nevada.

History – The Company was incorporated in Nevada on March 6, 1998, under the name of Microbial Solutions, Inc. The Company underwent a name change on February 26, 1999, when it changed its name to Skinvisible, Inc. The Company’s subsidiary’s name of Manloe Labs, Inc. was also changed to Skinvisible Pharmaceuticals, Inc.

On September 9, 2014, the Company formed Kinatri USA Inc., a wholly-owned subsidiary, to market a premium line of scientifically formulated skincare products powered by our patented Invisicare® technology. As part of its strategic focus on revenue generation and creating shareholder value, Kintari USA Inc. products will be sold via network marketing.

The Kintari product portfolio consists of anti-aging products to help fight the signs of aging. These products have been developed using proven anti-aging ingredients with scientific evidence of their effectiveness at reducing the look of fine lines and wrinkles resulting in youthful looking skin. These potent ingredients will be powered by patented Invisicare technology, providing consumers with unique, effective products which the Company believes cannot be duplicated. Additional products will be added to enhance this product line as the Company grows and expands.

On September 26, 2017, the Company purchased 5,750,000 shares of common stock of Ovation Science Inc. (“Ovation”) for $32,286 which at the time of purchase the Company represented 99.9% of the then issued and outstanding common stock. On March 28, 2018 the Company sold its interest in Ovation to officers of the Company for $500,000 which represented a 37.80% interest in Ovation. As of September 30, 2018 Skinvisible Inc. owned 0% of the issued and outstanding Common stock of Ovation.

Skinvisible granted to Ovation, and has assigned its rights under the Canopy Agreement, the exclusive worldwide right to manufacture, distribute, sell, market, sub-license and promote the Products made with cannabis or hemp seed oil including the right to use the subject matter of any Skinvisible patents and trademarks which cover the Products or

Polymer.

Skinvisible, Inc., together with its subsidiaries, shall herein be collectively referred to as the "Company."

2. BASIS OF PRESENTATION AND GOING CONCERN

Basis of presentation – The accompanying unaudited interim financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission, and should be read in conjunction with the audited financial statements and notes thereto contained in the Company's most recent Annual Financial Statements filed with the SEC on Form 10-K. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim period presented have been reflected herein. The results of operations for the interim period are not necessarily indicative of the results to be expected for the full year. Notes to the financial statements which would substantially duplicate the disclosures contained in the audited financial statements for the most recent fiscal period, as reported in the Form 10-K, have been omitted.

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. The Company has incurred cumulative net losses of $31,373,038 since its inception and requires capital for its contemplated operational and marketing activities to take place. The Company's ability to raise additional capital through the future issuances of common stock is unknown. The obtainment of additional financing, the successful development of the Company's contemplated plan of operations, and its transition, ultimately, to the attainment of profitable operations are necessary for the Company to continue operations. The ability to successfully resolve these factors raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements of the Company do not include any adjustments that may result from the outcome of these aforementioned uncertainties.

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SKINVISIBLE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

3. SUMMARY OF SIGNIFICANT POLICIES

This summary of significant accounting policies of Skinvisible, Inc. is presented to assist in understanding the Company's consolidated financial statements. The consolidated financial statements and notes are representations of the Company's management, who are responsible for their integrity and objectivity. These accounting policies conform to accounting principles generally accepted in the United States of America, and have been consistently applied in the preparation of the consolidated financial statements.

Principles of consolidation – The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated.

Use of estimates – The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include estimates used to review the Company's goodwill, impairments and estimations of long-lived assets, revenue recognition on percentage of completion type contracts, allowances for uncollectible accounts, inventory valuation, and the valuations of non-cash capital stock issuances. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable in the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Cash and cash equivalents – For purposes of the statement of cash flows, the Company considers all highly liquid investments and short-term instruments with original maturities of three months or less to be cash equivalents. There are $8,285 and $23,318 in cash and cash equivalents as of September 30, 2018 and December 31, 2017 respectively.

Fair Value of Financial Instruments – The carrying amounts reflected in the balance sheets for cash, accounts payable and accrued expenses approximate the respective fair values due to the short maturities of these items.

As required by the Fair Value Measurements and Disclosures Topic of the FASB ASC, fair value is measured based on a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The three levels of the fair value hierarchy are described below:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

<u>Revenue recognition</u>

<u>Product sales</u> – Revenues from the sale of products (Invisicare® polymers) are recognized when title to the products are transferred to the customer and only when no further contingencies or material performance obligations are warranted, and thereby have earned the right to receive reasonably assured payments for products sold and delivered.

<u>Royalty sales</u> – The Company also recognizes royalty revenue from licensing its patented product formulations only when earned, when no further contingencies or material performance obligations are warranted, and thereby have earned the right to receive and retain reasonably assured payments.

<u>Distribution and license rights sales</u> – The Company also recognizes revenue from distribution and license rights only when earned, when no further contingencies or material performance obligations are warranted, and thereby have earned the right to receive and retain reasonably assured payments.

<u>Costs of Revenue</u> – Cost of revenue includes raw materials, component parts, and shipping supplies. Shipping and handling costs is not a significant portion of the cost of revenue.

