

BION ENVIRONMENTAL TECHNOLOGIES INC

Form 10-Q

February 07, 2014

**U.S. 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 December 31, 2013**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. **000-19333**

**Bion Environmental Technologies, Inc.**

(Name of registrant in its charter)

**Colorado**

**84-1176672**

(State or other jurisdiction of incorporation or formation)

(I.R.S. employer identification number)

**Box 566 / 1774 Summitview Way**

**Crestone, Colorado 81131**

(Address of principal executive offices)

**(212) 758-6622**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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

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.

L a r g e  
accelerated filer  
..

A c c e l e r a t e d  
filer ..

Non-accelerated  
filer ..

(Do not check if  
a s m a l l e r  
r e p o r t i n g  
company)

S m a l l e r  
r e p o r t i n g  
company x

**SEC 1296 (03-10) Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.**

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

.. Yes x No

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY**

**PROCEEDINGS DURING THE PRECEDING FIVE YEARS:** Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. **Not applicable.**

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. On February 6, 2014, there were 18,554,650 Common Shares issued and 17,850,341 Common Shares outstanding.

**BION ENVIRONMENTAL TECHNOLOGIES, INC.**

**FORM 10-Q**

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**FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains forward-looking statements, within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), that involve substantial risks and uncertainties. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "may," "will," "expect," "intend," "estimate," "anticipate," "project," "predict," "plan," "believe" or "continue" or the negative thereof or variations thereon or similar terminology. The expectations reflected in forward-looking statements may prove to be incorrect.

**PART I -  
FINANCIAL  
INFORMATION**

**BION  
ENVIRONMENTAL  
TECHNOLOGIES,  
INC. AND  
SUBSIDIARIES**

**CONSOLIDATED  
BALANCE SHEETS**

**December 31,**

**2013**

**June 30,**

**2013**

**(unaudited)**

**ASSETS**

**Current assets:**

Cash

\$

4,244

\$

44,666

Restricted cash  
(Notes 8 and 9)

52,500

57,315

Prepaid insurance and  
expenses

13,278

44,812

Subscription  
receivable (Note 8)

-

25,000

Deposits and other  
receivables

6,108

6,108

Total current assets

76,130

177,901



Deposits on property  
and equipment

23,410

-

Property and  
equipment, net (Note  
3)

6,838,799

7,331,020

Total assets

\$

6,938,339

7,508,921

LIABILITIES AND  
EQUITY (DEFICIT)

Current liabilities:

Accounts payable and  
accrued expenses

\$

1,277,805

\$

1,010,528

Deferred rent (Note  
9)

-

10,929

Subscribed stock

52,500

-

Loans payable -  
affiliates (Note 4)

298,688

276,618

Deferred  
compensation (Note 5)

643,833

520,583

Loan payable (Note  
6)

7,754,000

7,754,000

Total current  
liabilities

10,026,826

9,572,658

Convertible notes  
payable - affiliates  
(Note 7)

1,676,402

1,316,478

Total liabilities

11,703,228

10,889,136

Series B Redeemable  
Convertible Preferred  
stock, \$0.01 par value,  
50,000

shares authorized;  
200 shares issued and  
outstanding,  
liquidation

preference of \$25,000  
and \$24,000,  
respectively

22,400

21,400

Deficit :

Bion's stockholders'  
equity (deficit):

Series A Preferred  
stock, \$0.01 par value,  
10,000 shares  
authorized, no

shares issued and  
outstanding

-

-

Series C Convertible  
Preferred stock, \$0.01  
par value, 60,000  
shares

authorized; no  
shares issued and  
outstanding

-

-

Common stock, no  
par value, 100,000,000  
shares authorized,  
18,289,729

and 17,673,983  
shares issued,  
respectively;  
17,585,420 and  
16,969,674

shares outstanding,  
respectively

-

-

Additional paid-in  
capital

97,688,869



96,829,488

Accumulated deficit

(102,551,173)

(100,308,856)

Total Bion s  
stockholders deficit

(4,862,304)

(3,479,368)

Noncontrolling interest

75,015

77,753

Total deficit

(4,787,289)

(3,401,615)

Total liabilities and  
deficit

\$

6,938,339

\$

7,508,921

See notes to consolidated financial statements.



**BION  
ENVIRONMENTAL  
TECHNOLOGIES,  
INC. AND  
SUBSIDIARIES**

**CONSOLIDATED  
STATEMENTS OF  
OPERATIONS**

**THREE AND SIX  
MONTHS ENDED  
DECEMBER 31,  
2013 AND 2012**

**(UNAUDITED)**

**Three Months Ended**

**December 31,**

**Six Months Ended**

**December 31,**

**2013**

**2012**

**2013**

2012

Revenue

\$

-

\$

-

\$

-

\$

-

Operating expenses:

General and  
administrative  
(including stock-  
  
based compensation  
(Note 8))

526,558

824,947

1,631,562

3,008,217

Depreciation

244,307

246,747

490,303

412,537

Research and  
development  
(including stock-

based compensation  
(Note 8))

(120,003)

37,713

(53,445)

86,319



Total operating  
expenses

650,862

1,109,407

2,068,420

3,507,073

Loss from operations

(650,862)

(1,109,407)

(2,068,420)

(3,507,073)

Other expense  
(income):

Interest expense

88,606

72,022

174,717

127,288

Other expense

-

-

1,918

-

88,606

72,022

176,635

127,288

Net loss

(739,468)

(1,181,429)

(2,245,055)

(3,634,361)

Net loss attributable to  
the noncontrolling

Interest

1,444

1,393

2,738

2,791

Net loss attributable to  
Bion

(738,024)

(1,180,036)

(2,242,317)

(3,631,570)



Dividends on preferred  
stock

(500)

(1,250)

(1,000)

(2,917)

Net loss applicable to  
Bion's common  
stockholders

\$

(738,524)

\$

(1,181,286)

\$

(2,243,317)

\$  
(3,634,487)

Net loss applicable to  
Bion's common  
stockholders per basic  
and diluted common  
share

\$  
(0.04)

\$  
(0.07)

\$  
(0.12)

\$  
(0.21)

Weighted-average  
number of common  
shares

outstanding:

Basic and diluted

18,405,229

17,196,001

18,230,127

17,061,635

See notes to consolidated financial statements.



**BION  
ENVIRONMENTAL  
TECHNOLOGIES,  
INC. AND  
SUBSIDIARIES**

**CONSOLIDATED  
STATEMENT OF  
CHANGES IN  
EQUITY (DEFICIT)**

**SIX MONTHS  
ENDED  
DECEMBER 31,  
2013**

**(UNAUDITED)**

**Common Stock**

**Additional  
paid-in capital**

**Accumulated  
deficit**

**Noncontrolling  
interest**

**Total  
equity/  
(deficit)  
Shares**

**Amount**

Balances, July 1, 2013

17,673,983

\$ -

\$96,829,488



\$(100,308,856)

\$77,753

\$(3,401,615)

Vesting of options for  
services

-

-

(223,457)

-

-

(223,457)

Issuance of common  
stock for services

182,377

-

252,714

-

-

252,714

Issuance of common  
stock to satisfy

accounts payable

13,369

-

19,940

-

-

19,940

Modification of  
options

-  
-  
307,638  
-  
-  
307,638

Issuance of warrants  
for services

-

-

3,546

-

-

3,546

Sale of common stock

420,000

-

500,000

-

-

500,000

Dividends on Series  
B preferred stock

|         |
|---------|
| -       |
| -       |
| (1,000) |
| -       |
| -       |
| (1,000) |



Net loss

-

-

-

(2,242,317)

(2,738)

(2,245,055)

Balances, December  
31, 2013

18,289,729

\$ -

\$97,688,869

\$(102,551,173)

\$75,015

\$(4,787,289)

See notes to consolidated financial statements.

**BION  
ENVIRONMENTAL  
TECHNOLOGIES,  
INC. AND  
SUBSIDIARIES**

**CONSOLIDATED  
STATEMENTS OF  
CASH FLOWS**

**SIX MONTHS  
ENDED  
DECEMBER 31,  
2013 AND 2012  
(UNAUDITED)**

**2013**

**2012**

CASH FLOWS FROM  
OPERATING  
ACTIVITIES

Net loss

\$

(2,245,055)

\$

(3,634,361)

Adjustments to  
reconcile net loss to net  
cash used in operating

activities:

Loss on disposal of  
property and  
equipment

1,919

-

Depreciation  
expense

490,303

412,537

Accrued interest on  
deferred compensation  
and other

174,767

44,431

Stock-based  
compensation

322,025

1,592,982

Decrease in prepaid  
insurance and expenses

31,534

36,450

Increase in accounts payable and accrued expenses

186,642

159,046

Increase in deferred compensation

415,416

384,050

Decrease in deferred rent

(10,929)

(8,531)

Net cash used in  
operating activities

(633,378)

(1,013,396)



CASH FLOWS FROM  
INVESTING  
ACTIVITIES

Release of restricted  
cash

57,315

-

Increase in restricted  
cash

(52,500)

-

Increase in deposits  
for property and  
equipment

(23,410)

-

Purchase of property  
and equipment

-

(63,695)

Net cash used in  
investing activities

(18,595)

(63,695)

CASH FLOWS FROM  
FINANCING  
ACTIVITIES

Decrease in  
subscription receivable

25,000

-

Proceeds from the  
sale of units

-

960,499

Proceeds from sale of  
common stock

500,000

-

Proceeds from  
subscribed stock

52,500

-

Proceeds from loans  
payable - affiliates

105,149

125,000

Redemption of Series  
B preferred shares

-

(25,000)

Payment of loans  
payable affiliates

(71,098)

-

Payment of Series B  
preferred dividends

-

(2,917)

Net cash provided  
by financing activities

611,551

1,057,582

Net decrease in cash

(40,422)

(19,509)

Cash at beginning of  
period

44,666

399,992

Cash at end of period

\$

4,244

\$

380,483



Supplemental  
disclosure of cash flow  
information:

Cash paid for interest,  
including nil and  
\$15,793 of capitalized  
interest

\$

1,098

\$

98,747

Cash paid for income  
taxes

\$

\$

-

Non-cash investing and  
financing transactions:

Series B preferred  
stock dividends  
accrued

|   |        |
|---|--------|
|   | \$     |
|   | 1,000  |
|   | \$     |
|   | 1,417  |
| Series C preferred<br>stock dividends<br>accrued                |        |
|   | \$     |
|   | -      |
|   | \$     |
|   | 1,500  |
| Issuance of common<br>stock to satisfy<br>deferred compensation |        |
|   | \$     |
|   | 18,416 |
|   | \$     |
|   | -      |
| Issuance of common<br>stock to satisfy<br>accounts payable      |        |

\$  
19,940

\$  
-

**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**SIX MONTHS ENDED DECEMBER 31, 2013**

1.

**ORGANIZATION, NATURE OF BUSINESS, GOING CONCERN AND MANAGEMENT'S PLANS:**

**Organization and nature of business:**

Bion Environmental Technologies, Inc. ( Bion or We or the "Company") was incorporated in 1987 in the State of Colorado and has developed and continues to develop patented and proprietary technology and business models that provide comprehensive environmental solutions to a significant source of pollution in United States agriculture, large scale livestock facilities known as Confined Animal Feeding Operations ("CAFO's"). Bion's technologies (and applications related thereto) produce substantial reductions of nutrient releases (primarily nitrogen and phosphorus) to both water and air (including ammonia, which is subsequently re-deposited to the ground) from livestock waste streams based upon our operations and research to date (and third party peer review thereof). Because Bion's technologies (and related applications) reduce the harmful releases and emissions from a CAFO on which it is utilized, the CAFO can potentially increase its herd concentration (thereby utilizing less land per animal) while lowering or maintaining its level of nutrient releases and atmospheric emissions.

From 2003 through early 2008, the Company primarily focused on completing re-development of its technology platform and business model. As such, during that period Bion elected not to pursue near-term business opportunities such as retrofitting existing CAFO's with waste management solutions, because management believed such efforts would have diverted scarce management and financial resources and negatively impacted Bion's ability to complete: 1) re-development of technologies for environmentally sound treatment of CAFO waste streams and 2) development of an integrated technology platform in support of large-scale sustainable Integrated Projects (defined below) including renewable energy production.

Bion is now actively pursuing business opportunities in three broad areas 1) installation of Bion systems to retrofit and environmentally remediate existing CAFO's to reduce nutrient (primarily nitrogen and phosphorus) releases, gaseous emissions (ammonia, greenhouse gases, volatile organic compounds, etc.), and pathogens, hormones and other compounds in order to clean the air and water in the surrounding areas (as described below) to ensure compliance with existing (and future) regulations and to permit herd expansion; 2) development of Integrated Projects opportunities within the United States and internationally; and 3) licensing and/or joint venturing of Bion's technology and applications outside North America. The opportunities described at 1) and 2) above (and at greater length below) each require substantial political (federal, state and local) efforts on the part of the Company and a substantial part of Bion's efforts are focused on such political matters.

Management believes that Bion's technology platform (including utilization of various third party technologies to supplement the Company's proprietary technologies) allows the integration of large-scale CAFO's and their end-product users, renewable energy production from the CAFO waste stream, on site utilization of the renewable energy generated and biofuel/ethanol production in an environmentally and economically sustainable manner while reducing the aggregate capital expense and operating costs for the entire integrated complex ("Integrated Projects" or "Projects"). In the context of Integrated Projects, Bion's waste treatment process, in addition to mitigating polluting

releases, enables generation of renewable energy from cellulosic portions of the CAFO waste stream, which renewable energy can be utilized by integrated facilities including ethanol plants, CAFO end-product processors (including cheese, ice cream and/or bottling plants in the case of dairy CAFO s and/or slaughter and/or processing facilities in the context of beef CAFO s) and/or other users as a fossil fuel replacement. The nutrients (primarily nitrogen and phosphorus) can be harvested from the solids and liquid streams recovered from the livestock waste stream and can be utilized as either high value fertilizer and/or the basis for high protein animal feed and the nutrient rich effluent can potentially be utilized in integrated hydroponic agriculture and/or field applied as fertilizer.

