Islet Sciences, Inc
Form 10-Q
September 11, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: July 31, 2014

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: 001-34048

Islet Sciences, Inc.
(Exact name of registrant as specified in its charter)

Nevada	87-0531751
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

8601 Six Forks Rd, Suite 400
Raleigh, NC 27615
(Address of Principal Executive Office) (Zip Code)
(919) 480-1518
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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	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 September 9, 2014, there were 66,928,724 shares of the issuer's common stock outstanding.

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Part I – Financial Information

Islet Sciences, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets

	July 31, 2014 Unaudited	April 30, 2014 Audited
ASSETS		
CURRENT ASSETS		
Cash	$457,436	$1,141,380
Prepaid expenses	700	700
Total current assets	458,136	1,142,080
OTHER ASSETS		
Intangible asset (Note 3)	1,367,000	1,367,000
Goodwill (Note 3)	2,111,107	2,111,107
Total other assets	3,478,107	3,478,107
TOTAL ASSETS	$3,936,243	$4,620,187
LIABILITIES & STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$3,042,768	$3,271,174
Accrued stock compensation expenses (Note 4)	142,177	433,346
Notes payable - related parties	51,818	91,641
Total current liabilities	3,236,763	3,796,161
Deferred income taxes	547,000	547,000
Total liabilities	3,783,763	4,343,161
Commitments and Contingencies (Note 5)		
STOCKHOLDERS' EQUITY		
Preferred stock, $0.001 par value, 10,000,000 shares authorized; no shares issued and outstanding at July 31, 2014 and April 30, 2014	-	-
Common stock, $0.001 par value, 100,000,000 shares authorized; 66,928,724 and 67,516,253 shares issued and outstanding at July 31, 2014 and April 30, 2014, respectively	66,929	67,517
Additional paid-in capital	20,938,814	20,598,242
Accumulated deficit	(20,853,263)	(20,388,733)
Total stockholders' equity	152,480	277,026
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$3,936,243	$4,620,187

See notes to condensed consolidated financial statements

Islet Sciences, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)

	Three months ended July 31,	
	2014	2013
REVENUE	$-	$-
OPERATING EXPENSES		
General and administrative	405,399	518,439
Research and development	58,331	774,184
Total operating expenses	463,730	1,292,623
LOSS FROM OPERATIONS	(463,730)	(1,292,623)
OTHER INCOME (EXPENSE)		
Interest expense	(800)	(2,231)
Total other expense	(800)	(2,231)
LOSS BEFORE INCOME TAXES	(464,530)	(1,294,854)
INCOME TAX EXPENSE	-	-
NET LOSS	$(464,530)	$(1,294,854)
NET LOSS PER COMMON SHARE, BASIC AND DILUTED	$(0.01)	$(0.02)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING BASIC AND DILUTED	67,069,789	56,715,117

See notes to condensed consolidated financial statements

Islet Sciences, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three months ended July 31,	
	2014	2013
Cash flows from operating activities:		
Net loss	$(464,530)	$(1,294,854)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock based compensation for services and other	78,815	239,000
Derivative liability	-	24,283
Amortization of intangible asset	-	7,601
Change in operating assets and liabilities:		
Accounts payable	(228,406)	988,134
Net cash used in operating activities	(614,121)	(35,836)
Cash flows from investing activities:		
Net cash provided by investing activities	-	-
Cash flows from financing activities:		
Proceeds from notes payable - related parties	-	32,362
Payments on notes payable - related parties	(39,823)	-
Repurchase of stock	(30,000)	-
Net cash (used in) provided by financing activities	(69,823)	32,362
Net decrease in cash	(683,944)	(3,474)
Cash at beginning period	1,141,380	3,589
Cash at end period	$457,436	$115
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$800	$-
Income taxes	$-	$-
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING INFORMATION:		
Shares issued for settlement of accrued expenses	$313,444	$-

See notes to condensed consolidated financial statements

Islet Sciences, Inc. and Subsidiaries
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited Interim financial statements

The accompanying unaudited interim condensed consolidated financial statements have been prepared by the Islet Sciences, Inc. pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). In the opinion of management, all adjustments (which include only normal recurring adjustments except as noted in management's discussion and analysis of financial condition and results of operations) necessary to present fairly the financial position, results of operations and changes in cash flows have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the 2014 financial statements and notes thereto included within the report on Form 10-K filed with the SEC on July 28, 2014. The results of operations for the three months ended July 31, 2014, are not necessarily indicative of the operating results for the full year.