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SKINVISIBLE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Accounts Receivable – Accounts receivable is comprised of uncollateralized customer obligations due under normal trade terms requiring payment within 30 days from the invoice date. The carrying amount of accounts receivable is reviewed periodically for collectability. If management determines that collection is unlikely, an allowance that reflects management’s best estimate of the amounts that will not be collected is recorded. Management reviews each accounts receivable balance that exceeds 30 days from the invoice date and, based on an assessment of creditworthiness, estimates the portion, if any, of the balance that will not be collected. As of September 30, 2018, the Company had not recorded a reserve for doubtful accounts. The Company has $389,500 in convertible notes payable which are secured by the accounts receivable of a license agreement the Company has with Women's Choice Pharmaceuticals, LLC on its proprietary prescription product, ProCort®.

Inventory – Substantially all inventory consists of finished goods and are valued based upon first-in first-out ("FIFO") cost, not in excess of market. The determination of whether the carrying amount of inventory requires a write-down is based on an evaluation of inventory.

Goodwill and intangible assets – The Company follows Financial Accounting Standard Board’s (FASB) Codification Topic 350-10 (“ASC 350-10”), “*Intangibles – Goodwill and Other*”. According to this statement, goodwill and intangible assets with indefinite lives are no longer subject to amortization, but rather an annual assessment of impairment by applying a fair-value based test. Fair value for goodwill is based on discounted cash flows, market multiples and/or appraised values as appropriate. Under ASC 350-10, the carrying value of assets are calculated at the lowest level for which there are identifiable cash flows.

Income taxes – The Company accounts for its income taxes in accordance with FASB Codification Topic ASC 740-10, “*Income Taxes*”, which requires recognition of deferred tax assets and liabilities for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Stock-based compensation – The Company follows the guidelines in FASB Codification Topic ASC 718-10 “*Compensation-Stock Compensation*”, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options and employee stock purchases related to an Employee Stock Purchase Plan based on the estimated fair values.

Stock based compensation expense recognized under ASC 718-10 for the nine months ended September 30, 2018 and 2017 totaled $0 and $162,634, respectively.

Earnings (loss) per share – The Company reports earnings (loss) per share in accordance with FASB Codification Topic ASC 260-10 "*Earnings Per Share*", Basic earnings (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares available. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Diluted earnings (loss) per share has not been presented since the effect of the assumed exercise of options and warrants to purchase common shares (common stock equivalents) would have an anti-dilutive effect.

Recently issued accounting pronouncements – The Company has evaluated the all recent accounting pronouncements through ASU 2018-18, and believes that none of them will have a material effect on the Company's financial position, results of operations or cash flows except as discussed below.

Revenue from Contracts with Customers. In May 2014, the FASB issued Accounting Standards Update No. 2014-09 ("ASU 2014-09"), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. Additionally, the new guidance requires enhanced disclosures about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including revenue recognition policies to identify performance obligations, assets recognized from costs incurred to obtain and fulfill a contract, and significant judgments in measurement and recognition.

In July 2015, the FASB made a decision to defer the effective date of the new standard for one year and permit early adoption as of the original effective date. The Company is has reviewed its revenue streams and does not believe that the adoption of this standard has a material effect on its revenue recognition in 2017 or 2018.

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SKINVISIBLE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

4. FIXED ASSETS

Fixed assets consist of the following as of September 30, 2018 and December 31, 2017:

	September 30, 2018	**December 31, 2017**
Machinery and equipment	$48,163	$48,163
Furniture and fixtures	113,635	113,635
Computers, equipment and software	39,722	39,722
Leasehold improvements	12,569	12,569
Lab equipment	113,461	113,461
Total	327,550	327,550
Less: accumulated depreciation	(327,373)	(327,191)
Fixed assets, net of accumulated depreciation	$177	$359

Depreciation expense for the nine months ended September 30, 2018 and 2017 was $182 and $243, respectively.

5. INVENTORY

Inventory consist of the following as of September 30, 2018 and December 31, 2017:

	September 30, 2018	**December 31, 2017**
Shipping and Packing materials	$ 8,632	$ 8,684
Finished Goods	2,898	10,433
Raw Materials	6,119	6,906
Total	$ 17,649	$ 26,023

6. INTANGIBLE AND OTHER ASSETS

Patents and trademarks and other intangible assets are capitalized at their historical cost and are amortized over their estimated useful lives. As of September 30, 2018, intangible assets total $671,070, net of $484,151 of accumulated amortization.

Amortization expense for the nine months ended September 30, 2018 and 2017 was $28,964 and $42,555, respectively.

License and distributor rights (“agreement”) were acquired by the Company in January 1999 and provide exclusive use distribution of polymers and polymer based products. The Company has a non-expiring term on the license and distribution rights. Accordingly, the Company annually assesses this license and distribution rights for impairment and has determined that no impairment write-down is considered necessary as of September 30, 2018.

7. SALE OF EQUITY METHOD INVESTMENT IN OVATION SCIENCES INC.

On September 26, 2017, the Company purchased 5,750,000 shares of common stock of Ovation Science Inc. (“Ovation”) for $32,286 which at the time of purchase the Company represented 99.9% of the then issued and outstanding common stock. Ovation sold shares to investors subsequent to Skinvisible’s’ investment that diluted Skinvisible’s interest to below down to 37.8%.

On March 28, 2018, Skinvisible Inc. sold all 5,750,000 shares of Ovation Science Inc. to its officers and an employee in exchange for an agreement to forgive $500,000 in debt. $240,115 of the debt was convertible debt owed to related parties, accordingly the Company revalued the repurchase of the beneficial conversion feature as of the date of the transaction and recorded a corresponding gain. As of March 28, 2018 the carrying value of the investment in Ovation was $88,158, as a result of the sale the Company recorded a total net gain on sale of its equity method investment of $595,127 related to the sale of the Company’s interest in Ovation.