**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**SIX MONTHS ENDED DECEMBER 31, 2013**

Bion believes that its Integrated Projects will produce high quality, traceable animal protein at a lower cost than current industry practices while also maintaining a far lower net environmental footprint per unit of protein produced due to water recycling (possible due to the removal of nutrients, etc. from the water by Bion's technology applications), production of renewable energy from the waste stream (reducing the use of fossil fuels), and multiple levels of economies of scale, co-location and integration savings in transportation and other logistics. Some projects may involve only partial integration which will limit the benefits described herein.

Bion is presently involved in the very early development and pre-development activities related to its initial Integrated Project(s) in Pennsylvania. The Company is also involved in pre-development evaluations and discussions regarding opportunities for Integrated Projects in the Northeast, Midwest, and the North Central United States (dairy and/or beef). While all such discussions are still in preliminary stages, multiple meetings and discussions are ongoing with local and state level Pennsylvania officials related to the development of a Bion Integrated Project involving a major international livestock entity with existing operations in Pennsylvania. Additionally, the Company is involved in early stage discussions regarding development of Integrated Projects to meet specific needs of certain international markets (and regarding licensing our technology for use in overseas locations).

Additionally, Bion has commenced discussions that may lead to installation of Bion systems on existing and/or new dairies, beef facilities and swine farms in the Midwest and/or North Central states. The most advanced discussions currently involve an initiative by Bion in Wisconsin.

On September 27, 2008, the Company executed an agreement with Kreider Farms (and its affiliated entities) (collectively "Kreider") to design, construct and operate (through its wholly-owned subsidiaries, Bion Services Group, Inc. ( Bion Services ) and Bion PA-1 LLC ( PA-1 ) a Bion system to treat the waste of 1,200 milking dairy cows (milkers, dry cows and heifers) at the Kreider Dairy, located in Manheim, Pennsylvania. In addition, the agreement (as amended and supplemented) provides for a second phase which will treat the wastes from the rest of Kreider's herd and includes renewable energy production from the cellulosic solid wastes from the Phase 1 system (referred to as Kreider 1 ) together with the waste stream from Kreider's poultry facilities for use at the facilities and/or for market sales. The Kreider projects are owned and operated by Bion through subsidiaries, in which Kreider has the option to purchase a noncontrolling interest. To complete these projects, substantial capital (equity and/or debt) has been and will continue to be expended. Additional funds will be required for continuing operations of Kreider 1 until sufficient revenues can be generated, of which there is no assurance. Upon successful construction and operation of these systems, the Company anticipates that it will earn revenue primarily from the sale of nutrient reduction (and/or other) environmental credits related to Kreider 1 and the Kreider Phase 2 poultry waste treatment system (not yet constructed), and secondarily through sales of renewable energy generated by the Kreider Phase 2 system. To date the market for long-term nutrient reduction credits in Pennsylvania has been very slow to develop and the Company's activities have been negatively affected by the lack of such development.





**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**SIX MONTHS ENDED DECEMBER 31, 2013**

The Company's subsidiary PA-1 financed Kreider 1 through a \$7.8 million loan ( Pennvest Loan ) from Pennsylvania Infrastructure Investment Authority ( Pennvest ) secured by Kreider 1 (and its revenue streams, if any) plus advances from the Company. Initial construction-related activities of Kreider 1 commenced in October 2010 and construction was completed and a period of system operation shakedown commenced in May 2011. Kreider 1 reached full, stabilized operation by the end of the 2012 fiscal year. During 2011 the Pennsylvania Department of Environmental Protection ( PADEP ) re-certified the nutrient credits for this project. The economics (potential revenues and profitability) of Kreider 1 are based largely on the long-term sale of nutrient reduction credits (nitrogen and/or phosphorus) to meet the requirements of the Chesapeake Bay environmental clean-up. The PADEP issued final permits for Kreider 1 (including the credit verification plan) on August 1, 2012 on which date the Company deemed that Kreider 1 was placed in service . As a result, PA-1 has commenced generating nutrient reduction credits for potential sale while continuing to utilize the system to test improvements and add-ons. Operating results at Kreider 1 have documented the efficacy of Bion's nutrient reduction technology and vetted potential add-ons and modifications for use in future installations. During August 2012 the Company provided Pennvest (and the PADEP) with data demonstrating that Kreider 1 met the technology guarantee standards which were incorporated in the Pennvest financing documents and, as a result, the Pennvest Loan is now solely an obligation of PA-1. To date liquidity in the Pennsylvania nutrient credit market has been slow to develop significant breadth and depth and limited liquidity has negatively impacted Bion's business plans and has resulted in challenges to monetizing the nutrient reduction credits created by PA-1's existing Kreider 1 project and Bion's other proposed projects. These difficulties have prevented PA-1 from generating any material revenues from the Kreider 1 project to date (operating expenses have been funded by loans from Bion) and raise significant questions as to when PA-1 will be able to generate such revenues from the Kreider 1 system. PA-1 has commenced negotiations with Pennvest related to forbearance, re-structuring and other matters related to the Kreider 1 project and its obligations pursuant to the Pennvest Loan. In the context of such negotiations, PA-1 elected not to make interest payments to Pennvest on the Pennvest Loan since January 2013. Additionally the Company has not made any principal payments, which were to begin in fiscal 2013. As a result, Pennvest has the right to declare that the Pennvest Loan is in default and, therefore, the Company has classified the Pennvest Loan as a current liability as of December 31, 2013. It is not possible at this date to predict the outcome of these negotiations but the Company believes that there is a reasonable likelihood that an interim, short-term agreement will be reached that will allow PA-1 and Pennvest a period of time to evaluate developments in the Pennsylvania nutrient reduction market and possible long-term resolutions. Subject to the results of the negotiations with Pennvest and pending development of a more robust market for nutrient reductions in Pennsylvania, Bion anticipates that it will be necessary to evaluate various options with regard to Kreider 1 over the next 60-150 days.

Development work and technology evaluation, including amended credit certification and negotiations with potential joint venture partners, continues related to the details of the second phase of the Kreider project. Assuming there are positive developments related to the market for nutrient reduction in Pennsylvania, the Company intends to pursue development, design and construction of the Kreider 2 poultry waste/renewable energy project with a goal of achieving operational status during 2014. However, as discussed above, this project faces challenges related to the current limits of the existing nutrient reduction market and funding of technology-based, verifiable agricultural nutrient reductions.

The limited development of the nutrient reduction market in Pennsylvania has led Bion to redeploy some of its limited resources from its efforts in Pennsylvania to its initiatives in the Great Lakes and Midwest states with current efforts being most advanced in Wisconsin.



**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**SIX MONTHS ENDED DECEMBER 31, 2013**

A significant portion of Bion's activities concern efforts with private and public stakeholders (at local and state level) in Pennsylvania and other Chesapeake Bay states and at the federal level (the Environmental Protection Agency (EPA) (and other executive departments) and Congress) to establish appropriate public policies which will create regulations and funding mechanisms that foster installation of the low cost environmental solutions that Bion (and others) can provide through clean-up of agricultural waste streams.

**Going concern and management's plans:**

The consolidated financial statements have been prepared assuming the Company will continue as a going concern. The Company has not generated significant revenues and has incurred net losses (including significant non-cash expenses) of approximately \$8,250,000 and \$6,465,000 during the years ended June 30, 2013 and 2012, respectively, and a net loss (including significant non-cash expenses) of approximately \$2,242,000 for the six months ended December 31, 2013. At December 31, 2013, the Company has a working capital deficit and a stockholders' deficit of approximately \$9,951,000 and \$4,862,000, respectively. These factors raise substantial doubt about the Company's ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability or classification of assets or the amounts and classification of liabilities that may result should the Company be unable to continue as a going concern. The following paragraphs describe management's plans with regard to these conditions.

The Company continues to explore sources of additional financing to satisfy its current operating requirements as it is not currently generating any significant revenues.

During the years ended June 30, 2013 and 2012, the Company received total proceeds of \$1,330,499 and \$1,259,250, (including \$200,000 of subscriptions receivable), respectively, from the sale of its equity securities. Proceeds during the 2013 and 2012 fiscal years have been lower than in earlier years and accordingly has negatively impacted the Company's business development efforts.

During the six months ended December 31, 2013, the Company sold 400,000 shares of the Company's restricted common stock at \$1.25 per share for proceeds of \$500,000. The Company also issued 20,000 shares of the Company's restricted common stock upon receipt of its subscription receivable of \$25,000.

During the six months ended December 31, 2013 the Company entered into promissory note agreements with two affiliates of the Company whereby the affiliates have agreed to lend up to \$75,000 each for working capital needs. As of December 31, 2013, the Company has borrowed \$65,000 under these notes.

During the six months ended December 31, 2013, the Company entered into a subscription agreement to sell 70,000 share of the Company's restricted common stock at \$0.75 per share for gross proceeds of \$52,500, net proceeds of \$45,675. The offering closed on January 31, 2014.



**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**SIX MONTHS ENDED DECEMBER 31, 2013**

During fiscal years 2013 and 2012 and through the six months ended December 31, 2013, the Company experienced greater difficulty in raising equity funding than in the prior years, particularly during the latter part of fiscal 2013 and through December 31, 2013. As a result, the Company faced, and continues to face, significant cash flow management challenges due to working capital constraints. To partially mitigate these working capital constraints, the Company's core senior management and several key employees and consultants have been deferring (and continue to defer) all or part of their cash compensation and/or are accepting compensation in the form of securities of the Company (Notes 5 and 7) and members of the Company's senior management have made loans to the Company (Note 4). Additionally, the Company has made reductions in its personnel during the six months ended December 31, 2013. The constraint on available resources has had, and continues to have, negative effects on the pace and scope of the Company's efforts to develop its business. The Company has had to delay payment of trade obligations and has had to economize in many ways that have potentially negative consequences. The Company's accounts payable have increased materially in fiscal year 2013 and through the six months ended December 31, 2013. If the Company does not have greater success in its efforts to raise needed funds during fiscal 2014 (and subsequent periods), management will need to consider deeper cuts (including additional personnel cuts) and curtailment of operations (including possibly Kreider 1 operations).

The Company will need to obtain additional capital to fund its operations and technology development, to satisfy existing creditors, to develop Integrated Projects and CAFO waste remediation systems (including the Kreider 2 facility) and to continue to operate the Kreider 1 facility. The Company anticipates that it will seek to raise from \$2,500,000 to \$50,000,000 or more (debt and equity) during the next twelve months. However, as discussed above, there is no assurance, especially in light of the difficulties the Company has experienced in recent periods and the extremely unsettled capital markets that presently exist (especially for small companies), that the Company will be able to obtain the funds that it needs to stay in business, complete its technology development or to successfully develop its business and projects.

There is no realistic likelihood that funds required during the next twelve months or in the periods immediately thereafter for the Company's basic operations and/or proposed projects will be generated from operations. Therefore, the Company will need to raise sufficient funds from external sources such as debt or equity financings or other potential sources. The lack of sufficient additional capital resulting from the inability to generate cash flow from operations and/or to raise capital from external sources would force the Company to substantially curtail or cease operations and would, therefore, have a material adverse effect on its business. Further, there can be no assurance that any such required funds, if available, will be available on attractive terms or that they will not have a significantly dilutive effect on the Company's existing shareholders. All of these factors have been exacerbated by the extremely unsettled credit and capital markets presently existing for small companies like Bion.

2.

**SIGNIFICANT ACCOUNTING POLICIES**

**Principles of consolidation:**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Bion Integrated Projects Group, Inc. (formerly Bion Dairy Corporation) ( Bion Integrated Projects Group ), Bion Technologies, Inc.,

BionSoil, Inc., Bion Services, PA-1, and Bion PA 2 LLC; and its 58.9% owned subsidiary, Centerpoint Corporation ( Centerpoint ). All significant intercompany accounts and transactions have been eliminated in consolidation.

**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**SIX MONTHS ENDED DECEMBER 31, 2013**

The accompanying consolidated financial statements have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). The consolidated financial statements reflect all adjustments (consisting of only normal recurring entries) that, in the opinion of management, are necessary to present fairly the financial position at December 31, 2013, the results of operations of the Company for the three and six months ended December 31, 2013 and 2012 and cash flows of the Company for the six months ended December 31, 2013 and 2012. Operating results for the three and six months ended December 31, 2013 are not necessarily indicative of the results that may be expected for the year ending June 30, 2014.

**Fair value measurements:**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market. The Company uses a fair value hierarchy that has three levels of inputs, both observable and unobservable, with use of the lowest possible level of input to determine fair value.

Level 1 quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 observable inputs other than Level 1, quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and model-derived prices whose inputs are observable or whose significant value drivers are observable; and

Level 3 assets and liabilities whose significant value drivers are unobservable.

Observable inputs are based on market data obtained from independent sources, while unobservable inputs are based on the Company's market assumptions. Unobservable inputs require significant management judgment or estimation. In some cases, the inputs used to measure an asset or liability may fall into different levels of the fair value hierarchy. In those instances, the fair value measurement is required to be classified using the lowest level of input that is significant to the fair value measurement. Such determination requires significant management judgment.

The fair value of cash and accounts payable approximates their carrying amounts due to their short-term maturities. The fair value of the loan payable approximates its carrying amount as it bears interest at rates commensurate with market rates. The fair value of the redeemable preferred stock approximates its carrying value due to the dividends accrued on the preferred stock which are reflected as part of the redemption value. The fair value of deferred compensation and loans payable affiliates are not practicable to estimate due to the related party nature of the underlying transactions.