NOTE 1. DESCRIPTION OF BUSINESS

Description of Business

We are a biotechnology company engaged in the research, development, and commercialization of new medicines and technologies for the treatment of metabolic disease and related indications where there is significant measurable unmet medical need. The rising incidence of obesity is associated with many obesity-related health complications, including cardiovascular disease, diabetes, hyperlipidemia, hypertension, nonalcoholic fatty liver disease/steatohepatitis (NAFLD/NASH). This constellation is also recognized as the metabolic syndrome and is characterized by underlying insulin resistance. These various diseases have interrelated risk factors and markers, such that often treatment of one disease may allow new therapies and opportunities for treatment in one of these related indications. Our focused effort to develop new therapies and related diagnostics for metabolic related diseases establishes us as a recognized leader in a large and growing market.

In March 2014, the Company announced it had signed a binding letter of intent to enter into a merger agreement with and acquire Brighthaven Ventures, LLC d/b/a BHV Pharma ("BHV") a privately held pharmaceutical company developing the SGLT2 inhibitor remogliflozin etabonate ("remogliflozin") for type 2 diabetes and non-alcoholic steatohepatitis ("NASH"). Remogliflozin is currently in phase II clinical development.

Islet Sciences was incorporated under the name One E-Commerce Corporation on September 14, 1994 in the State of Nevada. Effective February 23, 2012, the Company changed its name to Islet Sciences, Inc. On March 14, 2012, Islet Sciences acquired DiaKine Therapeutics, Inc., a Delaware corporation ("DTI"). Islet Sciences together with its subsidiaries, Islet Sciences Inc., a Delaware corporation ("ISI"), and DTI are referred to as the Company.

Going Concern

The condensed consolidated financial statements have been prepared assuming the Company will continue as a going concern. This contemplates the continuity of operations, realization of assets, and liquidation of liabilities in the normal course of business. Since inception, the Company has incurred operating losses of $20,853,263. As of July 31, 2014, the Company had cash of $457,436. Further, the Company has incurred net losses of $464,530 and negative operating cash flows of $614,121 for the three months ended July 31, 2014. The condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

The Company’s future cash requirements will depend on many factors, including continued scientific progress in its research and development programs, the scope and results of pre-clinical and clinical trials, the time and costs involved in obtaining regulatory approvals, the costs involved in filing, prosecuting and enforcing patents, competing technological and market developments, and the cost of product commercialization. The Company does not expect to generate a positive cash flow from operations at least until the commercial launch of its first product and possibly later given the expected spending for research and development programs and the cost of commercializing product candidates. The Company’s continued operations will depend on its ability to raise funds through various potential sources such as debt and equity financing. There can be no assurance that such capital will be available on favorable terms or at all. If the Company is unable to raise additional capital, the Company will likely be forced to curtail its desired development activities, which would delay the development of its product candidates.

Merger with BHV Pharma

In March 2014, the Company announced it had signed a binding letter of intent to enter into a merger agreement with and acquire Brighthaven Ventures, LLC, a North Carolina limited liability company, d/b/a BHV Pharma (“BHV”) a privately held pharmaceutical company developing the SGLT2 inhibitor remogliflozin etabonate (“remogliflozin”) for type 2 diabetes and non-alcoholic steatohepatitis (“NASH”). Remogliflozin is currently in phase II clinical development. In exchange for 100% ownership of BHV, the Company will issue 30 million shares of its common stock to the holders of BHV units. Additional shares of common stock will be issued upon successful completion of development, regulatory and commercial milestones associated with the remogliflozin program. James Green and William Wilkison, the current members of BHV, are the Chief Executive Officer ("CEO") and the Chief Operating Officer ("COO"), of the Company, respectively, and are the sole members of BHV.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

The accompanying condensed consolidated financial statements include the accounts of Islet Sciences and its wholly-owned subsidiaries, ISI and DTI. All significant intercompany balances have been eliminated.

Use of Estimates

The preparation of condensed 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 and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include the recoverability of long-lived assets, the valuation of intangible assets and goodwill, the valuation of common stock, warrants and stock options and the valuation of deferred tax assets. Actual results could differ from those estimates.

Concentration of Credit Risk

The Company maintains its cash balances at a credit-worthy financial institution and management believes the risk of loss of cash balances to be low. The Company's cash balances were not fully insured at July 31, 2014.

Intangible Assets

Intangible assets represent a patent acquired from a third party, which is recorded at cost and amortized over the remaining life of the patent. This patent was fully impaired and written off during the year ended April 30, 2014. Intangible assets also include the purchase of DiaKine Therapeutics, Inc. patent portfolio and know-how as in-process research and development ("IPR&D"). IPR&D has an indefinite life and is not amortized until completion and development of the project, at which time the IPR&D becomes an amortizable asset. If the related project is not completed in a timely manner or the project is terminated or abandoned, the Company may have an impairment related to the IPR&D, calculated as the excess of the asset's carrying value over its fair value. The intangible assets with estimable useful lives are amortized on a straight line basis over their respective estimated useful lives to their estimated residual values. This method of amortization approximates the expected future cash flow generated from their use. Definite lived intangibles are reviewed for impairment in accordance with FASB ASC 360, Property, Plant and Equipment (FASB ASC 360).