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SKINVISIBLE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

8. STOCK OPTIONS AND WARRANTS

The following is a summary of option activity during the nine months ended September 30, 2018.

	Number of Shares	**Weighted Average Exercise Price**
Balance, December 31, 2017	10,600,000	$ 0.03
Options granted and assumed	—	—
Options expired	(800,000)	0.04
Options canceled	—	—
Options exercised	—	—
Balance, September 30, 2018	9,800,000	$ 0.03

As of September 30, 2018, all stock options outstanding are exercisable.

Stock warrants -

The following is a summary of warrants activity during the nine months ended September 30, 2018.

	Number of Shares	**Weighted Average Exercise Price**
Balance, December 31, 2017	7,022,975	$ 0.03
Warrants granted and assumed	—	—
Warrants expired	(661,000)	0.03
Warrants canceled	—	—

Warrants exercised	—	—
Balance, September 30, 2018	6,361,975	$ 0.03

All warrants outstanding as of September 30, 2018 are exercisable.

9. NOTES PAYABLE

On May 22, 2013, the Company approved a financing plan to offer accredited investors up to $1,000,000 in secured promissory notes. During the year ended December 31, 2013, the Company entered into twenty-four 9% notes payable to investors and received total proceeds of $1,000,000. The notes are due two years from the anniversary date of execution. The Notes are secured by the US Patent rights granted for the Company's Sunscreen Products: US patent number #8,128,913: "Sunscreen Composition with Enhanced UV-A Absorber Stability and Methods.” During the nine months ending September 30, 2018 the Company made principal payments of $5,000.

On May 19, 2014, the Company approved a financing plan to offer accredited investors up to an additional $1,000,000 in secured promissory notes. During the period from May 19, 2014 to March 31, 2015 the Company entered into twenty-seven 9% notes payable to investors and received total proceeds of $1,000,000. The notes were due two years from the anniversary date of execution. The Notes are secured by the US Patent rights granted for the Company's Sunscreen Products: US patent number #8,128,913: "Sunscreen Composition with Enhanced UV-A Absorber Stability and Methods." $1,000,000 in notes have reached their maturity date.

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SKINVISIBLE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

During the period from April 1, 2015 and September 30, 2015, the Company entered into thirteen additional 9% notes payable to investors and received total proceeds of $326,000. The notes were due two years from the anniversary date of execution. The Notes are secured by the US Patent rights granted for the Company's Sunscreen Products: US patent number #8,128,913: "Sunscreen Composition with Enhanced UV-A Absorber Stability and Methods".

During the quarter ending September 30, 2018, the Company executed agreements with 31 noteholders that participated in the Company’s debt offerings between May 22, 2013 and September 30, 2015. In accordance with the agreements the Company and the investors agreed settle a total of $1,304,875 in outstanding principal and $297,484 in accrued interest in exchange for the issuance of 40,058,976 shares. The Company fair valued the shares issuable on the date each investors signed their respective agreement, as of the September 30, 2018 the Company had not yet issued the shares to the investors, as a result of the transaction and has recorded stock payable of $603,478 and a gain on settlement of debt of $1,017,004.

On January 27, 2016, the Company entered into a 12% unsecured note payable to an investor and received total proceeds of $33,000. The note was due on May 30, 2016. As of September 30, 2018, no payments had been made towards the principal balance.

As of September 30, 2018, $992,000 of the outstanding notes payable were due in less than 12 months and have been classified as current notes payable.

10. RELATED PARTY TRANSACTIONS

During the nine months ended September 30, 2018, $10,000 was advanced by an officer and $20,000 was paid to officer in settlement of advances provided to the Company in the current and prior years. An additional $7,260 in advances were settled as part of the purchase of Ovation Science Inc. (see note 6 for additional details.)

As of September 30, 2018, all other related party notes have been extinguished or re-negotiated as convertible notes. (See note 9 for additional details.)

Ovation license agreement

Skinvisible granted to Ovation, and has assigned its rights under the Canopy Agreement, the exclusive worldwide right to manufacture, distribute, sell, market, sub-license and promote the Products made with cannabis or hemp seed oil including the right to use the subject matter of any Skinvisible patents and trademarks which cover the Products or Polymer. As consideration for the grant of the License and the assignment of the Canopy agreement Ovation agreed to pay Skinvisible Inc. $500,000. $250,000 is due within 90 days of execution of the Agreement and a promissory note for $250,000 is payable upon the earlier of the company completing an initial public offering or March 31, 2018. As of September 30, 2018 Ovation has paid the initial cash payment of $250,000 to Skinvisible Inc. and the $250,000 due under the promissory note.

The note receivable from Ovation did not bear interest per the agreement as a result the Company has imputed interest in accordance with ASC 835-30. The interest has been recorded as a debt discount and is being amortized over the note term. During the nine months ended September 30, 2018, the Company recorded $4,807 in interest income related to the note receivable.

During the year ending December 31, 2017, the Company recorded the full $500,000 in license revenue as earned in accordance with ASU 2016-10.