**Revenue Recognition:**

Revenues are generated from the sale of nutrient reduction credits. The Company recognizes revenue from the sale of nutrient credits when there is persuasive evidence that an arrangement exists, when title has passed, the price is fixed or determinable, and collection is reasonably assured.





**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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The Company expects that technology license fees will be generated from the licensing of Bion's integrated system. The Company anticipates that it will charge its customers a non-refundable up-front technology license fee, which will be recognized over the estimated life of the customer relationship. In addition, any on-going technology license fees will be recognized as earned based upon the performance requirements of the agreement. Annual waste treatment fees will be recognized upon receipt. Revenues, if any, from the Company's interest in Integrated Projects will be recognized when the entity in which the Integrated Project has been developed recognizes such revenue.

**Loss per share:**

Basic loss per share amounts are calculated using the weighted average number of shares of common stock outstanding during the period. Diluted loss per share assumes the conversion, exercise or issuance of all potential common stock instruments, such as options or warrants, unless the effect is to reduce the loss per share. During the six months ended December 31, 2013 and 2012, the basic and diluted loss per share was the same, as the impact of potential dilutive common shares was anti-dilutive.

The following table represents the warrants, options and convertible securities excluded from the calculation of diluted loss per share:

|              |
|--------------|
| December 31, |
| 2013         |
| December 31, |
| 2012         |
| Warrants     |
| 7,161,700    |
| 7,067,282    |
| Options      |

5,128,870

5,261,145

Convertible debt

2,399,280

628,249

Convertible  
preferred stock

12,500

20,125

The following is a reconciliation of the denominators of the basic loss per share computations for the three and six months ended December 31, 2013 and 2012:

Three months

ended

December 31,

2013

Three months

ended

December 31,

|                |
|----------------|
| 2012           |
| Six months     |
| ended          |
| December 31,   |
| 2013           |
| Six months     |
| ended          |
| December 31,   |
| 2012           |
| Shares issued  |
| beginning of   |
| period         |
| 18,212,104     |
| 16,974,517     |
| 17,673,983     |
| 16,814,103     |
| Shares held by |
| subsidiaries   |
| (Note 8)       |
| (704,309)      |
| (704,309)      |
| (704,309)      |
| (704,309)      |
| Shares         |
| outstanding    |
| beginning of   |
| period         |
| 17,507,795     |
| 16,270,208     |

16,969,674

16,109,794

Weighted  
average shares  
for fully

vested stock  
bonuses (Note  
10)

840,000

840,000

840,000

803,315

Weighted  
average shares  
issued

during the  
period

57,434

85,793

420,453

148,526

Basic weighted  
average shares

end of period

18,405,229

17,196,001

18,230,127

17,061,635

**Recent Accounting Pronouncements:**

The Company has evaluated all newly issued accounting pronouncements and believes such pronouncements do not have a material effect on the Company's financial statements.

**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**SIX MONTHS ENDED DECEMBER 31, 2013**

**3.**

**PROPERTY AND EQUIPMENT:**

**Property and equipment consists of the following:**

|                             | December 31,<br>2013 | June 30,<br>2013 |
|-----------------------------|----------------------|------------------|
| Machinery and<br>equipment  | \$5,432,947          | \$5,432,947      |
| Buildings and<br>structures |                      | 2,574,010        |
|                             |                      | 2,574,010        |

Leasehold  
improvements

-

31,336

Furniture

-

28,932

Computers and  
office equipment

234,704

243,058

8,241,661

8,310,283

Less accumulated  
depreciation

(1,402,862)



(979,263)

\$6,838,799

\$7,331,020

During the year ended June 30, 2013, Kreider 1 was placed into service and the capitalized costs of \$8,219,617 were allocated among its separately identifiable components. Depreciation expense was \$244,307 and \$246,747 for the three months ended December 31, 2013 and 2012, respectively, and \$490,303 and \$412,537 for the six months ended December 31, 2013 and 2012, respectively.

**4.****LOANS PAYABLE - AFFILIATES:**

As of December 31, 2013, Dominic Bassani ( Bassani ), the Company's Chief Executive Officer ( CEO ), has loaned the Company \$200,000 for fiscal year 2013 working capital needs ( FY 2013 Loan ). The FY 2013 Loan bears interest at 8% per annum and was payable on August 31, 2013. The due date of the FY 2013 Loan plus accrued interest was extended to September 30, 2013. Subsequent to September 30, 2013, the FY 2013 Loan was extended to January 1, 2014 and then further extended to April 30, 2014. Conversion terms substantially identical to those described in Note 7 have been added to the terms of the FY 2013 Loan. Interest expense related to the FY 2013 Loan was \$4,113 for the three months ended December 31, 2013 and \$8,226 for the six months ended December 31, 2013.

During the six months ended December 31, 2013, Bassani loaned the Company \$19,000 ( November Note ). The November Note bears interest at 8% per annum and is payable on February 28, 2014. Interest expense related to the November Note was \$150 for the three and six months ended December 31, 2013.

During the six months ended December 31, 2013, the Company entered into promissory note agreements ( December Notes ) with Bassani and a major shareholder ( Shareholder ) whereby Bassani and Shareholder agreed to lend the Company up to \$75,000 each for working capital needs. The December Notes bear interest at 8% per annum and are payable on March 31, 2014. However, if the Company does not have sufficient funds for working capital needs to allow repayment of the December Notes on March 31, 2014, the maturity date of the December Notes can be extended for three months; which process may be repeated up to three additional times with the maturity date extended to a date as late as December 31, 2014. In consideration for the December Notes, the Company shall issue warrants to purchase up to 18,750 shares of the Company's common stock at \$0.85 per share until December 31, 2018 (proportionately reduced if the December Notes are funded for less than the \$75,000 maximum). Additional warrants (in the same amount and terms) will be issued upon each extension of the maturity date of the December Notes. The warrants will vest immediately upon issuance. As of December 31, 2013, Bassani and Shareholder had loaned the Company \$40,000 and \$25,000, respectively, under the terms of the December Notes. Interest expense of \$286 related to the December Notes had been recorded for both the three and six months ended December 31, 2013.



**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**SIX MONTHS ENDED DECEMBER 31, 2013**

5.

**DEFERRED COMPENSATION:**

The Company owes Edward Schafer ( Schafer ), the Company s Executive Vice Chairman, and three other key employees, aggregate deferred compensation of \$421,083 as of December 31, 2013. The balance is payable dependent upon the cash reserves of the Company.

As of December 31, 2013, the Company owed Bassani deferred compensation of \$222,750 including interest of \$57,750, which is due and payable on April 30, 2014. The deferred compensation accrues interest at 10% per annum and is convertible into the Company s restricted common stock at \$1.50 per share.

See Note 7 for information related to Convertible Notes Payable Affiliates owned by Bassani and Mark A. Smith ( Smith ), the Company s President, for additional deferred compensation (and other items).

6.

**LOAN PAYABLE:**

As of December 31, 2013, PA-1, the Company s wholly-owned subsidiary, owes \$7,754,000 under the terms of the Pennvest Loan related to the construction of the Kreider 1 System. The terms of the Pennvest Loan provide for funding of up to \$7,754,000 which is to be repaid by interest-only payments for three years, followed by an additional ten-year amortization of principal. The Pennvest Loan accrues interest at 2.547% for years 1 through 5 and 3.184% for years 6 through maturity. The Pennvest Loan requires minimum annual principal payments of approximately \$574,000 in fiscal year 2013, \$704,000 in fiscal year 2014, \$723,000 in fiscal year 2015, \$741,000 in fiscal year 2016, \$760,000 in fiscal year 2017 and \$4,252,000 thereafter. The Pennvest Loan is collateralized by the Kreider 1 facility and by a pledge of all revenues generated from Kreider 1 including, but not limited to, revenues generated from nutrient reduction credit sales and by-product sales. In addition, in consideration for the excess credit risk associated with the project, Pennvest is entitled to participate in the profits from Kreider 1 calculated on a net cash flow basis, as defined. The Company has incurred interest expense related to the Pennvest Loan of \$49,374 for both the three month periods ended December 31, 2013 and 2012, respectively. For the six months ended December 31, 2013 and 2012, the Company has incurred interest expense related to the Pennvest Loan of \$98,748 and \$98,747, respectively, of which nil and \$15,793 has been capitalized as a cost of Kreider 1 for the six months ended December 31, 2013 and 2012, respectively. Based on the limited development of the depth and breadth of the Pennsylvania nutrient reduction credit market to date, PA-1 has commenced negotiations with Pennvest related to forbearance and/or re-structuring the obligations under the Pennvest Loan. In the context of such negotiations, PA-1 has elected not to make interest payments to Pennvest on the Pennvest Loan since January 2013. Additionally, the Company has not made any principal payments, which were to begin in fiscal 2013. Although Pennvest has not declared the Pennvest Loan in default, the Company has classified the Pennvest Loan as a current liability as of December 31, 2013. It is not possible at this date to predict the outcome of negotiations with Pennvest. Subject to the results of the negotiations and pending development of a more robust market for nutrient reduction credits in Pennsylvania, Bion anticipates that it

will be necessary to evaluate various options with regard to Kreider 1.

**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
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**SIX MONTHS ENDED DECEMBER 31, 2013**

In connection with the Pennvest Loan, the Company provided a technology guaranty regarding nutrient reduction performance of Kreider 1 which was structured to expire when Kreider 1's nutrient reduction performance had been demonstrated. On August 1, 2012 the Company informed Pennvest and the PADEP (with supporting performance data) that the Kreider 1 System had surpassed the requisite performance criteria and that, as a result, the Company's technology guaranty was met.

7.

**CONVERTIBLE NOTES PAYABLE - AFFILIATES:**

Effective May 15, 2013, the Board of Directors approved agreements with Bassani and Smith, under which, Bassani and Smith have agreed to continue to defer their cash compensation up to April 30, 2014 (unless the Board of Directors elects to re-commence cash payment on an earlier date) and to extend the due date of their deferred cash compensation until January 15, 2015. The agreements have been evidenced in the form of convertible promissory notes ( Convertible Notes ).

The Convertible Notes accrue interest at 8% per annum and are due and payable on January 15, 2015. The Convertible Notes (including accrued interest) of \$761,146 and \$915,256 at December 31, 2013 owed to Smith and Bassani, respectively, plus all future deferred compensation or other sums subsequently added to the principal of the Convertible Notes, may be converted, at the sole election of Smith and Bassani, into Units consisting of one share of the Company's common stock and one warrant to purchase a share of the Company's common stock, at a price of \$1.25 per Unit until January 15, 2015. The warrant contained in the Unit shall be exercisable at \$2.50 per share until December 31, 2018. As the original conversion price of \$1.25 per Unit approximated the fair value of the Units at the date of the agreements, no beneficial conversion feature exists at December 31, 2013. Pursuant to the deferral agreements, the conversion price of the Convertible Notes plus accrued interest is the lower of the \$1.25 per Unit price or the lowest price at which the Company sells its common stock on or before January 15, 2015. As of December 31, 2013, the lowest price at which the Company had sold its common stock during the relevant period is \$0.84 per share. As of February 6, 2013, the Company has issued or entered into agreements to issue common stock priced at \$0.75 per share, which issuance has reduced the price at which Bassani and Smith may convert the Convertible Notes to \$0.75 per share. Management evaluated the terms and conditions of the embedded conversion features based on the guidance of Accounting Standards Codification ( ASC ) 815-15 Embedded Derivatives to determine if there was an embedded derivative requiring bifurcation. An embedded derivative instrument (such as a conversion option embedded in the deferred compensation) must be bifurcated from its host instruments and accounted for separately as a derivative instrument only if the risks and rewards of the embedded derivative instrument are not clearly and closely related to the risks and rewards of the host instrument in which it is embedded. Management concluded that the embedded conversion feature of the deferred compensation was not required to be bifurcated because the conversion feature is clearly and closely related to the host instrument, and because of the Company's limited trading volume that indicates the feature is not readily convertible to cash in accordance with ASC 815-10, Derivatives and Hedging . As of December 31, 2013, the Company owes Smith, \$761,146 under the terms of his Convertible Note. The Convertible Note is comprised of deferred compensation of \$621,754, a working capital loan of \$46,149, reimbursable expenses of \$29,889 and accrued interest of \$63,354. As of December 31, 2013, the Company owes Bassani, \$915,256, comprised of deferred compensation of \$832,000 and accrued interest of \$83,256, under the terms of his Convertible Note. As of February 6, 2014, the Company owes Bassani and Smith approximately \$947,000 and \$787,000, respectively, under

the terms of the Convertible Notes.

**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**SIX MONTHS ENDED DECEMBER 31, 2013**

As part of the agreements, Bassani and Smith have also forgiven any possible obligations that Bion may have owed each of them in relation to unused vacation time for periods (over 10 years) prior to the year ended June 30, 2012. In consideration of these agreements, Bassani and Smith: a) have been granted 50% execution/exercise bonuses to be effective upon future exercise of outstanding (or subsequently acquired) options and warrants owned by Bassani and Smith (and their respective donees) and in relation to contingent stock bonuses (see Note 10 for further details); b) warrants and options, if due to expire prior to December 31, 2018, have been extended to that date (with possible further extensions) and c) other modifications have been made to existing agreements.

**8.**

**STOCKHOLDERS' EQUITY:**

**Series B Preferred stock:**

At July 1, 2013, the Company had 200 shares of Series B redeemable convertible Preferred stock outstanding with a par value of \$0.01 per share, convertible at the option of the holder at \$2.00 per share, with dividends accrued and payable at 2.5% per quarter. The Series B Preferred stock is mandatorily redeemable at \$2.00 per share by the Company three years after issuance and accordingly was classified outside of shareholders' equity.