Goodwill

Goodwill represents the excess of the purchase price over the estimated fair value of the identifiable assets acquired and liabilities assumed in business acquisitions. Goodwill is reviewed at least annually for impairment in the fourth quarter of the fiscal year, at the Company level, which is the sole reporting unit, and at any other time at which events occur or circumstances indicate that the carrying amount of goodwill may exceed its fair value. Such indicators would include a significant reduction in the Company's market capitalization, a decrease in operating results or deterioration in the Company's financial position.

Impairment of Long-Lived Assets

The Company applies the provisions of FASB ASC 360-10, Property, Plant and Equipment (FASB ASC 360-10), where applicable to all long lived assets. FASB ASC 360-10 addresses accounting and reporting for impairment and disposal of long-lived assets. The Company periodically evaluates the carrying value of long-lived assets to be held and used in accordance with FASB ASC 360-10. FASB ASC 360-10 requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair market value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair market values are reduced for the cost of disposal.

Loss Per Share Data

Basic loss per share is calculated based on the weighted average common shares outstanding during the period. Diluted earnings per share also give effect to the dilutive effect of restricted common stock and warrants. The Company does not present diluted earnings per share for years in which it incurred net losses as the effect is anti-dilutive.

At July 31, 2014, there are no unvested shares of restricted common stock and warrants to exercise 12,430,798 shares of common stock were outstanding, but were not included in the computation of diluted earnings per share as their

effect would be anti-dilutive. At July 31, 2013, 1,368,750 unvested shares of restricted common stock and warrants to exercise 6,366,794 shares of common stock were outstanding, but were not included in the computation of diluted earnings per share as their effect would be anti-dilutive

Research and Development

Research and development expenses consist of expenses incurred in performing research and development activities including salaries and benefits, facilities and other overhead expenses, contract services and other outside expenses. Research and development costs are charged to operations when incurred.

Stock Based Compensation

Stock awards

FASB ASC 718, Compensation-Stock Compensation (FASB ASC 718), requires the fair value of all share-based payments to employees, including grants of stock options, to be recognized in the condensed consolidated statement of operations over the requisite service period.FASB ASC 718 requires all share based payments to employees, including grants of employee stock option, to be recognized in operating results as compensation expense based on fair value over the requisite service period of the awards. The Company determines the fair value of share-based awards using the Black-Scholes option-pricing model which uses both historical and current market data to estimate fair value. The method incorporates various assumptions such as the risk-free interest rate, expected volatility, expected dividend yield, expected forfeiture rate and expected life of the options. As allowed by FASB ASC 718, for companies with a short period of publicly traded stock history, the Company's estimate of expected volatility is based on the average volatilities of a sampling of three companies with similar attributes to the Company, including industry, stage of life cycle, size and financial leverage. The risk-free rate for periods within the contractual life of the stock options is based on the U.S. Treasury yield curve in effect at the time of grant valuation. The expected term of options granted is derived using the "simplified method" which computes expected term as the average of the sum of the vesting term plus the contract term as historically the Company had limited activity surrounding its options. The Company has not issued stock options for nonemployees.

Warrants

Warrants granted to service providers are normally valued at the fair value of the instrument on the date of the grant (grant date) and are recognized in the condensed consolidated statement of operations over the requisite service period or when they vest. When the requisite service period precedes the grant date and a market condition exists in the warrant, the Company values the warrant using the Black-Scholes option pricing model. Warrants issued in connection with capital raises are normally valued at the fair value of the instrument on the date of the grant (grant date) and valued for disclosure purposes if they meet all the criteria under FASB ASC 718. The Company values these warrant using the Black-Scholes option pricing model as well. As allowed by FASB ASC 718, for companies with a short period of publicly traded stock history, the Company's estimate of expected volatility is based on the average volatilities of a sampling of three companies with similar attributes to the Company, including industry, stage of life cycle, size and financial leverage. The risk-free rate for periods within the contractual life of the warrant is based on the U.S. Treasury yield curve in effect at the time of grant valuation.

Segment Reporting

The Company currently operates in a single operating segment. In addition, financial results are prepared and reviewed by management as a single operating segment. The Company continually evaluates its operating activities and the method utilized by management to evaluate such activities and will report on a segment basis if and when appropriate to do so.

Reclassification

Certain prior period balances have been reclassified to conform to current period presentation.