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SKINVISIBLE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

11. CONVERTIBLE NOTES PAYABLE

Convertible Notes Payable at consists of the following:	**September 30, 2018**	**December 31, 2017**
$1,000,000 face value 9% secured notes payable to investors, due in 2015. At the investor's option until the repayment date, the note and related interest may be converted to shares of the Company's common stock a discount of 90% of the current share price after the first anniversary of the note. The notes are secured by the accounts receivable of a license agreement the Company has with Womens Choice Pharmaceuticals, LLC on its proprietary prescription product, ProCort®. The Company has determined the value associated with the beneficial conversion feature in connection with the notes and interest to be $111,110. The aggregate beneficial conversion feature has been accreted and charged to interest expenses as a financing expense. The beneficial conversion feature is valued under the intrinsic value method. The notes have reach maturity and are now in default, under the notes default provisions the entire balance is now due upon demand.		
During the quarter ending September 30, 2018, the Company executed agreements with 14 noteholders that participated in the Company's convertible debt offering. In accordance with the agreements the Company and the investors agreed settle a total of 745,500$ in outstanding principal and $170,985 in accrued interest in exchange for the issuance of 22,912,124shares.	254,500	1,000,000
As of the September 30, 2018 the Company had not yet issued the shares to the investors The company treated the loan modification as a debt repurchase and as a result of the transaction has recorded stock payable of $916,485.		
Original issue discount	-	-
Unamortized debt discount	-	-
Total, net of unamortized discount	254,500	1,000,000
$135,000 face value 9% unsecured notes payable to investors, due October 26, 2017. At the investor's option until the repayment date, the note and related interest may be converted to shares of the Company's common stock a discount of 90% of the current share price after the first anniversary of the note. The notes are secured by the accounts receivable of a license agreement the Company has with Womens Choice Pharmaceuticals, LLC on its proprietary prescription product, ProCort®. The Company has determined the value associated with the beneficial conversion feature in connection with the notes and interest to be $117,535. The	135,000	135,000

beneficial conversion feature has been accreted and charged to interest expenses as a financing expense. The beneficial conversion feature is valued under the intrinsic value method.

Unamortized debt discount	-	-
Total, net of unamortized discount	135,000	135,000

On February 17, 2016, the Company entered into a convertible promissory note pursuant to which it borrowed $20,000. Interest under the convertible promissory note is 9% per annum, and the principal and all accrued but unpaid interest is due on February 17, 2018. The note is convertible at any time following 90 days after the issuance date at noteholders option into shares of our common stock at a variable conversion price of 90% of the average five day market price of our common stock during the 5 trading days prior to the notice of conversion, subject to adjustment as described in the note. The holder's ability to convert the note, however, is limited in that it will not be permitted to convert any portion of the note if the number of shares of our common stock beneficially owned by the holder and its affiliates, together with the number of shares of our common stock issuable upon any full or partial conversion, would exceed 4.99% of the Company's outstanding shares of common stock.	20,000	20,000

The Company has determined the value associated with the beneficial conversion feature in connection with the notes negotiated on February 27, 2016 to be $14,049. The aggregate beneficial conversion feature feature has been accreted and charged to interest expenses as a financing expense in the amount of $904 during the nine months ended September 30, 2018. The beneficial conversion feature is valued under the intrinsic value method

Unamortized debt discount	-	(904)
Total, net of unamortized discount	20,000	19,096

On August 11, 2016, the Company entered into a convertible promissory note pursuant to which it borrowed $15,000. Interest under the convertible promissory note is 9% per annum, and the principal and all accrued but unpaid interest is due on August 11, 2018. The note is convertible into shares of our common stock at a variable conversion price of 90% of the average market price of our common stock during the 5 trading days prior to the notice of conversion, subject to adjustment as described in the note.	15,000	15,000

The Company has determined the value associated with the beneficial conversion feature in connection with the notes negotiated on August 11, 2016 to be $14,728. The aggregate beneficial conversion feature has been accreted and charged to interest expenses as a financing expense in the amount of $4,499 during the nine months ended September 30, 2018. The beneficial conversion feature is valued under the intrinsic value method

Unamortized debt discount	-	(4,499)

Total, net of unamortized discount	15,000	10,501
On January 27, 2017, the Company entered into a convertible promissory note pursuant to which it borrowed $10,000. Interest under the convertible promissory note is 9% per annum, and the principal and all accrued but unpaid interest is due on January 27, 2019. The note is convertible into shares of our common stock at a variable conversion price of 90% of the average market price of our common stock during the 5 trading days prior to the notice of conversion, subject to adjustment as described in the note.	10,000	10,000
The Company has determined the value associated with the beneficial conversion feature in connection with the notes negotiated on January 27, 2017 to be $2,138. The aggregate beneficial conversion feature has been accreted and charged to interest expenses as a financing expense in the amount of $800 during the nine months ended September 30, 2018. The beneficial conversion feature is valued under the intrinsic value method		
Unamortized debt discount	(348)	(1,148)
Total, net of unamortized discount	9,652	8,852
	$ 434,152	$ 1,173,449

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12. CONVERTIBLE NOTES PAYABLE RELATED PARTY

Convertible Notes Payable Related Party at consists of the following:	**September 30, 2018**	**December 31, 2017**

On October 20, 2016, the Company re-negotiated $982,253 of the unsecured notes payable. Under the modified terms the $982,253 face value notes maturity date was extended until December 31, 2019 and adjusted to the current market prices. At the investor’s option until the repayment date, the note can be converted to shares of the Company’s common stock at a fixed price of $0.01 per share along with additional warrants to purchase one share for every two shares issued at the exercise price of $0.02 per share for six years after the conversion date. In accordance with ASC 470, the Company has determined the value associated with the beneficial conversion feature in connection with the re-negotiated notes on October 20, 2016 to be $982,253. The aggregate beneficial conversion feature has been accreted and charged to interest expenses as a financing expense in the amount of 190,819 during the nine months ended September 30TD VALIGN="bottom" ALIGN="right">62.71 $ 67.06