During the years ended June 30, 2013 and 2012, the Company declared dividends of \$2,417 and \$72,500 respectively.

During the six months ended December 31, 2013, the Company declared dividends of \$1,000. At December 31, 2013, accrued dividends payable are \$5,000.

**Common stock:**

Holders of common stock are entitled to one vote per share on all matters to be voted on by common stockholders. In the event of liquidation, dissolution or winding up of the Company, the holders of common stock are entitled to share in all assets remaining after liabilities have been paid in full or set aside and the rights of any outstanding preferred stock have been satisfied. Common stock has no preemptive, redemption or conversion rights. The rights of holders of common stock are subject to, and may be adversely affected by, the rights of the holders of any outstanding series of preferred stock or any series of preferred stock the Company may designate in the future.

Centerpoint holds 704,309 shares of the Company's common stock. These shares of the Company's common stock held by Centerpoint are for the benefit of its shareholders without any beneficial interest. The Company accounts for these shares similar to treasury stock.

During the six months ended December 31, 2013, the Company issued 182,377 shares of the Company's common stock at prices ranging from \$1.12 to \$1.85 per share for consulting services valued at \$252,714, in the aggregate, to consultants and employees. During the six months ended December 31, 2013, the Company issued 13,369 shares of the Company's common stock at prices ranging from \$1.46 to \$1.51 per share for employee expense reimbursements.

During the six months ended December 31, 2013, the Company sold 400,000 shares of the Company's restricted common stock for total net proceeds of \$500,000. The Company also issued 20,000 shares of the Company's restricted common stock upon receipt of its subscription receivable of \$25,000 during the six months ended December 31, 2013.



**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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During the six months ended December 31, 2013, an investor executed a subscription agreement to purchase 70,000 shares of the Company's restricted common stock at \$0.75 per share for proceeds of \$52,500 which has been recorded as a subscribed stock liability as of December 31, 2013. The proceeds are considered restricted cash as the stock offering was not closed and the shares had not been issued as of December 31, 2013. The subscription agreement was accepted by the Company on January 31, 2014.

**Warrants:**

As of December 31, 2013, the Company had approximately 7.2 million warrants outstanding, with exercise prices from \$0.75 to \$4.25 and expiring on various dates through January 15, 2019.

The weighted-average exercise price for the outstanding warrants is \$2.18, and the weighted-average remaining contractual life as of December 31, 2013 is 4.18 years.

During the six months ended December 31, 2013 warrants to purchase 35,465 shares of the Company's common stock at prices ranging from \$1.12 to \$1.71 per share were issued pursuant to an agreement with a consultant. The warrants were determined to have a fair value of \$0.10 per warrant and expire five years from date of issuance. The Company recorded non-cash compensation expense of \$3,547 related to the warrant issuances. The Company entered into an agreement with the consultant whereby the 35,465 warrants issued during the six months ended December 31, 2013 and 38,786 warrants previously issued carry an exercise bonus equal to 75% of the exercise price to be offset against the exercise price if exercised after 24 months from the issuance of the warrants.

As of December 31, 2013, 5,419,324 of the warrants of the Company are subject to execution/exercise bonuses under agreements with Bassani and Smith (Note 10).

**Stock options:**

The Company's 2006 Consolidated Incentive Plan (the 2006 Plan), as amended, provides for the issuance of options (or other incentive grants) to purchase up to 12,000,000 shares of the Company's common stock. Terms of exercise and expiration of options (or other incentive grants) granted under the 2006 Plan may be established at the discretion of the Board of Directors, but no option may be exercisable for more than ten years.

In July 2013, the Company entered into an agreement with a terminated employee which entitled the former employee to modifications of existing stock options resulting in the extension of certain expiration dates and resulting in incremental non-cash compensation expense of \$97,125 for the six months ended December 31, 2013.

During the six months ended December 31, 2013, the Company entered into agreements with Schafer and a board member, pursuant to which each is entitled to execution/exercise bonuses identical to those previously offered to Bassani and Smith (Note 10). The modification of the options for Schafer and the board member resulted in incremental non-cash compensation expense of \$210,513 for the six months ended December 31, 2013. As of December 31, 2013, 2,295,000 of the outstanding options of the Company are subject to execution/exercise bonuses.



**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**SIX MONTHS ENDED DECEMBER 31, 2013**

The Company recorded compensation expense/(credits) related to employee stock options of \$(309,315) and \$114,055 for the three months ended December 31, 2013 and 2012, respectively, and \$(223,457) and \$353,110 for the six months ended December 31, 2013 and 2012, respectively. The Company granted 67,725 and 150,000 options during the six months ended December 31, 2013 and 2012, respectively. During the six months ended December 31, 2013, 200,000 options were forfeited. The fair value of the options granted during the six months ended December 31, 2013 and 2012 was estimated on the grant date using the Black-Scholes option-pricing model with the following assumptions:

Weighted  
Average,  
December 31,  
2013  
  
Range,  
December 31,  
2013  
  
Weighted  
Average,  
December 31,  
2012  
  
Range,

December 31,

2012

Volatility

49%

49%-50%

66%

60%-68%

Dividend yield

-

-

-

-

Risk-free interest  
rate

0.62%

0.59%-0.68%

0.32%

0.31%-0.34%

Expected term  
(years)

2.68

2.63-2.71

3.05

2.66-3.25

The expected volatility was based on the historical price volatility of the Company's common stock. The dividend yield represents the Company's anticipated cash dividend on common stock over the expected term of the stock options. The U.S. Treasury bill rate for the expected term of the stock options was utilized to determine the risk-free interest rate. The expected term of stock options represents the period of time the stock options granted are expected to be outstanding based upon management's estimates.

A summary of option activity under the 2006 Plan for the six months ended December 31, 2013 is as follows:

Options

Weighted-

Average

Exercise

Price

Weighted-

Average  
Remaining  
Contractual  
Life

Aggregate  
Intrinsic  
Value  
Outstanding at  
July 1, 2013

5,261,145

\$2.84

4.0

\$168,750

Granted

67,725

1.51

Exercised

-

-

Forfeited

(200,000)

3.00

Expired

-

-

Outstanding at  
December 31,  
2013

5,128,870

\$2.82

3.5

\$ -

Exercisable at  
December 31,  
2013

5,003,870

\$2.83

3.5

\$ -



**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**SIX MONTHS ENDED DECEMBER 31, 2013**

The following table presents information relating to nonvested stock options as of December 31, 2013:

| Options                                      |
|--|
| Weighted Average<br>Grant-Date Fair<br>Value |
| Nonvested at July 1,<br>2013                 |
| 325,000                                      |
| \$ 1.86                                      |
| Granted                                      |
| 67,725                                       |
| 0.51   |
| Vested                                       |
| (67,725)                                     |

(0.51)

Forfeited

(200,000)

(2.10)

Nonvested at  
December 31, 2013

125,000

\$ 1.49

The total fair value of stock options that vested during the six months ended December 31, 2013 and 2012 was \$34,822 and \$125,000, respectively. As of December 31, 2013, the Company had no unrecognized compensation cost related to stock options.

Stock-based employee compensation charges in operating expenses in the Company's financial statements for the three and six months ended December 31, 2013 and 2012 are as follows:

Three  
months  
ended  
December 31,  
2013  
Three  
months  
ended  
December 31,  
2012  
Six months  
ended

December 31,

2013

Six months

ended

December 31,

2012

General and  
administrative:

Fair value of  
stock/warrant  
bonuses expensed

\$ -

\$ -

\$ -

\$1,151,250

Fair value of stock  
issued to an  
employee

24,999

24,999

94,998

49,998

Change in fair  
value from  
modification of

option terms

-

-

307,638

-

Fair value of stock  
options  
(credited)/expensed

(155,728)

104,732

(87,517)

335,085

Total

\$(130,729)

\$129,731

\$ 315,119

\$1,536,333

Research and  
development:

Fair value of stock  
options  
(credited)/expensed

\$(153,587)

\$ 9,323

\$(135,939)

\$ 18,025

Total

\$(153,587)

\$ 9,323

\$(135,939)

\$ 18,025

9.

**OPERATING LEASE:**

The Company entered into an agreement effective September 26, 2013 whereby the Company assigned its rights, title and interest as a tenant of its non-cancellable operating lease commitment for office space in New York, effective August 1, 2006 and expiring November 30, 2013. In conjunction with the assignment of its lease, the Company was released from its obligation to the lessor of its secured letter of credit. Pursuant to the Master Sublease entered into with Mr. Salvatore Zizza, a former officer and director of the Company effective January 1, 2009, Mr. Zizza was entitled to the previously restricted funds securing the letter of credit of \$57,315. Mr. Zizza was paid the \$57,315 in October 2013.



**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**SIX MONTHS ENDED DECEMBER 31, 2013**

**10.**

**COMMITMENTS AND CONTINGENCIES:**

**Employment and consulting agreements:**

Smith has held the positions of Director, President and General Counsel of Company and its subsidiaries under various agreements and terms since March 2003. During July 2011, the Company entered into an extension agreement pursuant to which Smith continued to hold his current position in the Company through a date no later than December 31, 2012. Commencing January 1, 2012, Smith's monthly salary was \$20,000, which has been accrued and deferred. In addition, 90,000 shares of the Company's common stock would be issued to Smith in two tranches of 45,000 shares on each of January 15, 2013 (issued) and 2014 (issued), respectively. The Company recorded expense of \$240,300 for the year ended June 30, 2012, related to the future stock issuances as the bonus was fully vested at the grant date. As part of the extension agreement, Smith was also granted 200,000 options, which vested immediately, to purchase common shares of the Company at a price of \$3.00 per share and which options expire on December 31, 2019. The Company recorded expense of \$334,000 during the year ended June 30, 2012 as the options were fully vested at the grant date. Effective July 15, 2012, the Company entered into an extension agreement pursuant to which Smith will continue to hold his current positions in the Company through a date no later than June 30, 2014. Effective September 2012, Smith's monthly salary became \$21,000 (which is currently being deferred). In addition, the extension provides that Smith will be issued 150,000 shares of the Company's common stock in two tranches of 75,000 shares on each of January 15, 2014 (issued) and 2015 (to be issued), which shares vested immediately. The Company recorded expense of \$292,500 for the year ended June 30, 2013, related to the future stock issuances as the bonus was fully vested at the grant date. As part of the extension agreement, Smith was also granted a bonus of \$25,000 paid in warrants, which vested immediately, to purchase 250,000 shares of the Company's common stock at a price of \$2.10 per share and which warrants expire on December 31, 2018 and a contingent stock bonus of 100,000 shares payable on the date on which the Company's stock price first reaches \$10.00 per share (regardless of whether Smith is still providing services to the Company on such date).

Since March 31, 2005, the Company has had various agreements with Brightcap and/or Bassani, through which the services of Bassani are provided. On September 30, 2009 the Company entered into an extension agreement with Brightcap pursuant to which Bassani provided services to the Company through September 30, 2012 for \$312,000 annually (currently deferred). The Board appointed Bassani as the Company's CEO effective May 13, 2011. On July 15, 2011, Bassani, Brightcap and the Company agreed to an extension/amendment of the existing agreement with Brightcap which provided that Bassani would continue to provide the services of CEO through June 30, 2013 and will continue to provide full-time services to the Company in other capacities through June 30, 2014 at a salary of \$26,000 per month. In addition Bassani will be issued 300,000 shares of the Company's common stock issuable in three tranches of 100,000 shares on each of January 15, 2015, 2016 and 2017, respectively. During the year ended June 30, 2012 the Company recorded expense of \$795,000 related to the future stock issuances as the bonus was fully vested at the grant date. Bassani was also granted 725,000 options, which vested immediately, to purchase shares of the Company's common stock at \$3.00 per share which options expire on December 31, 2019. The Company recorded expense of \$1,203,500 during the year ended June 30, 2012 as the options were fully vested at the grant date. Effective July 15, 2012, Bassani, Brightcap and the Company agreed to a further extension/amendment of the

existing agreement with Brightcap which provides that Bassani will continue to provide the services of CEO through June 30, 2014. The extension provided that Bassani will continue to provide full-time services to the Company at a cash salary of \$26,000 per month (which is currently being deferred) and Bassani will be issued 300,000 shares of the Company's common stock issuable in two tranches of 150,000 shares on each of January 15, 2015 and 2016, respectively, which were immediately vested. The Company recorded expense of



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**SIX MONTHS ENDED DECEMBER 31, 2013**

\$585,000 for the year ended June 30, 2013, related to the future stock issuances as the bonus was fully vested at the grant date. As part of the extension agreement, Bassani was also granted a bonus of \$5,000 paid in warrants, which vested immediately, to purchase 50,000 shares of the Company's common stock at a price of \$2.10 per share and which warrants expire on December 31, 2018.

On May 5, 2013, the Board of Directors approved agreements with Bassani and Smith, with effective dates of May 15, 2013, in which Bassani and Smith have agreed to continue to defer their respective cash compensation through April 30, 2014 (unless the Board of Directors elects to re-commence cash payment on an earlier date) and to extend the due date of their respective deferred cash compensation until January 15, 2015 on the terms set forth in Note 7. The Company has provided Bassani and Smith with convertible promissory notes which reflect all the terms of these agreements to which future accruals will be added as additional principal. As part of the agreements, Bassani and Smith have also forgiven any possible obligations that Bion may have owed each of them in relation to unused vacation time for periods (over 10 years) prior to June 30, 2012. In consideration of these agreements, Bassani and Smith: a) have been granted 50% execution/exercise bonuses to be effective upon future exercise of outstanding (or subsequently acquired) options and warrants owned by Bassani and Smith (and their respective donees) and in relation to contingent stock bonuses; b) their warrants and options, if due to expire prior to December 31, 2018, have been extended to that date (with possible further extensions); and c) other modifications have been made.