Recent Pronouncements

In May 2014, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers," which will supercede nearly all existing revenue recognition guidance under GAAP. ASU No. 2014-09 provides that an entity recognize

revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgements and changes in judgements, and assets recognized from costs incurred to obtain or fulfill a contract. ASU No. 2014-09 allows for either full retrospective or modified retrospective adoption and will become efective for the Company in the first quarter of 2018. The Company is a development stage entity and will evaluate the effects of this update on its Condensed consolidated financial statements when it generates revenues.

In June 2014, the FASB issued ASU No. 2014-10, which eliminated certain financial reporting requirements of companies previously identified as “Development Stage Entities” (Topic 915). The amendments in this ASU simplify accounting guidance by removing all incremental financial reporting requirements for development stage entities. The amendments also reduce data maintenance and, for those entities subject to audit, audit costs by eliminating the requirement for development stage entities to present inception-to-date information in the statements of income, cash flows, and shareholder equity. Early application of each of the amendments is permitted for any annual reporting period or interim period for which the entity’s financial statements have not yet been issued (public business entities) or made available for issuance (other entities). Upon adoption, entities will no longer present or disclose any information required by Topic 915. The Company has adopted this standard in the current quarter.

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concen ("ASU 2014-15"). ASU 2014-15 will explicitly require management to assess an entity's ability to continue as a going concern, and to provide related footnote disclosure in certain circumstances. The new standard will be effective for all entities in the first annual period ending after December 15, 2016. Earlier adoption is permitted. The Company is currently evaluating the impact of the adoption of ASU 2014-15.

NOTE 3. INTANGIBLE ASSET AND GOODWILL

On March 14, 2012, the Company acquired the IPR&D from DiaKine Therapeutics, Inc. As of July 31, 2014, the $1.4 million of acquired IPR&D is classified as indefinite life asset and is not being amortized. In conjunction with this acquisition, the Company recognized $2.1 million of goodwill. The Company has not identified any triggering events at July 31, 2014 that would require additional analysis for potential impairment of its intangible assets and goodwill.

NOTE 4. STOCKHOLDERS' EQUITY

On July 31, 2014, an aggregate of 123,750 shares of its common stock issuable to members of the Board of Directors fully vested. The Company valued these shares based on the July 31, 2014 share price of $0.18 per share, or $22,275, and recorded it to accrued stock compensation expense until the common stock is issued. The Company has included these costs as general and administrative expenses within the condensed consolidated statements of operations for the three months ended July 31, 2014.

On June 4, 2014, the Company issued 14,500 shares of common stock to a consultant pursuant to a settlement agreement. The Company valued these shares at $48,000 and were included in accrued stock compensation expense at April 30, 2014.

On May 9, 2014, the Company issued 742,500 shares of common stock, previously vested and included in accrued stock compensation expense, to the members of the Board of Directors as part of the approved compensation plan.

On October 30, 2013, as part of the employee agreements with the new CEO and COO, the Board of Directors granted each of them stock options to purchase 1.5 million shares of Company common stock at an exercise price of $0.265. The stock options will vest as follows: (i) 500,000 shares vesting on the 91st day from the option grant date, (ii) 1,000,000 shares vesting in equal installments of 200,000 on the last day of each 90 day period starting from the 91st day after the option grant date. For the three months ended July 30, 2014, 200,000 stock options vested for each the CEO and COO. The Company recorded stock-based compensation of $54,886 for the vested stock options as general and administrative expenses within the condensed consolidated statements of operations for the three months ended July 31, 2014.

On May 22, 2014, as part of the employee agreement with the new Chief Financial Officer, the Board of Directors granted stock options to purchase 300,000 shares of Company common stock at an exercise price of $0.23. The stock options will vest over 48 months. The Company recorded stock-based compensation of $1,655 for the vested stock options as general and administrative expenses within the condensed consolidated statements of operations for the three months ended July 31, 2014.

NOTE 5. COMMITMENTS AND CONTINGENCIES

Licenses

On May 2, 2012, the Company, entered into a license agreement with the Yale University ("Yale"). Under the agreement, the Company received exclusive license to the technology patented by Yale. In consideration of the license granted under the agreement, the Company paid Yale a license issue royalty of $10,000 (plus a $10,000 annual renewal fee) and issued 20,000 shares of its common stock, and agreed to pay certain milestones royalties by issuing an aggregate of 160,000 shares of common stock. The Company also agreed to pay to Yale a royalty on net sales. The agreement will expire automatically, on a country-by-country basis, on the date on which the last of the claims of the subject patents expires. The agreement can be terminated by Yale if the Company defaults on its obligations under the agreement and fails to cure such default within 60 days of a written notice by Yale. The Company can terminate the agreement upon a six month notice subject to payment of all amounts due to Yale under the agreement. During the three months ended July 31, 2014 and 2013, the Company expensed approximately $0 and $39,000, respectively, within the consolidated statements of operations.