2014				
First Quarter	$	68.03	$ 62.31	$ 67.17
Second Quarter	$	70.67	$ 66.26	$ 68.37
Third Quarter	$	69.25	$ 64.12	$ 64.12
Fourth Quarter	$	64.51	$ 59.53	$ 60.84
2015				
First Quarter	$	65.99	$ 58.48	$ 64.17
Second Quarter	$	68.42	$ 63.49	$ 63.49
Third Quarter	$	65.46	$ 56.25	$ 57.32
Fourth Quarter	$	62.06	$ 57.50	$ 58.75
2016				
January 1, 2016 to March 9, 2016	$	57.80	$ 51.38	$ 55.95

Market Linked Securities Leveraged Upside Participation

and Contingent Downside

Principal at Risk Securities Linked to the Worst Performing of the iShares® MSCI EAFE ETF and the iShares® MSCI Emerging Markets ETF due September 12, 2019

The iShares MSCI Emerging Markets ETF

The iShares MSCI Emerging Markets ETF seeks investment results that correspond generally to the price and yield performance, before fees and expenses, of the MSCI Emerging Markets Index, an equity index that is designed to measure equity market performance in the global emerging markets. See Description of Exchange Traded Funds The iShares® MSCI Emerging Markets ETF in the accompanying market measure supplement for additional information about the iShares MSCI Emerging Markets ETF.

MSCI, Inc. has announced that, effective with the November 2015 semi-annual index review, companies traded outside of their country of classification (i.e., foreign listed companies) will become eligible for inclusion in the component country indices included in the MSCI Emerging Markets Index. In order for a component country index to be eligible to include foreign listed companies, it must meet the Foreign Listing Materiality Requirement. To meet the Foreign Listing Materiality Requirement, the aggregate market capitalization of all securities represented by foreign listings should represent at least (i) 5% of the free float-adjusted market capitalization of the relevant component country index and (ii) 0.05% of the free-float adjusted market capitalization of the MSCI ACWI Investable Market Index (an index that measures equity performance in both the developed and emerging markets). In connection with the November 2015 semi-annual index review, one of the component country indices included in the MSCI Emerging Markets Index, the MSCI China Index, became eligible to include foreign listed companies. The newly eligible foreign listed securities were added at half their free float-adjusted market capitalization as part of the November 2015 semi-annual index review, and their remaining free float-adjusted market capitalization will be added as part of the May 2016 semi-annual index review.

The information about the MSCI Emerging Markets Index contained herein updates the information included in the accompanying market measure supplement. See Description of Equity Indices The MSCI Emerging Markets IndexSM in the accompanying market measure supplement for additional information about the MSCI Emerging Markets Index

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Historical Information

We obtained the closing prices listed below from Bloomberg Financial Markets without independent verification.

The historical performance of the iShares MSCI Emerging Markets ETF should not be taken as an indication of the future performance of the iShares MSCI Emerging Markets ETF during the term of the securities.

The following graph sets forth the daily closing prices of the iShares MSCI Emerging Markets ETF on each day in the period from January 1, 2006 through March 9, 2016. The closing price on March 9, 2016 was $32.41.

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The iShares MSCI Emerging Markets ETF (Continued)

The following table sets forth the high and low closing prices, as well as end-of-period closing prices, of the iShares MSCI Emerging Markets ETF for each quarter in the period from January 1, 2006 through December 31, 2015 and for the period from January 1, 2016 to March 9, 2016.

	High	Low	Last
2006			
First Quarter	$ 33.59	$ 30.81	$ 33.02
Second Quarter	$ 37.03	$ 27.34	$ 31.23
Third Quarter	$ 33.14	$ 29.20	$ 32.29
Fourth Quarter	$ 38.15	$ 31.80	$ 38.10
2007			
First Quarter	$ 39.53	$ 35.03	$ 38.75
Second Quarter	$ 44.42	$ 39.13	$ 43.82
Third Quarter	$ 50.11	$ 39.50	$ 49.78
Fourth Quarter	$ 55.64	$ 47.27	$ 50.10
2008			
First Quarter	$ 50.37	$ 42.17	$ 44.79
Second Quarter	$ 51.70	$ 44.43	$ 45.19
Third Quarter	$ 44.43	$ 31.33	$ 34.53
Fourth Quarter	$ 33.90	$ 18.22	$ 24.97
2009			
First Quarter	$ 27.09	$ 19.94	$ 24.81
Second Quarter	$ 34.64	$ 25.65	$ 32.23
Third Quarter	$ 39.29	$ 30.75	$ 38.91
Fourth Quarter	$ 42.07	$ 37.56	$ 41.50
2010			
First Quarter	$ 43.22	$ 36.83	$ 42.12
Second Quarter	$ 43.98	$ 36.16	$ 37.32
Third Quarter	$ 44.77	$ 37.59	$ 44.77
Fourth Quarter	$ 48.58	$ 44.77	$ 47.62
2011			
First Quarter	$ 48.69	$ 44.63	$ 48.69
Second Quarter	$ 50.21	$ 45.50	$ 47.60
Third Quarter	$ 48.46	$ 34.95	$ 35.07
Fourth Quarter	$ 42.80	$ 34.36	$ 37.94
2012			