Effective January 1, 2011, the Company entered into an employment agreement with Edward Schafer pursuant to which for a period of three years, Schafer will provide senior management services to the Company on an approximately 75% full time basis, initially as Executive Vice Chairman and as a director. Compensation for Schafer's services will initially be at an annual rate of \$250,000, which will consist of \$150,000 in cash compensation and \$100,000 payable in the Company's common stock. Commencing the month following the first calendar month-end after the Company has completed an equity financing in excess of \$3,000,000 (net of commissions and other offering expenses), Schafer's compensation shall be at an annual rate of \$225,000, all of which shall be payable in cash.

Effective July 15, 2012, the Company entered into a deferral/employment/compensation agreement with Mr. Schafer pursuant to which Schafer will continue to provide senior management services to the Company on an approximately 75% full time basis, initially as Executive Vice Chairman and as a director. Basic compensation for Schafer's services will remain unchanged and Schafer was issued 100,000 options to purchase shares of the Company's common stock at \$2.10 per share until December 31, 2018, which immediately vested and a contingent stock bonus of 25,000 shares payable on January 1 of the first year after the Company's stock price first reaches \$10.00 per share (regardless of whether Schafer is still providing services to the Company on such date). Due to the Company's cash constraints, Schafer agreed to defer the cash portion of his compensation effective May 15, 2012. Mr. Schafer's employment agreement expired on December 31, 2013. Mr. Schafer will continue to serve as the Company's Executive Vice Chairman on a consulting basis with compensation to be determined by the Board from time-to-time.

Effective September 18, 2006, the Company entered into a four-year employment agreement with Jeremy Rowland whereby Mr. Rowland assumed the position of Chief Operating Officer of Projects at an annual salary of \$150,000.

In June 2008, the employment agreement terms were extended through July 1, 2012. Mr. Rowland's services were terminated effective July 31, 2013. Mr. Rowland currently provides consulting services for the Company on an as needed basis.



**BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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During January 2012, the Company approved an employment agreement contract extension effective January 1, 2012 with Craig Scott pursuant to which he continued to act as Vice President of Capital Markets and Shareholder Relations through December 31, 2012, at an annual salary of \$144,000. In consideration for his extension agreement, Mr. Scott was granted 75,000 options to purchase shares of the Company's common shares at \$2.75 per share with an expiration date of December 31, 2016, 12,500 contingent stock options that will be issued if the Company's stock price exceeds \$10.00 and \$20.00 per share, respectively, and an extension of the expiration dates all his existing warrants and options as of January 1, 2012 until December 31, 2016. Mr. Scott currently works for the Company on a month-to-month basis and beginning August 1, 2013 is receiving his compensation in common stock of the Company.

Effective February 1, 2011, the Company entered into an employment agreement with James Morris, pursuant to which Mr. Morris will act as Chief Technology Officer of the Company through January 31, 2015 at an annual salary of \$150,000 through July 1, 2011, and \$180,000 thereafter. Mr. Morris's services were terminated effective November 30, 2013. The Company accrued an expense of \$75,000 related to this termination, which is included in accrued liabilities as of December 31, 2013.

Effective September 27, 2011, the Company entered into an employment agreement with George Bloom, pursuant to which Mr. Bloom, the Company's Chief Engineering Officer, will act as Vice President-Engineering of the Company through January 31, 2016 at an annual salary of \$180,000. Mr. Bloom's services were terminated effective November 30, 2013. The Company accrued an expense of \$75,000 related to this termination, which is included in accrued liabilities as of December 31, 2013.

**Contingent stock bonuses:**

In May 2005 the Company declared contingent deferred stock bonuses of 690,000 shares to its key employees and consultants. The stock bonuses of 492,500 and 197,500 shares are contingent upon the Company's stock price exceeding \$10.00 and \$20.00 per share, respectively, and the grantees still being employed by or providing services to the Company at the time the target prices are reached. As of December 31, 2013, 227,500 and 65,000 of these contingent bonus shares, respectively, remain outstanding, to be issued when and if the Company's stock price exceeds \$10.00 and \$20.00 per share, respectively.

Effective January 1, 2011 the Company declared a contingent stock bonus of 50,000 shares to Smith and effective July 15, 2012 the Company declared contingent stock bonuses of 100,000 and 25,000 shares to Smith and Schafer, respectively. The stock bonuses are contingent upon the Company's stock price exceeding \$10.00 and do not require that Smith or Schafer remain employed by the Company.

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**SIX MONTHS ENDED DECEMBER 31, 2013**

**Execution/exercise bonuses:**

As part of the agreements the Company entered into with Bassani and Smith (Note 7) effective May 15, 2013, whereby they agreed to continue to defer their cash compensation up to April 30, 2014, they were each granted the following: a) a 50% execution/exercise bonus which shall be applied upon the effective date of the notice of intent to exercise (for options and warrants) or issuance event, as applicable, of any currently outstanding and/or subsequently acquired options, warrants and/or contingent stock bonuses owned by each as follows: i) in the case of exercise by payment of cash, the bonus shall take the form of reduction of the exercise price; ii) in the case of cashless exercise, the bonus shall be applied to reduce the exercise price prior to the cashless exercise calculations; and iii) with regard to contingent stock bonuses, issuance shall be triggered upon the Company's common stock reaching a closing price equal to 50% of currently specified price; and b) the right to extend the exercise period of all or part of the applicable options and warrants for up to five years (one year at a time) by annual payments of \$.05 per option or warrant to the Company on or before a date during the three months prior to expiration of the exercise period at least three business days before the end of the expiration period.

During the six months ended December 31, 2013, the Company extended execution/exercise bonuses with the same terms as described above to Schafer and to one of the Company's board members.

**Litigation:**

The Company currently is not involved in any material litigation.

**11.**

**SUBSEQUENT EVENTS:**

The Company has evaluated events that occurred subsequent to December 31, 2013 for recognition and disclosure in the financial statements and notes to the financial statements.

From January 1, 2014 through February 6, 2014 the Company has issued 129,921 shares of the Company's common shares to two employees valued at approximately \$83,300.

From January 1, 2014 through February 6, 2014, the Company issued 70,000 shares of the Company's restricted common stock at \$0.75 per share, in satisfaction of its subscribed stock agreement grossing \$52,500.

From January 1, 2014 through February 6, 2014 the Company sold 65,000 shares of the Company's restricted common stock at \$0.75 per share for proceeds of \$48,750.

From January 1, 2014 through February 6, 2014 the Company has received subscription agreements to sell 246,665 shares of the Company's restricted common stock for \$0.75 per share for gross proceeds of approximately \$185,000.



## PART I - FINANCIAL INFORMATION

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

Statements made in this Form 10-Q that are not historical or current facts, which represent the Company's expectations or beliefs including, but not limited to, statements concerning the Company's operations, performance, financial condition, business strategies, and other information, involve substantial risks and uncertainties. The Company's actual results of operations, most of which are beyond the Company's control, could differ materially. These statements often can be identified by the use of terms such as "may," "will," "expect," "believe," "anticipate," "estimate," or "continue" or the negative thereof. We wish to caution readers not to place undue reliance on any such forward looking statements, which speak only as of the date made. Any forward looking statements represent management's best judgment as to what may occur in the future. However, forward looking statements are subject to risks, uncertainties and important factors beyond our control that could cause actual results and events to differ materially from historical results of operations and events and those presently anticipated or projected.

These factors include adverse economic conditions, entry of new and stronger competitors, inadequate capital, unexpected costs, failure (or delay) to gain product or regulatory approvals in the United States (or particular states) or foreign countries and failure to capitalize upon access to new markets. Additional risks and uncertainties that may affect forward looking statements about Bion's business and prospects include the possibility that markets for nutrient reduction credits (discussed below) and/or other ways to monetize nutrient reductions will be slow to develop (or not develop at all), the possibility that a competitor will develop a more comprehensive or less expensive environmental solution, delays in market awareness of Bion and our Systems, and/or possible delays in Bion's development of Projects and failure of marketing strategies, each of which could have an immediate and/or long term material adverse effects by placing us behind our competitors. Bion disclaims any obligation subsequently to revise any forward looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. See our Form 10-K (period ended June 30, 2013) for more details regarding these risk factors.

The following discussion and analysis should be read in conjunction with the unaudited Consolidated Financial Statements and Notes to Consolidated Financial Statements filed herein with the Company's Form 10-K for the year ended June 30, 2013.

### BUSINESS OVERVIEW

For several years, the Company focused on completion of the development of the next generation of its technology which provides comprehensive environmental solutions to a significant source of pollution in U.S. agriculture, large scale livestock facilities known as Confined Animal Feeding Operations ("CAFO's"). The re-development process was substantially completed a couple of years ago and the initial commercial system, based on our updated technology, has been constructed and placed in full commercial operation. Bion continues to focus on refining, testing and/or developing technologies which can supplement our technologies and or be utilized with our technology platform.

Operational results from this initial commercial system have confirmed the ability of Bion's technologies to meet its nutrient reduction goals at commercial scale for an extended period of operation. Bion's technology platform centers on its patented biological process that separates and aggregates the various assets in the CAFO waste stream so they become benign and/or valuable and transportable. The system can remove up to 95% of the nutrients in the effluent, reduces greenhouse gases by 90% (or more) and virtually eliminates ammonia emissions, as well as pathogens,

antibiotics and hormones in the waste stream. In addition to capturing valuable nutrients for reuse, the technology platform also recovers cellulosic biomass which can be used to generate renewable energy from the waste stream in a process

more efficient than other technologies that seek to exploit this CAFO waste stream. The technology is now proven in commercial operations; it has been accepted by the Environmental Protection Agency ( EPA ) and other regulatory agencies; and it is protected by Bion s portfolio of U.S. and international patents (both issued and applied for).

Currently, Bion is focused on using applications of its patented waste management technologies and technology platform to pursue three main business opportunities: 1) installation of Bion systems to retrofit and environmentally remediate existing CAFOs in selected markets where: a) government policy supports such efforts (such as the Chesapeake Bay watershed and/or other states and watersheds facing EPA total maximum daily load ( TMDL ) issues, and/or b) where CAFO s need our technology to obtain permits to expand or develop without negative environmental consequences; 2) development of Integrated Projects which will include large CAFOs, such as large dairies, beef cattle feed lots and hog farms, with Bion waste treatment system modules processing the aggregate CAFO waste stream from the equivalent of 40,000 or more beef and/or dairy cows (or the waste stream equivalent of other species) while recovering cellulosic biomass (to be utilized for renewable energy production) and nutrient rich solids (that can potentially to be marketed as feed and/or fertilizer), integrated with an ethanol plant capable of producing 40 million gallons (or more) of ethanol per year and/or with CAFO end product processors, and 3) licensing and/or joint venturing of Bion s technology and applications outside North America. The opportunities described at 1) and 2) above each require substantial political (federal, state and local) efforts on the part of the Company and a substantial part of Bion s efforts are focused on such political matters.

The Company has commenced actively pursuing the opportunity presented by environmental retrofit and remediation of the waste streams of existing CAFOs. The first commercial activity in this area is represented by our agreements with Kreider Farms ("KF") in Pennsylvania pursuant to which a Bion system to treat KF's dairy and poultry waste streams to reduce nutrient releases to the environment while generating marketable nutrient credits and renewable energy was designed, constructed and has been in full-scale operation since 2011. On January 26, 2009 the Board of the Pennsylvania Infrastructure Investment Authority ( Pennvest ) approved a \$7.75 million loan to Bion PA 1, LLC ( PA-1 ), a wholly-owned subsidiary of the Company, for the initial stage of Bion's Kreider Farms project ( Phase 1 Kreider System ). After substantial unanticipated delays, on August 12, 2010 the PA-1 received a permit for construction of the Phase 1 Kreider system. Construction activities commenced during November 2010. The closing/settlement of the Pennvest Loan took place on November 3, 2010. PA-1 finished the construction of the Phase 1 Kreider System and entered a period of system operational shakedown during May 2011. The Phase 1 Kreider System reached full, stabilized operation by the end of the 2012 fiscal year. During 2011 the Pennsylvania Department of Environmental Protection ( PADEP ) re-certified the nutrient credits for this project. **The economics (potential revenues and profitability) of the Phase 1 Kreider System are based largely on the long term sale of nutrient (nitrogen and/or phosphorus) reduction credits to meet the requirements of the Chesapeake Bay environmental clean-up, which sales have not yet materialized.** The PADEP issued final permits for the Kreider System (including the credit verification plan) on August 1, 2012 on which date the Company deemed that the Kreider System was placed in service . As a result, PA-1 has commenced generating and verifying nutrient reduction credits for potential sale while continuing to utilize the system to test improvements and add-ons. Operating results of the Phase 1 Kreider System have documented the efficacy of Bion s nutrient reduction technology and vetted potential add-ons for future installations. During August 2012 the Company provided Pennvest (and the PADEP) with data demonstrating that the Kreider 1 system met the technology guaranty standards which were incorporated in the Pennvest financing documents and, as a result, the Pennvest Loan is now solely an obligation of PA-1. As a result of this extended period of operations, Bion is confident that future systems can be constructed with even higher operational efficiencies at lower capital expense and with lower operational costs. **To date liquidity in the Pennsylvania nutrient credit market has been slow to develop significant breadth and depth which limited liquidity has negatively impacted Bion s business plans and has resulted in challenges to monetizing the nutrient reductions created by PA-1 s existing Kreider 1 project and Bion s other proposed projects. These difficulties**