On July 23, 2012, the Company entered into a licensing agreement with the Winthrop University Hospital ("Winthrop") to license certain patents and technology. In consideration of the license granted under the agreement, the Company

agreed to pay to Winthrop a license issue royalty of $10,000 (plus a $10,000 annual renewal fee) and issue 20,000 shares of its common stock, and to pay certain milestones royalties by issuing an aggregate of 160,000 shares of common stock. The Company also agreed to pay to Winthrop a royalty on net sales. The agreement will expire automatically, on a country-by-country basis, on the date on which the last of the claims of the subject patents expires. It can be terminated by Winthrop if the Company defaults on its obligations under the agreement and fails to cure such default within 60 days of a written notice by the university. The Company can terminate the agreement upon a six month notice subject to payment of all amounts due Winthrop under the agreement. During the three months ended July 31, 2014 and 2013, the Company expensed as research and development expense within the consolidated statements of operations of approximately $0 and $62,000 respectively, related to this contract. The Company is currently in default regarding its payment obligations under the foregoing license and research agreements.

Related Party Transactions

The Company borrowed $25,880 from its former CEO. Promissory notes were issued for these amounts. Repayments of $5,000 were made during the three months ended July 31, 2014. The remaining balance at July 31, 2014 was $8,475.

During the year ended April 30, 2014, one of the Company's Board Members loaned the Company a total of $74,531 at a 6.5% interest rate. A promissory note was issued for this amount. Repayments of $20,000 were made during the three months ended July 31, 2014, which included $800 of accrued interest. The remaining balance at July 31, 2014 was $43,343.

A contractor of the Company loaned the Company $15,623. Payments of $15,623 have been made during the three months ended July 31, 2014. The remaining balance at July 31, 2014 was $0.

Litigation

In April 2012, Sand Dollar Partners, LLC, a shareholder of the Company filed a complaint in the Superior Court of Arizona, Pima County against, among other parties, ISI, our wholly-owned subsidiary, John Steel, our former CEO and director, and Jonathan Lakey, our former director. In 2010, Sand Dollar invested $357,000 in ISI through the purchase of a convertible promissory note which was converted into 3,591,729 shares of the Company's common stock. The plaintiff contends that it was entitled to issuance of additional shares and nomination of one board member.

On October 25, 2013, the Company entered into a settlement agreement with Sand Dollar Partners, LLC. At a hearing on February 21, 2014, the Company and Sand Dollar agreed to amend the settlement agreement whereby, Sand Dollar placed in escrow all of the Company's common stock it held and retained a broker dealer to sell sufficient shares to receive $500,000 in cash and to pay fees to the broker dealer. Additionally, the Company agreed to issue 130,000 warrants that will vest over the next three years and make a $30,000 payment on May 15, 2014. The Company issued these warrants and made the $30,000 payment on May 15, 2014 fully completing the settlement. The broker dealer sold 2,247,200 shares of the Company's escrowed stock to settle the obligation and the Company has received back the remaining 1,344,529 shares of its common stock. The sale of these shares and the return of the remaining shares had no impact on the condensed consolidated financial statements.

On April 25, 2014, Progenitor Cell Therapy, LLC ("PCT"), filed a lawsuit against the Company in the United States District Court for the District of New Jersey (Case No. 2:14-cv-02658-SDW-MCA). PCT's complaint asserts various claims, including breach of contract and unjust enrichment, based on the alleged failure of the Company to pay for services and goods provided by PCT under a January 10, 2012 letter agreement. PCT seeks an unspecified amount of compensatory and other damages, plus interest and costs. The Company filed an answer to the complaint on June 24, 2014 denying all liability, including on the grounds that the January 10, 2012 letter agreement is unenforceable and PCT failed to provide the goods and services it stated it would provide. In connection with its answer to PCT's complaint, the Company filed a counterclaim against PCT and a third-party complaint against NeoStem to seek, among other things, (i) a declaration that the January 10, 2012 letter agreement is unenforceable, (ii) monetary damages and (iii) rescission of equity securities the Company previously issued to NeoStem. The Company intends to vigorously defend the claims by PCT and prosecute its claims against PCT and NeoStem. As the lawsuit is at an early stage, the Company cannot at this time estimate the possible loss or range of loss, if any, that may result from this lawsuit.

In July 2012, a complaint was filed against the Company and John Steel in the United States District Court for the District of Utah, Central Division for infringement and misappropriation of a patent. The plaintiffs contend that they were the actual purchasers of the MicroIslet patent out of MicroIslet's bankruptcy proceedings in 2009 and that the

respective intellectual property rights have been never assigned to either ISI or the Company. As a result, they allege that the Company's claim to the ownership of the MicroIslet patent based on the assignment of the patent by its founders is baseless. The complaint sought monetary damages including punitive damages of at least $12 million, costs, attorneys' fees, and declaratory judgment. On January 8, 2013, the Court dismissed the plaintiff's action for lack of recoverable damages. The plaintiffs refiled their claim and the Company has filed a motion with the Court for dismissal. The Company believes the plaintiffs' claims to be without merit and will continue to vigorously defend against this action and has determined that it is unlikely any damages will be paid.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.