First Quarter	$ 44.76	$ 38.23	$ 42.94
Second Quarter	$ 43.54	$ 36.68	$ 39.19
Third Quarter	$ 42.37	$ 37.42	$ 41.32
Fourth Quarter	$ 44.35	$ 40.14	$ 44.35
2013			
First Quarter	$ 45.20	$ 41.80	$ 42.78
Second Quarter	$ 44.23	$ 36.63	$ 38.57
Third Quarter	$ 43.29	$ 37.34	$ 40.77
Fourth Quarter	$ 43.66	$ 40.44	$ 41.77
2014			
First Quarter	$ 40.99	$ 37.09	$ 40.99
Second Quarter	$ 43.95	$ 40.82	$ 43.23
Third Quarter	$ 45.85	$ 41.56	$ 41.56
Fourth Quarter	$ 42.44	$ 37.73	$ 39.29
2015			
First Quarter	$ 41.07	$ 37.92	$ 40.13
Second Quarter	$ 44.09	$ 39.04	$ 39.62
Third Quarter	$ 39.78	$ 31.32	$ 32.78
Fourth Quarter	$ 36.29	$ 31.55	$ 32.19
2016			
January 1, 2016 to March 9, 2016	$ 32.82	$ 28.25	$ 32.41

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Benefit Plan Investor Considerations

Each fiduciary of a pension, profit-sharing or other employee benefit plan to which Title I of the Employee Retirement Income Security Act of 1974 (ERISA) applies (a plan), should consider the fiduciary standards of ERISA in the context of the plan s particular circumstances before authorizing an investment in the securities. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the plan. When we use the term holder in this section, we are referring to a beneficial owner of the securities and not the record holder.

Section 406 of ERISA and Section 4975 of the Code prohibit plans, as well as individual retirement accounts and Keogh plans to which Section 4975 of the Code applies (also plans), from engaging in specified transactions involving plan assets with persons who are parties in interest under ERISA or disqualified persons under the Code (collectively parties in interest) with respect to such plan. A violation of those prohibited transaction rules may result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for such persons, unless statutory or administrative exemptive relief is available. Therefore, a fiduciary of a plan should also consider whether an investment in the securities might constitute or give rise to a prohibited transaction under ERISA and the Code.

Employee benefit plans that are governmental plans, as defined in Section 3(32) of ERISA, certain church plans, as defined in Section 3(33) of ERISA, and foreign plans, as described in Section 4(b)(4) of ERISA (collectively, non-ERISA arrangements), are not subject to the requirements of ERISA, or Section 4975 of the Code, but may be subject to similar rules under other applicable laws or regulations (similar laws).

We and our affiliates may each be considered a party in interest with respect to many plans. Special caution should be exercised, therefore, before the securities are purchased by a plan. In particular, the fiduciary of the plan should consider whether statutory or administrative exemptive relief is available. The U.S. Department of Labor has issued five prohibited transaction class exemptions (PTCEs) that may provide exemptive relief for direct or indirect prohibited transactions resulting from the purchase or holding of the securities. Those class exemptions are:

PTCE 96-23, for specified transactions determined by in-house asset managers;

PTCE 95-60, for specified transactions involving insurance company general accounts;

PTCE 91-38, for specified transactions involving bank collective investment funds;

PTCE 90-1, for specified transactions involving insurance company separate accounts; and

PTCE 84-14, for specified transactions determined by independent qualified professional asset managers.

In addition, Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code provide an exemption for transactions between a plan and a person who is a party in interest (other than a fiduciary who has or exercises any discretionary authority or control with respect to investment of the plan assets involved in the transaction or renders investment advice with respect thereto) solely by reason of providing services to the plan (or by reason of a relationship to such a service provider), if in connection with the transaction the plan receives no less and pays no more, than adequate consideration (within the meaning of Section 408(b)(17) of ERISA).

Any purchaser or holder of the securities or any interest in the securities will be deemed to have represented by its purchase and holding that either:

no portion of the assets used by such purchaser or holder to acquire or purchase the securities constitutes assets of any plan or non-ERISA arrangement; or

the purchase and holding of the securities by such purchaser or holder will not constitute a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or similar violation under any similar laws.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries or other persons considering purchasing the securities on behalf of or with

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Benefit Plan Investor Considerations (Continued)

plan assets of any plan consult with their counsel regarding the potential consequences under ERISA and the Code of the acquisition of the securities and the availability of exemptive relief.

The securities are contractual financial instruments. The financial exposure provided by the securities is not a substitute or proxy for, and is not intended as a substitute or proxy for, individualized investment management or advice for the benefit of any purchaser or holder of the securities. The securities have not been designed and will not be administered in a manner intended to reflect the individualized needs and objectives of any purchaser or holder of the securities.

Each purchaser or holder of the securities acknowledges and agrees that:

(i) the purchaser or holder or its fiduciary has made and shall make all investment decisions for the purchaser or holder and the purchaser or holder has not relied and shall not rely in any way upon us or our affiliates to act as a fiduciary or adviser of the purchaser or holder with respect to (a) the design and terms of the securities, (b) the purchaser or holder s investment in the securities, or (c) the exercise of or failure to exercise any rights we have under or with respect to the securities;

(ii) we and our affiliates have acted and will act solely for our own account in connection with (a) all transactions relating to the securities and (b) all hedging transactions in connection with our obligations under the securities;

(iii) any and all assets and positions relating to hedging transactions by us or our affiliates are assets and positions of those entities and are not assets and positions held for the benefit of the purchaser or holder;

(iv) our interests may be adverse to the interests of the purchaser or holder; and

(v) neither we nor any of our affiliates is a fiduciary or adviser of the purchaser or holder in connection with any such assets, positions or transactions, and any information that we or any of our affiliates may provide is not intended to be impartial investment advice.