**have prevented PA-1 from generating any**

**material revenues from the Kreider 1 project to date (PA-1's Kreider 1 operating expenses have been funded by loans from Bion) and raise significant questions as to when, if ever, PA-1 will be able to generate such material revenues from the Kreider 1 system. PA-1 has been engaged in active negotiations with Pennvest related to forbearance and/or re-structuring its obligations pursuant to the Pennvest Loan for several months. In the context of such negotiations, PA-1 has elected not to make interest payments to Pennvest on the Pennvest Loan since January 2013. Additionally, the Company has not made any principal payments, which were to begin in fiscal 2013. As a result, Pennvest has the right to declare the Pennvest Loan in default and, therefore, the Company has re-classified the Pennvest Loan as a current liability on its balance sheet as of December 31, 2013. It is not possible at this date to predict the outcome of such negotiations but the Company believes that there is a reasonable likelihood that an interim, short-term agreement will be reached that will allow PA-1 and Pennvest a period of time to evaluate developments in the Pennsylvania nutrient reduction market and possible long-term resolutions. Subject to the results of the negotiations with Pennvest and pending development of a more robust market for nutrient reductions in Pennsylvania, PA-1 and Bion anticipates that it will be necessary to evaluate various options with regard to Kreider 1 over the next 60-150 days.**

The Company continues its development work related to the second phase of the Kreider project ( Phase 2 Kreider Project ) which involves production of renewable energy from the waste of KF's poultry operations and the cellulosic solids recovered by the Kreider 1 system. During May 2011 the PADEP certified the Phase 2 Kreider Project for 559,457 nutrient credits under the old EPA's Chesapeake Bay model. The Company anticipates that this project will be certified for between 1.5-2 million nutrient reduction credits pursuant to the amended EPA Chesapeake Bay model which was published subsequent to the original certification. Assuming there are positive developments related to the market for nutrient reduction in Pennsylvania, the Company intends to pursue development, design and construction of the Kreider poultry waste/renewable energy project with a goal of achieving operational status during late 2014. **The economics (potential revenues and profitability) of the Phase 2 Kreider Project are based largely on the long term sale of nutrient (nitrogen and/or phosphorus) reduction credits to meet the requirements of the Chesapeake Bay environmental clean-up. However, liquidity in the Pennsylvania nutrient credit market has been slow to develop significant breadth and depth which lack of liquidity to date has negatively impacted Bion's business plans and has resulted in challenges to monetizing the nutrient reduction credits created by PA-1's existing Kreider 1 project and will delay the Company's Phase 2 Kreider Project and other proposed projects in Pennsylvania.**

The Company has commenced activities related to marketing and potential use of its technology in relation to expansion and/or development of CAFO's in the Great Lakes watersheds and the Midwest states with current efforts being most advanced in Wisconsin. Bion considers this to be a large potential market for the Company's growth over the next 18-36 months (and thereafter). Based upon the final permitting and verification plan approval and operational results at the Kreider 1 system, the Company intends to seek to advance commercial sales in additional areas which face deadlines to meet EPA TMDL requirements.

A significant portion of Bion's current activities concern efforts with private and public stakeholders (at local and state level) in Pennsylvania and other Chesapeake Bay states and at the federal level (EPA and other executive departments and Congress) to establish appropriate public policies which will create regulations and funding mechanisms that foster installation of the low cost, technology-based environmental solutions that Bion (and others) can provide through clean-up of agricultural waste streams. In January 2013, the Pennsylvania Legislative Budget and Finance Committee issued a report stating that targeting upstream livestock would save Pennsylvania's taxpayers up to 80% of previously estimated costs (potential savings for Pennsylvania in excess of a billion dollars per year over the next 20 years) which would be available for other needs (notably aging drinking water and sewer infrastructure) while creating large local benefits of an upstream treatment strategy including reduced freshwater compliance costs, future cost

avoidance of treating drinking water from contaminated local aquifers and

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increased economic activity for agriculture, tourism and recreation. The Coalition for an Affordable Bay Solution ( Coalition ) was formed to support the creation of a competitively-bid nitrogen trading program in Pennsylvania that will enable Pennsylvania to capture the economic benefits outlined in the legislative study. The Coalition supports legislation to establish a competitively-bid RFP program for nitrogen reductions, where bids will also be scored to reflect the value of the benefits to Pennsylvania's interior waterways and communities. Founding members of the Coalition represent both Chesapeake Bay and national industry participants, and include Bion, JBS, SA, Kreider Farms, and Fair Oaks Farms. The head of the Coalition is Ed Schafer, Bion's Executive Vice Chairman. Legislation was filed in the Pennsylvania Senate during the spring of 2013 that, if passed and signed into law, will potentially enable Bion (and others) to compete for public funding on an equal basis with public works and storm water authorities. **Bion believes that such legislation is likely to be passed (in some version) by the Pennsylvania Legislature during the Spring 2014 session but cannot predict the exact final content of such legislation or guarantee such passage.** If such a program is passed and implemented, Bion expects that the policies and strategies being developed in Pennsylvania will not only benefit the Company's existing and proposed Pennsylvania projects, but will also subsequently provide the basis for a larger Chesapeake Bay watershed strategy and, thereafter, a national clean water strategy.

The Company believes that Pennsylvania is ground zero in the long-standing clean water battle between agriculture and the further regulation of agriculture relative to nutrient impacts. The ability of Bion and other technology providers to achieve verified reductions from agricultural non-point sources can resolve the current stalemate and enable implementation of constructive solutions that benefit all stakeholders, providing a mechanism that ensures that taxpayer funds will be used to achieve the most beneficial result at the lowest cost, regardless of source. All sources, point and non-point, rural and urban, will be able to compete for tax payer-funded nitrogen reductions in a fair and transparent process; and since payment from the tax and rate payers will now be performance-based, these providers will be held financially accountable.

We believe that the overwhelming environmental, economic, quality of life and public health benefits to all stakeholders in the watershed, both within and outside of Pennsylvania, make the case for adoption of the strategies outlined in the Pennsylvania legislative study less an issue of if, but of when and how. The adoption of a competitive procurement program will have significant positive impact on technology providers that can deliver verified nitrogen reductions such as Bion, by allocating existing tax- and rate-payer clean water funding to low cost solutions based upon a voluntary and transparent procurement process. The Company believes that implementation of a competitively-bid nutrient reduction program to achieve the goals for the Chesapeake Bay watershed can also provide a working policy model and platform for other states to adopt that will enhance their efforts to comply with both current and future requirements for local and federal estuarine watersheds, including the Mississippi River/Gulf of Mexico, the Great Lakes Basin and other nutrient-impaired watersheds.

Additionally, we believe that Bion's technology platform (including utilization of various third party technologies to supplement the Company's proprietary technologies) will allow the integration of large-scale CAFO's and their end-product users, renewable energy production from the CAFO waste stream, and on site utilization of the renewable energy generated and biofuel/ethanol production in an environmentally and economically sustainable manner while reducing the aggregate capital expense and operating costs and increasing revenue and profitability for the entire integrated complex ("Integrated Projects" or "Projects"). In the context of Integrated Projects, Bion's waste treatment process, in addition to mitigating polluting releases, will generate renewable energy from cellulosic portions of the

CAFO waste stream which renewable energy can be utilized by integrated facilities including ethanol plants, CAFO end-product processors (including cheese, ice cream and/or bottling plants in the case of dairy CAFOs, and/or slaughter and/or processing facilities in the context of beef CAFOs) and/or other users as a replacement for fossil fuel usage. In addition an integrated ethanol plant's main by-product, called distillers grain, can be added to the feed of the animals in wet form, thereby lowering the capital expenditures, operating, marketing and shipping costs and energy usage of the ethanol production

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process. In such cases, the ethanol plant would act as a feed mill for the integrated CAFO, thereby reducing the CAFO's feeding costs as well as generating revenue to the ethanol plant, and would also provide a market for the renewable energy that Bion's System produces from the CAFO waste stream. And, in some cases the nutrient rich liquid effluent from the Bion system modules may be directly utilized for greenhouse and/or hydroponic agriculture. Accordingly, such Bion Integrated Projects can be denominated "closed loop". Bion anticipates that many projects may initially include only partial integration. Based on the degree of integration in a Project, greater or lesser amounts of benefits will be realized. Bion, as developer of, and participant in, Integrated Projects, anticipates that it will share in the cost savings and the revenues generated from these activities.

Bion is currently working with local, state and federal officials with regard to regulatory and legislative initiatives, and with such parties and potential industry participants to evaluate sites in multiple states. The Company believes that its initial Integrated Project will most likely be located and developed (probably in stages) in Pennsylvania and anticipates optioning land for such a Project during the current calendar year or soon thereafter. Note that locations in other states are also under review and the initial Integrated Project could be developed elsewhere. It is possible that the Company will develop one or more Integrated Projects as joint ventures specifically targeted to meet the growing animal protein demand outside of the United States (including without limitation Asia, Europe and/or the Middle East). Bion intends to choose sites for additional Projects during the calendar years 2014-2015 to create a pipeline of Projects. Management has a 5-year development target (through calendar year 2019) of approximately 10-24 Integrated Projects. At the end of that period, Bion projects that 5 or more of these Integrated Projects will be in full operation in 3-5 states (or other locations), and the balance would be in various stages ranging from partial operation to early permitting stage. **No Integrated Project has been developed to date.**

The Company's audited financial statements for the years ended June 30, 2013 and 2012 have been prepared assuming the Company will continue as a going concern. The Company has incurred net losses of approximately \$8,250,000 and \$6,465,000 during the years ended June 30, 2013 and 2012, respectively. The Report of the Independent Registered Public Accounting Firm on the Company's consolidated financial statements as of and for the year ended June 30, 2013 includes a "going concern" explanatory paragraph which means that the accounting firm has expressed substantial doubt about the Company's ability to continue as a going concern. The Company has incurred net losses (including significant non-cash expenses) of approximately \$738,000 and \$2,242,000 for the three and six months ended December 31, 2013, respectively. At December 31, 2013, the Company had a working capital deficit and a stockholders' deficit of approximately \$9,951,000 and \$4,862,000, respectively. **Management's plans with respect to these matters are described in this section and in our consolidated financial statements (and notes thereto), and this material does not include any adjustments that might result from the outcome of this uncertainty. However, there is no guarantee that we will be able to raise sufficient funds or further capital for the operations planned in the near future.**

## **CRITICAL ACCOUNTING POLICIES**

Management has identified the following policies below as critical to our business and results of operations. Our reported results are impacted by the application of the following accounting policies, certain of which require management to make subjective or complex judgments. These judgments involve making estimates about the effect of matters that are inherently uncertain and may significantly impact quarterly or annual results of operations. For all of these policies, management cautions that future events rarely develop exactly as expected, and the best estimates routinely require adjustment. Specific risks associated with these critical accounting policies are described in the paragraphs below.

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### ***Revenue Recognition***

While the Company has not recognized any significant operating revenues for the past two fiscal years, the Company has commenced generation of revenues during the year ended June 30, 2013. Revenues are generated from the sale of nutrient reduction credits, product sales, technology license fees, annual waste treatment fees and/or direct ownership interests in Integrated Projects. The Company recognizes revenue from the sale of nutrient credits and products when there is persuasive evidence that an arrangement exists, when title has passed, the price is fixed or determinable, and collection is reasonably assured. The Company expects that technology license fees will be generated from the licensing of Bion's systems. The Company anticipates that it will charge its customers a non-refundable up-front technology license fee, which will be recognized over the estimated life of the customer relationship. In addition, any on-going technology license fees will be recognized as earned based upon the performance requirements of the agreement. Annual waste treatment fees will be recognized upon receipt. Revenues, if any, from the Company's interest in Projects will be recognized when the entity in which the Project has been developed recognizes such revenue.

### ***Stock-based compensation***

The Company follows the provisions of Accounting Standards Codification ( ASC ) 718, which generally requires that share-based compensation transactions be accounted and recognized in the statement of income based upon their grant date fair values.

### **Derivative Financial Instruments:**

Pursuant to ASC Topic 815 Derivatives and Hedging ( Topic 815 ), the Company reviews all financial instruments for the existence of features which may require fair value accounting and a related mark-to-market adjustment at each reporting period end. Once determined, the Company assesses these instruments as derivative liabilities. The fair value of these instruments is adjusted to reflect the fair value at each reporting period end, with any increase or decrease in the fair value being recorded in results of operations as an adjustment to fair value of derivatives.

### **Warrants:**

The Company has issued warrants to purchase common shares of the Company. Warrants are valued using a fair value based method, whereby the fair value of the warrant is determined at the warrant issue date using a market-based option valuation model based on factors including an evaluation of the Company's value as of the date of the issuance, consideration of the Company's limited liquid resources and business prospects, the market price of the

Company's stock in its mostly inactive public market and the historical valuations and purchases of the Company's warrants. When warrants are issued in combination with debt or equity securities, the warrants are valued and accounted for based on the relative fair value of the warrants in relation to the total value assigned to the debt or equity securities and warrants combined.

**THREE MONTHS ENDED DECEMBER 31, 2013 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2012**

***Revenue***

Total revenues were nil for each of the three months ended December 31, 2013 and 2012, respectively.

***General and Administrative***

Total general and administrative expenses were \$527,000 and \$825,000 for the three months ended December 31, 2013 and 2012, respectively.

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General and administrative expenses, excluding stock-based compensation (credits)/charges of \$(131,000) and \$130,000, were \$658,000 and \$695,000 for the three months ended December 31, 2013 and 2012, respectively, representing a \$37,000 decrease. Salaries and related payroll tax expenses increased to \$355,000 for the three months ended December 31, 2013 from \$315,000 for the three months ended December 31, 2012. The increase is due to a one-time expense relating to the termination of two employees effective November 30, 2013, which was offset by lower overall salary due to the prior termination of two of the Company's employees during the three months ended September 30, 2013. Consulting expenses decreased \$32,000 from \$210,000 for the three months ended December 31, 2012 to \$178,000 for the three months ended December 31, 2013 due to the decreased utilization of strategic consultants. Contract labor costs at Kreider 1 also decreased \$15,000, from \$23,000 for the three months ended December 31, 2012 to \$8,000 for the three months ended December 31, 2013.