CERTAIN STATEMENTS IN THIS REPORT, INCLUDING STATEMENTS IN THE FOLLOWING DISCUSSION, ARE WHAT ARE KNOWN AS "FORWARD-LOOKING STATEMENTS", WHICH ARE BASICALLY STATEMENTS ABOUT THE FUTURE. FOR THAT REASON, THESE STATEMENTS INVOLVE RISK AND UNCERTAINTY SINCE NO ONE CAN ACCURATELY PREDICT THE FUTURE. WORDS SUCH AS "PLANS", "INTENDS", "WILL", "HOPES", "SEEKS", "ANTICIPATES", "EXPECTS" AND THE LIKE OFTEN IDENTIFY SUCH FORWARD-LOOKING STATEMENTS, BUT ARE NOT THE ONLY INDICATION THAT A STATEMENT IS A FORWARD-LOOKING STATEMENT. SUCH FORWARD-LOOKING STATEMENTS INCLUDE STATEMENTS CONCERNING OUR PLANS AND OBJECTIVES WITH RESPECT TO THE PRESENT AND FUTURE OPERATIONS OF THE COMPANY, AND STATEMENTS WHICH EXPRESS OR IMPLY THAT SUCH PRESENT AND FUTURE OPERATIONS WILL OR MAY PRODUCE REVENUES, INCOME OR PROFITS. NUMEROUS FACTORS AND FUTURE EVENTS COULD CAUSE THE COMPANY TO CHANGE SUCH PLANS AND OBJECTIVES OR FAIL TO SUCCESSFULLY IMPLEMENT SUCH PLANS OR ACHIEVE SUCH OBJECTIVES, OR CAUSE SUCH PRESENT AND FUTURE OPERATIONS TO FAIL TO PRODUCE REVENUES, INCOME OR PROFITS. THEREFORE, THE READER IS ADVISED THAT THE FOLLOWING DISCUSSION SHOULD BE CONSIDERED IN LIGHT OF THE DISCUSSION OF RISKS AND OTHER FACTORS CONTAINED IN THIS REPORT ON FORM 10-Q AND IN THE COMPANY'S OTHER FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION. NO STATEMENTS CONTAINED IN THE FOLLOWING DISCUSSION SHOULD BE CONSTRUED AS A GUARANTEE OR ASSURANCE OF FUTURE PERFORMANCE OR FUTURE RESULTS.

Unless the context otherwise requires, the "Company", "we," "us," and "our," refer to (i) Islet Sciences, Inc., a Nevada corporation; (ii) Islet Sciences, Inc., a Delaware corporation ("ISI"), and (iii) DiaKine Therapeutics, Inc. ("DTI"), a Delaware corporation.

Overview

Islet Sciences was incorporated under the name One E-Commerce Corporation on September 14, 1994 in the State of Nevada. Effective February 23, 2012, the Company changed its name to Islet Sciences, Inc. On March 14, 2012, Islet Sciences acquired DiaKine Therapeutics, Inc., a Delaware corporation ("DTI"). Islet Sciences together with its subsidiaries, Islet Sciences Inc., a Delaware corporation ("ISI"), and DTI are referred to as the Company.

We are a biotechnology company engaged in the research, development, and commercialization of new medicines and technologies for the treatment of metabolic disease and related indications where there is significant measurable unmet medical need. The rising incidence of obesity is associated with many obesity-related health complications, including cardiovascular disease, diabetes, hyperlipidemia, hypertension, nonalcoholic fatty liver disease/steatohepatitis (NAFLD/NASH). This constellation is also recognized as the metabolic syndrome and is characterized by underlying insulin resistance. These various diseases have interrelated risk factors and markers, such that often treatment of one disease may allow new therapies and opportunities for treatment in one of these related indications. Our focused effort to develop new therapies and related diagnostics for metabolic related diseases establishes us as a recognized leader in a large and growing market.

Recent Developments

In March 2014, the Company announced it had signed a binding letter of intent to enter into a merger agreement with and acquire Brighthaven Ventures, LLC d/b/a BHV Pharma ("BHV") a privately held pharmaceutical company developing the SGLT2 inhibitor remogliflozin etabonate ("remogliflozin") for type 2 diabetes and non-alcoholic steatohepatitis ("NASH"). Remogliflozin is currently in phase II clinical development.