Purchasers of the securities have the exclusive responsibility for ensuring that their purchase, holding and subsequent disposition of the securities does not violate the fiduciary or prohibited transaction rules of ERISA, the Code or any similar law. Nothing herein shall be construed as a representation that an investment in the securities would be appropriate for, or would meet any or all of the relevant legal requirements with respect to investments by, plans or non-ERISA arrangements generally or any particular plan or non-ERISA arrangement.

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United States Federal Tax Considerations

The following is a discussion of the material U.S. federal income and certain estate tax consequences of the ownership and disposition of the securities. It applies to you only if you purchase a security for cash in the initial offering at the issue price, which is the first price at which a substantial amount of the securities is sold to the public, and hold the security as a capital asset within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the Code). It does not address all of the tax consequences that may be relevant to you in light of your particular circumstances or if you are an investor subject to special rules, such as:

a financial institution;

a regulated investment company ;

a tax-exempt entity, including an individual retirement account or Roth IRA ;

a dealer or trader subject to a mark-to-market method of tax accounting with respect to the securities;

a person holding a security as part of a straddle or conversion transaction or who has entered into a constructive sale with respect to a security;

a U.S. holder (as defined below) whose functional currency is not the U.S. dollar; or

an entity classified as a partnership for U.S. federal income tax purposes.

If an entity that is classified as a partnership for U.S. federal income tax purposes holds the securities, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and the activities of the partnership. If you are a partnership holding the securities or a partner in such a partnership, you should consult your tax adviser as to your particular U.S. federal tax consequences of holding and disposing of the securities.

This discussion is based on the Code, administrative pronouncements, judicial decisions and final, temporary and proposed Treasury regulations, all as of the date of this pricing supplement, changes to any of which subsequent to the date of this pricing supplement may affect the tax consequences described herein, possibly with retroactive effect. This discussion does not address the effects of any applicable state, local or non-U.S. tax laws or the potential application of the alternative minimum tax or the Medicare tax on investment income. You should consult your tax adviser concerning the application of U.S. federal income and estate tax laws to your particular situation (including the possibility of alternative treatments of the securities), as well as any tax consequences arising under the laws of any state, local or non-U.S. jurisdiction.

Tax Treatment of the Securities

In the opinion of our counsel, Davis Polk & Wardwell LLP, which is based on current market conditions, a security should be treated as a prepaid derivative contract that is an open transaction for U.S. federal income tax purposes. By purchasing a security, you agree (in the absence of an administrative determination or judicial ruling to the contrary) to this treatment.

Due to the absence of statutory, judicial or administrative authorities that directly address the U.S. federal tax treatment of the securities or similar instruments, significant aspects of the treatment of an investment in the securities are uncertain. We do not plan to request a ruling from the IRS, and the IRS or a court might not agree with the treatment described below. Accordingly, you should consult your tax adviser regarding all aspects of the U.S. federal income and estate tax consequences of an investment in the securities. Unless otherwise indicated, the following discussion is based on the treatment of the securities as prepaid derivative contracts that are open transactions.

Tax Consequences to U.S. Holders

This section applies only to U.S. holders. You are a U.S. holder if you are a beneficial owner of a security that is, for U.S. federal income tax purposes:

- a citizen or individual resident of the United States;

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United States Federal Tax Considerations (Continued)

a corporation created or organized in or under the laws of the United States, any state therein or the District of Columbia; or

an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

Tax Treatment Prior to Maturity. You should not be required to recognize income over the term of the securities prior to maturity, other than pursuant to a sale, exchange or retirement as described below.

Sale, Exchange or Retirement of the Securities. Upon a sale, exchange or retirement of the securities, you should recognize gain or loss equal to the difference between the amount realized on the sale, exchange or retirement and your tax basis in the securities that are sold, exchanged or retired. Your tax basis in the securities should equal the amount you paid to acquire them. Subject to the discussion below concerning the potential application of the constructive ownership rules under Section 1260 of the Code, this gain or loss should be long-term capital gain or loss if at the time of the sale, exchange or retirement you held the securities for more than one year, and short-term capital gain or loss otherwise. Long-term capital gains recognized by non-corporate U.S. holders are generally subject to taxation at reduced rates. The deductibility of capital losses is subject to certain limitations.

Potential Application of Section 1260 of the Code. There is a risk that your purchase of a security may be treated as entry into a constructive ownership transaction, within the meaning of Section 1260 of the Code, with respect to shares of the Funds. In that case, all or a portion of any long-term capital gain you would otherwise recognize in respect of your securities would be recharacterized as ordinary income to the extent such gain exceeded the net underlying long-term capital gain. Any long-term capital gain recharacterized as ordinary income under Section 1260 of the Code would be treated as accruing at a constant rate over the period you held your securities, and you would be subject to an interest charge in respect of the deemed tax liability on the income treated as accruing in prior tax years. Due to the lack of governing authority under Section 1260 of the Code, our counsel is not able to opine as to whether or how Section 1260 of the Code applies to the securities, including how the net underlying long-term capital gain should be computed if Section 1260 does apply. You should consult your tax adviser regarding the potential application of the constructive ownership rule.