General and administrative stock-based employee compensation for the three months ended December 31, 2013 and 2012 consists of the following:

Three months  
ended  
December 31,  
2013

Three months

ended

December 31,

2012

General and  
administrative:

Fair value of stock  
issued to employees

\$ 25,000

\$ 25,000

Fair value of stock  
options  
(credited)/expensed

under ASC 718

(156,000)

105,000

Total

\$(131,000)

\$130,000

Stock-based compensation (credits)/charges were \$(131,000) and \$130,000 for the three months ended December 31, 2013 and 2012, respectively. Compensation (credits)/expense relating to stock options were \$(156,000) and \$105,000 during the three months ended December 31, 2013 and 2012, respectively. The credit for the three months ended December 31, 2013 resulted from the forfeiture of previously expensed unvested stock options of the two employees terminated during the quarter.

***Depreciation***

Total depreciation expense was \$244,000 and \$247,000 for the three months ended December 31, 2013 and 2012, respectively. The primary reason for the insignificant decrease in depreciation expense is due to the retirement of assets during the three months ended December 31, 2013.

***Research and Development***

Total research and development (credits)/expenses were \$(120,000) and \$38,000 for the three months ended December 31, 2013 and 2012, respectively.

Research and development expenses, excluding stock-based compensation (credits)/charges of \$(154,000) and \$9,000 were \$34,000 and \$29,000 for the three months ended December 31, 2013 and 2012, respectively.

Research and development stock-based employee compensation for the three months ended December 31, 2013 and 2012 consists of the following:

Three months ended

December 31, 2013

Three months ended

December 31, 2012

Research and  
development:



Fair value of stock  
options  
(credited)/expensed  
under

ASC 718

\$(154,000)

\$ 9,000

Total

\$(154,000)

\$ 9,000

Stock-based compensation (credits)/expense decreased from \$9,000 for the three months ended December 31, 2012 to \$(154,000) for the three months ended December 31, 2013 from the forfeiture of previously expensed unvested stock options of a research and development employee terminated during the quarter.

***Loss from Operations***

As a result of the factors described above, the loss from operations was \$651,000 and \$1,109,000 for the three months ended December 31, 2013 and 2012, respectively.

***Other Expense***

Other expense was \$89,000 and \$72,000 for the three months ended December 31, 2013 and 2012, respectively. Interest expense increased to \$89,000 for the three months ended December 31, 2013 from \$72,000 for the three months ended December 31, 2012. Interest expense increased primarily due to the deferred compensation balances owed to Brightcap/Bassani and Mark Smith which increased from \$16,000 for the three months ended December 31, 2012 to \$30,000 for the three months ended December 31, 2013.

***Net Loss Attributable to the Noncontrolling Interest***

The net loss attributable to the noncontrolling interest was \$1,000 for each of the three months ended December 31, 2013 and 2012.

***Net Loss Attributable to Bion's Common Stockholders***

As a result of the factors described above, the net loss attributable to Bion's stockholders was \$739,000 and \$1,181,000 for the three months ended December 31, 2013 and 2012, respectively, and the net loss per basic and diluted common share was \$0.04 and \$0.07, respectively.

**SIX MONTHS ENDED DECEMBER 31, 2013 COMPARED TO THE SIX MONTHS ENDED DECEMBER 31, 2012**

*General and Administrative*

Total general and administrative expenses were \$1,632,000 and \$3,008,000 for the six months ended December 31, 2013 and 2012, respectively.

General and administrative expenses, excluding stock-based compensation charges of \$315,000 and \$1,536,000, were \$1,317,000 and \$1,472,000 for the six months ended December 31, 2013 and 2012, respectively, representing a \$155,000 decrease. Salaries and related payroll tax expenses decreased from \$615,000 for the six months ended December 31, 2012 to \$605,000 for the six months ended December 31, 2013, primarily due to the fact that during the six months ended December 31, 2013 four employees were terminated which reduced recurring salary cost but was partially offset by a one-time accrual for termination benefits. Consulting costs were \$382,000 and \$437,000 for the six months ended December 31, 2013 and 2012, respectively, representing a \$55,000 decrease primarily due to the decreased utilization of a strategic affairs consultant during the fiscal 2014 period. Repairs and maintenance costs at Kreider 1 were \$10,000 and \$32,000 for the six months ended December 31, 2013 and 2012, respectively, representing a \$22,000 decrease.

General and administrative stock-based employee compensation for the six months ended December 31, 2013 and 2012 consists of the following:

Six months  
ended  
December 31,  
2013

Six months  
ended  
December 31,  
2012

General and  
administrative:

Fair value of  
stock/warrant  
bonuses expensed

\$ -

\$1,151,000

Fair value of stock  
issued to an  
employee

95,000

50,000

Change in fair  
value from  
modification of

option terms

308,000

-

Fair value of stock  
options  
(credited)/expensed

under ASC 718

(88,000)

335,000

Total

\$315,000

\$1,536,000

Stock-based compensation charges were \$315,000 and \$1,536,000 for the six months ended December 31, 2013 and 2012, respectively. The Company recognized general and administrative non-cash compensation expenses of nil and \$1,151,000 during the six months ended December 31, 2013 and 2012, respectively, due to the granting and vesting of stock and warrant bonuses in connection with the extension of employment agreements of two key officers during the six months ended December 31, 2012. Compensation expense relating to the change in fair value from the modification of option terms was \$308,000 and nil for the six months ended December 31, 2013 and 2012, respectively as the Company granted an extension of option expiration dates for a terminated employee and also granted exercise bonuses to a key employee and board member during the six months ended December 31, 2013.

Compensation (credit)/expense relating to stock options was \$(88,000) and \$335,000 during the six months ended December 31, 2013 and 2012, respectively, and the decrease resulted from the forfeiture of previously expensed unvested stock options of two employees terminated during the six months ended December 31, 2013.

### ***Depreciation***

Total depreciation expense was \$490,000 and \$413,000 for the six months ended December 31, 2013 and 2012, respectively. The primary reason for the increase in depreciation expense is due to the fact that the six months ended December 31, 2013 includes six months of depreciation on the Kreider 1 assets, while the six months ended December 31, 2012 only includes five months.

### ***Research and Development***

Total research and development (credits)/expenses were \$(53,000) and \$86,000 for the six months ended December 31, 2013 and 2012, respectively.

Research and development expenses, excluding stock-based compensation (credits)/charges of \$(136,000) and \$18,000 were \$83,000 and \$68,000 for the six months ended December 31, 2013 and 2012, respectively. The primary reason for the increase is due to salaries and payroll taxes increasing due to the increase in research and development projects during the six months ended December 31, 2013.

Research and development stock-based employee compensation for the six months ended December 31, 2013 and 2012 consists of the following:

|  |
|--|
| Six months<br>ended<br>December 31,<br>2013                    |
| Six months<br>ended<br>December 31,<br>2012                    |
| Research and<br>development:                                   |
|  |
| Fair value of stock<br>options<br>(credited)/expensed<br>under |
| ASC 718  |
| \$(136,000)  |
|  |
| \$18,000   |
| Total  |
| \$(136,000)  |

\$18,000

Stock-based compensation (credits)/expense decreased from \$18,000 for the six months ended December 31, 2012 to \$(136,000) for the six months ended December 31, 2013. The decrease resulted from the forfeiture of previously expensed unvested stock options of one employee terminated during the six months ended December 31, 2013.

### ***Loss from Operations***

As a result of the factors described above, the loss from operations was \$2,068,000 and \$3,507,000 for the six months ended December 31, 2013 and 2012, respectively.

### ***Other Expense***

Other expense was \$177,000 and \$127,000 for the six months ended December 31, 2013 and 2012, respectively. Interest expense increased to \$175,000 for the six months ended December 31, 2013 from \$127,000 for the six months ended December 31, 2012. Interest expense related to Kreider 1 was \$99,000 and \$83,000 for the six months ended December 31, 2013 and 2012, respectively. Interest also increased by \$27,000 due to deferred compensation balances owed to Bassani/Brightcap and Mark Smith as of December 31, 2013.

### ***Net Loss Attributable to the Noncontrolling Interest***

The net loss attributable to the noncontrolling interest was \$3,000 for each of the six months ended December 31, 2013 and 2012, respectively.

### ***Net Loss Attributable to Bion's Stockholders***

As a result of the factors described above, the net loss attributable to Bion's stockholders was \$2,243,000 and \$3,634,000 for the six months ended December 31, 2013 and 2012, respectively, representing a \$0.09 decrease in the net loss per basic and diluted common share from \$0.21 to \$0.12.

## **LIQUIDITY AND CAPITAL RESOURCES**

The Company's consolidated financial statements for the six months ended December 31, 2013 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The Report of our Independent Registered Public Accounting Firm on the Company's consolidated financial statements as of and for the year ended June 30, 2013 includes a "going concern" explanatory paragraph which means that the auditors stated that conditions exist that raise substantial doubt about the Company's ability to continue as a going concern.

### ***Operating Activities***

As of December 31, 2013, the Company had cash of approximately \$4,000. During the six months ended December 31, 2013, net cash used in operating activities was \$633,000, primarily consisting of cash operating expenses related to the Kreider Farms Project ( KF ) that are no longer being capitalized and general and administrative costs. **As previously noted, the Company is currently not generating significant revenue and accordingly has not generated cash flows from operations. The Company**

**does not anticipate generating sufficient revenues to offset operating and capital costs for a minimum of two to five years. While there are no assurances that the Company will be successful in its efforts to develop and construct its Projects and market its Systems, it is certain that the Company will require substantial funding from external sources. Given the unsettled state of the current credit and capital markets for companies such as Bion, there is no assurance the Company will be able to raise the funds it needs on reasonable terms.**

### *Investing Activities*

During the six months ended December 31, 2013, \$57,000 of restricted cash related to the Company's secured letter of credit which guaranteed its New York office lease was released. The restricted cash was increased by \$52,500 due to a subscription agreement for which the Company received the cash but the shares have not been issued as of December 31, 2013, pending the consummation of the offering. The Company also invested \$23,000 towards the purchase of property and equipment to be used in a research and development program.

### *Financing Activities*

During the six months ended December 31, 2013, the Company received cash proceeds of \$500,000 related to the sale of the Company's restricted common shares and \$53,000 from a restricted common shares subscription agreement.

The Company also received \$105,000 from loans from affiliates. The Company used \$71,000 to repay a loan payable to an affiliate.

As of December 31, 2013 the Company has debt obligations consisting of: a) loans payable affiliates of \$299,000, b) deferred compensation of \$644,000, c) convertible notes payable affiliates of \$1,676,000, and, d) a loan payable of \$7,754,000 (owed by PA-1).

### *Plan of Operations and Outlook*

As of December 31, 2013, the Company had cash of approximately \$4,000.

**The Company continues to explore sources of additional financing to satisfy its current operating requirements as it is not currently generating any significant revenues. During fiscal years 2012 and 2013 and through the six months ended December 31, 2013, the Company experienced greater difficulty in raising equity funding than in the prior years. During the year ended June 30, 2013 and during the period thereafter, the Company had the greatest difficulty raising funds to date. As a result, the Company faced, and continues to face, significant cash flow management challenges due to material working capital constraints.** To partially mitigate these working capital constraints, the Company's core senior management and several key employees have been deferring all or part of their cash compensation and/or are accepting compensation in the form of securities of the Company (Notes 5 and 7 to Financial Statements) and members of the Company's senior management have made loans to the Company totaling approximately \$299,000 including interest as of December 31, 2013. As of December 31, 2013 such deferrals totaled approximately \$2,320,000 (including accrued interest and deferred compensation converted into promissory notes). **The extended constraints on available resources have had, and continue to have, negative effects on the pace and scope of the Company's effort to develop its business.** The Company has made reductions in its personnel during the six months ended December 31, 2013. The Company has had to delay payments of trade obligations and economize in many ways that have potentially negative consequences. The Company's accounts payable have increased materially over this period. If the Company does not have greater success in its efforts to raise needed funds

during the current quarter (and subsequent periods), we will need to consider deeper cuts (including additional personnel cuts) and curtailments of operations (including possibly Kreider 1 operations). The Company will need to obtain additional capital to fund its operations and technology development, to satisfy existing creditors, to develop Integrated Projects and CAFO waste remediation systems (including the Kreider 2 facility) and to continue to operate the Kreider 1 facility (subject to agreements being reached with Pennvest as discussed above). The Company anticipates that it will seek to raise from \$2,500,000 to \$50,000,000 or more (debt and equity) during the next twelve months. **However, as discussed above, there is no guarantee that we will be able to raise sufficient funds or further capital for the operations planned in the near future.**

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**The Company is not currently generating any significant revenues. Further, the Company's anticipated revenues from existing projects and proposed projects will not be sufficient to meet the Company's anticipated operational and capital expenditure needs for many years.** During the six months ended December 31, 2013 the Company raised proceeds of \$500,000 through the sale of its securities (Note 8 to Financial Statements) and anticipates raising additional funds from such sales. **However, there is no guarantee that we will be able to raise sufficient funds or further capital for the operations planned in the near future.**

**Because the Company is not currently generating significant revenues, the Company will need to obtain additional capital to fund its operations and technology development, to satisfy existing creditors, to develop Projects and to sustain operations at the KF 1 facility.**