Going Concern

The condensed consolidated financial statements included elsewhere in this current report on Form 10-Q have been prepared assuming we will continue as a going concern. We incurred operating losses and negative operating cash flows through July 31, 2014, and as of that date our cash position was $457,436. We have incurred net losses of $464,530 and negative operating cash flows of $614,121 for the three months ended July 31, 2014. The condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Our future cash requirements will depend on many factors, including continued scientific progress in our research and development programs, the scope and results of pre-clinical and clinical trials, the time and costs involved in obtaining regulatory approvals, the costs involved in filing, prosecuting and enforcing patents, competing technological and market developments, and the cost of product commercialization. We do not expect to generate a positive cash flow from operations at least until the commercial launch of our first product and possibly later given the expected spending for research and development programs and the cost of commercializing product candidates. Our current plans involve raising additional capital and renogotiating contracts, both of which are ongoing. Although we have had success in raising capital in the past, there cannot be any assurance that this will success will continue in future periods which is necessary to fund our future capital requirements, research, and operations.

Results of Operations

Three Months Ended July 31, 2014 and 2013

There were no revenues for the three months ended July 31, 2014 and 2013.

During the three months ended July 31, 2014, general and administrative expenses totaled $405,399 compared to $518,439 for the three months ended July 31, 2013. The primary reason for the reduction in general and administrative expenses was due to the reduced operating activity during the current quarter. General and administrative expenses for the three months ended July 31, 2014 included approximately $271,000 for professional fees, approximately $57,000 for stock compensation for the Board of Directors and employees, and approximately $69,000 for employee payroll and benefits. General and administrative expenses for the three months ended July 31, 2013 included approximately $221,000 for professional fees, approximately $99,000 for stock compensation for the Board of Directors, and approximately $81,000 for consulting fees.

During the three months ended July 31, 2014, research and development expenses totaled $58,331 compared to $774,184, for the three months ended July 31, 2013. The primary reason for the $715,853 decrease in research and development expenses was the substantial completion or curtailment of various supply agreements, studies and various agreements with universities totaling approximately $482,000. Also, there was a reduction of expenses for subcontractors and compensation for the Scientific Advisory Board of approximately $234,000.

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Liquidity and Capital Resources

We have historically financed our operations primarily through the issuance of common stock and debt. We have not generated revenues from sales of products and have had losses since inception. We anticipate that we will incur substantial additional operating losses in the future as we progress in our research and development programs. We do not expect to produce revenues from product sales for the foreseeable future so our revenues will be limited to research grants we are able to obtain.

Management has determined that to allow us to continue our operations we therefore will need additional funding, either through equity or debt financings or partnering arrangements, or we will be forced to curtail or cease operations. As of July 31, 2014, we had $457,436 cash on hand. We intend to raise additional capital from investors to finance our operations. There can be no assurance that such capital will be available on favorable terms or at all. If we are unable to raise additional capital, we may be forced to curtail our operations.

Operating Activities

During the three month periods ending July 31, 2014 and 2013, cash used in operating activities was $614,121 and $35,836, respectively. The increase of cash used in operating activities is primarily attributable to the losses incurred, a reduction of accounts payable and a reduction of accrued stock compensation expense.

Financing Activities

We have financed our operating activities primarily from the proceeds of private placements of common stock. During the three months ended July 31, 2014, there was no cash provided by financing activities from the private placement of common stock.

Critical Accounting Policies

Our significant accounting policies are disclosed in Note 2 to our condensed consolidated financial statements. Certain of our policies require the application of management judgment in making estimates and assumptions which affect the amounts reported in the financial statements and disclosures made in the accompanying notes. Those estimates and assumptions are based on historical experience and various other factors deemed to be applicable and reasonable under the circumstances. The use of judgment in determining such estimates and assumptions is by nature, subject to a degree of uncertainty. Accordingly, actual results could differ from the estimates made.

Off-Balance Sheet Arrangements

We do not have off-balance sheet arrangements, financings, or other relationships with unconsolidated entities or other persons, also known as "special purpose entities" (SPEs).

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures.

The Securities and Exchange Commission defines the term “disclosure controls and procedures” to mean controls and other procedures of an issuer that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be

disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the issuer’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. The Company maintains such a system of controls and procedures in an effort to ensure that all information which it is required to disclose in the reports it files under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified under the SEC's rules and forms and that information required to be disclosed is accumulated and communicated to principal executive and principal financial officers to allow timely decisions regarding disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this report.

In our Annual Report, we indicated that we had a material weakness in our internal control over financial reporting due to the lack of sufficient controls in place to ensure that all disclosures required were addressed in our financial statements, lack of an internal audit function and lack of segregation of duties, all of which may result in ineffective oversight in the establishment and monitoring of required internal controls and procedures. Management believes that the appointment of additional management personnel will lead to increased oversight over the accounting and reporting function. As soon as we can raise sufficient capital or our operations generate sufficient cash flow, we will hire additional personnel to handle our accounting and reporting functions. We have not had time to address these issues nor have we added any additional personnel.