Possible Alternative Tax Treatments of an Investment in the Securities

Alternative U.S. federal income tax treatments of the securities are possible that, if applied, could materially and adversely affect the timing and/or character of income, gain or loss with respect to them. It is possible, for example, that the securities could be treated as debt instruments issued by us. Under this treatment, the securities would be governed by Treasury regulations relating to the taxation of contingent payment debt instruments. In that case, regardless of your method of tax accounting for U.S. federal income tax purposes, you would be required to accrue income based on our comparable yield for similar non-contingent debt, determined as of the time of issuance of the securities, in each year that you held the securities, even though we are not required to make any payment with respect to the securities prior to maturity. In addition, any gain on the sale, exchange or retirement of the securities would be treated as ordinary income.

Other possible U.S. federal income tax treatments of the securities could also affect the timing and character of income or loss with respect to the securities. In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of prepaid forward contracts and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; and whether these instruments are or should be subject to the constructive ownership regime, as discussed above. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax

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United States Federal Tax Considerations (Continued)

consequences of an investment in the securities, possibly with retroactive effect. You should consult your tax adviser regarding the possible alternative treatments of an investment in the securities and the issues presented by this notice.

Tax Consequences to Non-U.S. Holders

This section applies only to non-U.S. holders. You are a non-U.S. holder if you are a beneficial owner of a security that is, for U.S. federal income tax purposes:

- an individual who is classified as a nonresident alien;
- a foreign corporation; or
- a foreign estate or trust.

You are not a non-U.S. holder for purposes of this discussion if you are (i) an individual who is present in the United States for 183 days or more in the taxable year of disposition or (ii) a former citizen or resident of the United States. If you are or may become such a person during the period in which you hold a security, you should consult your tax adviser regarding the U.S. federal tax consequences of an investment in the securities.

Sale, Exchange or Retirement of the Securities. You generally should not be subject to U.S. federal income or withholding tax in respect of amounts paid to you, provided that income in respect of the securities is not effectively connected with your conduct of a trade or business in the United States.

If you are engaged in a U.S. trade or business, and if income from the securities is effectively connected with the conduct of that trade or business, you generally will be subject to regular U.S. federal income tax with respect to that income in the same manner as if you were a U.S. holder, unless an applicable income tax treaty provides otherwise. If you are such a holder and you are a corporation, you should also consider the potential application of a 30% (or lower treaty rate) branch profits tax.

Tax Consequences Under Possible Alternative Treatments. If all or any portion of a security were recharacterized as a debt instrument, subject to the discussion below regarding FATCA, any payment made to you with respect to the security generally should not be subject to U.S. federal withholding or income tax, provided that: (i) income or gain in respect of the security is not effectively connected with your conduct of a trade or business in the United States, and (ii) you provide an appropriate IRS Form W-8 certifying under penalties of perjury that you are not a United States person.

Other U.S. federal income tax treatments of the securities are also possible. In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of prepaid forward contracts and similar instruments. Among the issues addressed in the notice is the degree, if any, to which income with respect to instruments such as the securities should be subject to U.S. withholding tax. While the notice requests comments on appropriate transition rules and effective dates, it is possible that any Treasury regulations or other guidance promulgated after consideration of these issues might materially and adversely affect the withholding tax consequences of an investment in the securities, possibly with retroactive effect. If withholding applies to the securities, we will not be required to pay any additional amounts with respect to amounts withheld. Accordingly, you should consult your tax adviser regarding the issues presented by the notice.

U.S. Federal Estate Tax

If you are an individual non-U.S. holder or an entity the property of which is potentially includible in such an individual s gross estate for U.S. federal estate tax purposes (for example, a trust funded by such an individual and with respect to which the individual has retained certain interests or powers), you should note that, absent an applicable treaty exemption, the securities may be treated as U.S. situs property subject to U.S. federal estate tax. If you are such an individual or entity, you should consult your tax adviser regarding the U.S. federal estate tax consequences of investing in the securities.

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United States Federal Tax Considerations (Continued)

Information Reporting and Backup Withholding

Amounts paid on the securities, and the proceeds of a sale, exchange or other disposition of the securities, may be subject to information reporting and, if you fail to provide certain identifying information (such as an accurate taxpayer identification number if you are a U.S. holder) or meet certain other conditions, may also be subject to backup withholding at the rate specified in the Code. If you are a non-U.S. holder that provides an appropriate IRS Form W-8, you will generally establish an exemption from backup withholding. Amounts withheld under the backup withholding rules are not additional taxes and may be refunded or credited against your U.S. federal income tax liability, provided the relevant information is timely furnished to the IRS.

FATCA Legislation

Legislation commonly referred to as FATCA generally imposes a withholding tax of 30% on payments to certain non-U.S. entities (including financial intermediaries) with respect to certain financial instruments, unless various U.S. information reporting and due diligence requirements have been satisfied. An intergovernmental agreement between the United States and the non-U.S. entity s jurisdiction may modify these requirements. This legislation generally applies to certain financial instruments that are treated as paying U.S.-source interest or other U.S.-source fixed or determinable annual or periodical income. If the securities were treated as debt instruments, the withholding regime under FATCA would apply to any amounts treated as interest and to payments of gross proceeds of the disposition (including upon retirement) of the securities. Pursuant to published guidance issued by the IRS, withholding on the payment of gross proceeds of a disposition (other than any amount treated as interest) will be required only for dispositions after December 31, 2018. If withholding applies to the securities, we will not be required to pay any additional amounts with respect to amounts withheld. If you are a non-U.S. holder, or a U.S. holder holding securities through a non-U.S. intermediary, you should consult your tax adviser regarding the potential application of FATCA to the securities.

The preceding discussion constitutes the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of owning and disposing of the securities.

You should consult your tax adviser regarding all aspects of the U.S. federal income and estate tax consequences of an investment in the securities and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.