On January 26, 2009 the Board of the Pennsylvania Infrastructure Investment Authority ( Pennvest ) approved a \$7.75 million loan to Bion PA 1, LLC ( PA-1 ), a wholly-owned subsidiary of the Company, for the initial stage of Bion's Kreider Farms project ( Phase 1 Kreider System ). After substantial unanticipated delays, on August 12, 2010 the PA-1 received a permit for construction of the Phase 1 Kreider system. Construction activities commenced during November 2010. The closing/settlement of the Pennvest Loan took place on November 3, 2010. PA-1 finished the construction of the Phase 1 Kreider System and entered a period of system operational shakedown during May 2011. The Phase 1 Kreider System reached full, stabilized operation by the end of the 2012 fiscal year. During 2011 the Pennsylvania Department of Environmental Protection ( PADEP ) re-certified the nutrient credits for this project. The economics (potential revenues and profitability) of the Kreider 1 System are based largely on the long term sale of nutrient (nitrogen and/or phosphorus) reduction credits to meet the requirements of the Chesapeake Bay environmental clean-up. The PADEP issued final permits for the Kreider System (including the credit verification plan) on August 1, 2012 on which date the Company deemed that the Kreider System was placed in service . As a result, PA-1 has commenced generating nutrient reduction credits for potential sale while continuing to utilize the system to test improvements and add-ons. Operating results of the Phase 1 Kreider system have documented the efficacy of Bion's nutrient reduction technology and vetted potential add-ons for future installations. As a result of this extended period of operations, Bion is confident that future systems can be constructed with even higher operational efficiencies at lower capital expense and with lower operational costs. **To date liquidity in the Pennsylvania nutrient credit market has been slow to develop significant breadth and depth which limited liquidity has negatively impacted Bion's business plans and has resulted in challenges to monetizing the nutrient reductions created by PA-1's existing Kreider 1 project and Bion's other proposed projects. These difficulties have prevented PA-1 from generating any material revenues from the Kreider 1 project to date (PA-1's Kreider 1 operating expenses have been funded by loans from Bion) and raise significant questions as to when, if ever, PA-1 will be able to generate material revenues from the Kreider 1 system. PA-1 has been engaged in active negotiations with Pennvest related to forbearance and/or re-structuring its obligations pursuant to the Pennvest Loan for several months. In the context of such negotiations, PA-1 has elected not to make interest**



payments to Pennvest on the Pennvest Loan since January 2013. Additionally, the Company has not made any principal payments, which were to begin in fiscal 2013. As a result, Pennvest has the right to declare the Pennvest Loan in default and, therefore, the Company has classified the Pennvest Loan as a current liability as of December 31, 2013. It is not possible at this date to predict the outcome of such negotiations but the Company believes that there is a reasonable likelihood that an interim, short-term agreement will be reached that will allow PA-1 and Pennvest a period of time to evaluate developments in the Pennsylvania nutrient reduction market and possible long-term resolutions. Subject to the results of the negotiations with Pennvest and pending development of a more robust market for nutrient reductions in Pennsylvania, PA-1 and Bion anticipate that it will be necessary to evaluate various options with regard to Kreider 1 over the next 60-150 days.

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During August 2012 the Company provided Pennvest (and the PADEP) with data demonstrating that the Kreider 1 system has met the technology guaranty standards which were incorporated in the Pennvest financing documents and, as a result, the Pennvest Loan is now solely an obligation of PA-1.

As indicated above, the Company anticipates that it will seek to raise from \$2,500,000 to \$50,000,000 or more (debt and equity) during the next twelve months, some of which may be in the context of joint ventures for the development of one or more Integrated Projects. **We reiterate that there is no assurance, especially in the extremely unsettled capital markets that presently exist for companies such as Bion, that the Company will be able to obtain the funds that it needs to stay in business, finance its Projects and other activities, continue its technology development and/or to successfully develop its business.**

**There is no likelihood that funds required during the next twelve months or in the periods immediately thereafter will be generated from operations and there is no assurance that those funds will be available from external sources such as debt or equity financings or other potential sources. The lack of additional capital resulting from the inability to generate cash flow from operations and/or to raise capital from external sources would force the Company to substantially curtail or cease operations and would, therefore, have a material adverse effect on its business. Further, there can be no assurance that any such required funds, if available, will be available on attractive terms or that they will not have a significantly dilutive effect on the Company's existing shareholders. All of these factors have been exacerbated by the extremely unsettled credit and capital markets presently existing for companies such as Bion.**

Currently, Bion is focused on using applications of its patented waste management technology and its technology platform to pursue three main business opportunities: 1) development of Integrated Projects which will include large CAFOs, such as large dairies, beef cattle feed lots and hog farms, with Bion waste treatment System modules processing the aggregate CAFO waste stream from the equivalent of 40,000 or more beef and/or dairy cows (or the waste stream equivalent of other species) while producing solids to be utilized for renewable energy production (and potentially to be marketed as feed and/or fertilizer), integrated with an ethanol plant capable of producing 40 million gallons (or more) of ethanol per year, and/or integrated with CAFO end product processors, 2) installation of Bion systems to retrofit and environmentally remediate existing CAFOs in selected markets where: a) government policy supports such efforts (such as the Chesapeake Bay watershed or, potentially, other areas seeking to meet EPA TMDL requirements) and/or b) where CAFOs need our technology to obtain permits to expand or develop without negative environmental consequences, and 3) licensing and/or joint venturing its technology for use outside of North America.

The Company has commenced activities related to marketing and potential use of its technology in relation to expansion and/or development of CAFO s in the Northeast and Midwest (and elsewhere). Bion considers this to be a large potential market for the Company s growth over the next 18-36 months (and thereafter). Assuming that the Company can be successful in raising necessary funding and the development of a more robust market for nutrient reductions in Pennsylvania (and elsewhere), neither of which are assured at this date, it is anticipated at such activities will accelerate based on the operating results achieved by the Kreider 1 system.

The Company continues its development work related to the second phase of the Kreider project ( Phase 2 Kreider Project ) which involves production of renewable energy from the waste of KF s poultry operations and the cellulosic solids recovered by the Kreider 1 system. During May 2011 the PADEP certified the Phase 2 Kreider Project for 559,457 nutrient credits under the old EPA s Chesapeake Bay model. The Company anticipates that this project will be certified for between 1.5-2 million nutrient reduction credits pursuant to the amended EPA Chesapeake Bay model which was published subsequent to the original certification. If there are positive developments related to the market for nutrient reductions in Pennsylvania (of which there is no assurance), the Company intends to pursue development, design and

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construction of the Phase 2 Kreider Project with a goal of achieving operational status during the 2014 calendar year, and hopes to enter into agreements related to sales of the credits for future delivery (under long term contracts) during 2014 subject to verification by the PADEP. **The economics (potential revenues and profitability) of the Phase 2 Kreider Project are based largely on the long term sale of nutrient (nitrogen and/or phosphorus) reduction credits to meet the requirements of the Chesapeake Bay environmental clean-up. However, liquidity in the Pennsylvania nutrient credit market has been slow to develop significant breadth and depth which to date has negatively impacted Bion s business plans and has resulted in challenges to monetizing the nutrient reduction credits created by PA-1 s existing Kreider 1 project and will delay the Company s Phase 2 Kreider Project and other proposed projects in Pennsylvania.**

Bion is currently working with local, state and federal officials with regard to regulatory and legislative initiatives, and with such parties and potential industry participants to evaluate sites in multiple states. The Company believes that its initial Integrated Project will most likely be located and developed (possibly in stages) in Pennsylvania and anticipates optioning land for such a Project in one of those areas during the current fiscal year or soon thereafter. Note that locations in other states are also under review and the initial Integrated Project could be developed elsewhere. It is possible that the Company will develop one or more Integrated Projects as joint ventures specifically targeted to meet the growing animal protein demand outside of the United States (including without limitation Asia, Europe and/or the Middle East). Bion intends to choose sites for additional Projects during the calendar years 2014-2015 to create a pipeline of Projects. Management has a 5-year development target (through calendar year 2019) of approximately 10-24 Integrated Projects. At the end of that period, Bion projects that 5 or more of these Integrated Projects will be in full operation in 3-5 states (or other locations), and the balance would be in various stages ranging from partial operation to early permitting stage. **No Integrated Project has been developed to date.**

## CONTRACTUAL OBLIGATIONS

We have the following material contractual obligations (in addition to employment and consulting agreements with management and employees):

1) On September 27, 2008, the Company executed an agreement with Kreider Farms (and its affiliated entities) (collectively "Kreider") to design, construct and operate, through its wholly-owned subsidiary PA-1, a Bion system to treat the waste of the dairy cows (milkers, dry cows and heifers) at the Kreider Dairy, located in Mannheim, Pennsylvania. In addition, this agreement (as amended and extended) provides for a second phase which will include treatment of the cellulosic solid wastes from the Kreider 1 together with the waste stream from Kreider's poultry facilities to produce renewable energy for Bion's waste treatment facility and/or for market sales. The Kreider 1 system is owned and operated by PA-1, in which Kreider has the option to purchase a minority interest. Funds were expended over the last year to complete the construction of the Kreider 1 System and substantial capital and operating funds (equity and/or debt) has been and will continue to be expended. The Company anticipates that PA-1 will receive revenue from the sale of nutrient (and other) environmental credits related to the Kreider 1 system, and through sales of renewable energy generated in connection with the second phase (largely poultry manure) of the Kreider project. The \$7.75 million loan from the Pennsylvania Infrastructure Investment Authority to PA-1 ( Pennvest Loan ), together with funds provided by the Company, has provided the funds for construction of the Kreider 1 system. The Pennvest loan is to be repaid by interest only payments for the first three years, followed by an additional ten-year amortization of principal, and matures in November 2023. The Kreider 1 system reached full, stabilized operation by the end of the 2012 fiscal year and received final permits during August 2012. The Pennsylvania Department of Environmental Protection re-certified the nutrient credits for this project. As a result, PA-1 can now commence generating and verifying nutrient reduction credits for sale while continuing to utilize the system to test improvements and add-ons. Operating results of the Phase 1 Kreider system have documented the efficacy of Bion's nutrient reduction technology and vetted potential add-ons for future

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installations. As a result of this extended period of operations, Bion is confident that future systems can be constructed with even higher operational efficiencies at lower capital expense and with lower operational costs. **To date liquidity in the Pennsylvania nutrient credit market has been slow to develop significant breadth and depth which limited liquidity has negatively impacted Bion's business plans and has resulted in challenges to monetizing the nutrient reductions created by PA-1's existing Kreider 1 project and Bion's other proposed projects. These difficulties have prevented PA-1 from generating any material revenues from the Kreider 1 project to date (PA-1's Kreider 1 operating expenses have been funded by loans from Bion) and raise significant questions as to when, if ever, PA-1 will be able to generate material revenues from the Kreider 1 system. PA-1 has been engaged in active negotiations with Pennvest related to forbearance and/or re-structuring its obligations pursuant to the Pennvest Loan for several months. In the context of such negotiations, PA-1 has elected not to make interest payments to Pennvest on the Pennvest Loan since January 2013. Additionally, the Company has not made any principal payments, which were to begin in fiscal 2013. As a result, Pennvest has the right to declare the Pennvest Loan in default and, therefore, the Company has classified the Pennvest Loan as a current liability as of December 31, 2013. It is not possible at this date to predict the outcome of such negotiations but the Company believes that there is a reasonable likelihood that an interim, short-term agreement will be reached that will allow PA-1 and Pennvest a period of time to evaluate developments in the Pennsylvania nutrient reduction market and possible long-term resolutions. Subject to the results of the negotiations with Pennvest and pending development of a more robust market for nutrient reductions in Pennsylvania, PA-1 and Bion anticipate that it will be necessary to evaluate various options with regard to Kreider 1 over the next 60-150 days.**

#### OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements (as that term is defined in Item 303 of Regulation S-K) that are reasonably likely to have a current or future material effect on our financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Not applicable.

**Item 4. Controls and Procedures.**

(a) Evaluation of Disclosure Controls and Procedures.

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized, and reported within the required time periods. Our Chief Executive Officer and Principal Financial Officer has evaluated the effectiveness of the design and operations of our disclosure controls and procedures as of the end of the period covered by this quarterly report, and has concluded that, as of that date, our disclosure controls and procedures were not effective at ensuring that required information will be disclosed on a timely basis in our reports filed under the Exchange Act, as a result of the material weakness in internal control over financial reporting discussed in Item 9(A) of our Form 10-K for the year ended June 30, 2013.

(b) Changes in Internal Control over Financial Reporting.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

The Company is not involved in any material legal proceedings at this time.

**Item 1A. Risk Factors.**

Not applicable.

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

During the quarter ended December 31, 2013 the Company sold the following restricted securities 77,625 shares issued pursuant to our 2006 Consolidated Incentive Plan ( Plan ), valued at \$104,933, in aggregate, to certain consultants and/or employees for services. These securities were issued in reliance on the exemptions provided by Regulation D of the Securities Act of 1933 and/or Section 4(2) of the Securities Act of 1933. See Notes to Financial

Statements (included herein) for additional details.

The proceeds were utilized for general corporate purposes.

**Item 3. Defaults Upon Senior Securities.**

Not applicable.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

Not applicable.

**Item 6. Exhibits.**

(a) Exhibits required by Item 601 of Regulation S-K.

**Exhibit**

**Description**

31.1

Certification of CEO pursuant to Rule 13a-14(a) or Rule 15d-14(a) - Filed herewith electronically

31.2

Certification of Executive Chairman, President and CFO pursuant to Rule 13a-14(a) or Rule 15d-14(a) -  
Filed herewith electronically

32.1

Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - Filed herewith  
electronically

32.2

Certification of Executive Chairman, President and CFO pursuant to Section 906 of the Sarbanes-Oxley  
Act of 2002 - Filed herewith electronically

**SIGNATURES**

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

**BION ENVIRONMENTAL TECHNOLOGIES, INC.**

Date: February 7, 2014

By:

*/s/ Mark A. Smith*

Mark A. Smith, President and Chief Financial Officer (Principal  
Financial and Accounting Officer)

Date: February 7, 2014

By:

*/s/ Dominic Bassani*

Dominic Bassani, Chief Executive Officer