Changes in Internal Control over Financial Reporting.

There have been no changes in our internal control over financial reporting identified in connection with the evaluation that occurred during our last fiscal quarter that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In April 2012, Sand Dollar Partners, LLC, a shareholder of the Company filed a complaint in the Superior Court of Arizona, Pima County against, among other parties, ISI, our wholly-owned subsidiary, John Steel, our former CEO and director, and Jonathan Lakey, our former director. In 2010, Sand Dollar invested $357,000 in ISI through the purchase of a convertible promissory note which was converted into 3,591,729 shares of the Company's common stock. The plaintiff contends that it was entitled to issuance of additional shares and nomination of one board member.

On October 25, 2013, the Company entered into a settlement agreement with Sand Dollar Partners, LLC. At a hearing on February 21, 2014, the Company and Sand Dollar agreed to amend the settlement agreement whereby, Sand Dollar placed in escrow all of the Company's common stock it held and retained a broker dealer to sell sufficient shares to receive $500,000 in cash and to pay fees to the broker dealer. Additionally, the Company agreed to issue 130,000 warrants that will vest over the next three years and make a $30,000 payment on May 15, 2014. The Company issued these warrants and made the $30,000 payment on May 15, 2014 fully completing the settlement. The broker dealer sold 2,247,200 shares of the Company's escrowed stock to settle the obligation and the Company has received back the remaining 1,344,529 shares of its common stock. The sale of these shares and the return of the remaining shares had no impact on the condensed consolidated financial statements.

On April 25, 2014, PCT filed a lawsuit against the Company in the United States District Court for the District of New Jersey (Case No. 2:14-cv-02658-SDW-MCA). PCT's complaint asserts various claims, including breach of contract and unjust enrichment, based on the alleged failure of the Company to pay for services and goods provided by PCT under a January 10, 2012 letter agreement. PCT seeks an unspecified amount of compensatory and other damages, plus interest and costs. The Company filed an answer to the complaint on June 24, 2014 denying all liability, including on the grounds that the January 10, 2012 letter agreement is unenforceable and PCT failed to provide the goods and services it stated it would provide. In connection with its answer to PCT's complaint, the Company filed a counterclaim against PCT and a third-party complaint against NeoStem to seek, among other things, (i) a declaration that the January 10, 2012 letter agreement is unenforceable, (ii) monetary damages and (iii) rescission of equity securities the Company previously issued to NeoStem. The Company intends to vigorously defend the claims by PCT and prosecute its claims against PCT and NeoStem. As the lawsuit is at an early stage, the Company cannot at this time estimate the possible loss or range of loss, if any, that may result from this lawsuit.

In July 2012, a complaint was filed against the Company and John Steel in the United States District Court for the District of Utah, Central Division for infringement and misappropriation of a patent. The plaintiffs contend that they were the actual purchasers of the MicroIslet patent out of MicroIslet's bankruptcy proceedings in 2009 and that the respective intellectual property rights have been never assigned to either ISI or the Company. As a result, they allege that the Company's claim to the ownership of the MicroIslet patent based on the assignment of the patent by its founders is baseless. The complaint sought monetary damages including punitive damages of at least $12 million, costs, attorneys' fees, and declaratory judgment. On January 8, 2013, the Court dismissed the plaintiff's action for lack of recoverable damages. The plaintiffs refiled their claim and the Company has filed a motion with the Court for dismissal. The Company believes the plaintiffs' claims to be without merit and will continue to vigorously defend against this action and has determined that it is unlikely any damages will be paid.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

On June 4, 2014, the Company issued 14,500 shares of common stock to a consultant pursuant to a settlement agreement.

On May 9, 2014, the Company issued 742,500 shares of common stock, previously vested and included in accrued stock compensation expense, to the members of the Board of Directors as part of the approved compensation plan.

The foregoing issuances of the shares were effectuated pursuant to the exemption from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"), provided by Section 4(2) of the Securities Act and/or Regulation D promulgated thereunder.

ITEM 6. EXHIBITS.

The following exhibits are filed or furnished as part of this quarterly report on Form 10-Q:

Exhibit No.	Description
31.1	Certifications by James Green pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certifications by the Steve Delmar pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive data files pursuant to Rule 405 of Regulation S-T.

SIGNATURES

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

ISLET SCIENCES, INC.

Date: September 11, 2014	By:	/s/ James Green Name: James Green Title: Chief Executive Officer (principal executive officer)
Date: September 11, 2014	By:	/s/ Steve Delmar Name: Steve Delmar Title: Chief Financial Officer (principal financial officer)