

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2016

or

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

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

Commission File Number 001-33216

**SONOMA PHARMACEUTICALS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**68-0423298**

(I.R.S Employer  
Identification No.)

**1129 North McDowell Blvd.**

**Petaluma, CA 94954**

(Address of principal executive offices) (Zip Code)

**(707) 283-0550**

Registrant's telephone number, including area code

Indicate by checkmark 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.

Large accelerated filer

Accelerated filer

Non-accelerated filer  
(Do not check if a smaller reporting company)

Smaller reporting company

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

As of February 15, 2017 the number of shares outstanding of the registrant's common stock, \$0.0001 par value, was 4,262,754.

---

SONOMA PHARMACEUTICALS, INC.

Index

	<u>Page</u>
<b><u>PART I — FINANCIAL INFORMATION</u></b>	3
<b><u>Item 1. Financial Statements</u></b>	3
<u>Condensed Consolidated Balance Sheets</u>	3
<u>Condensed Consolidated Statements of Comprehensive Income (Loss)</u>	4
<u>Condensed Consolidated Statements of Cash Flows</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<b><u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u></b>	19
<b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u></b>	31
<b><u>Item 4. Controls and Procedures</u></b>	31
<b><u>PART II — OTHER INFORMATION</u></b>	32
<b><u>Item 1. Legal Proceedings</u></b>	32
<b><u>Item 1A. Risk Factors</u></b>	32
<b><u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	32
<b><u>Item 3. Defaults Upon Senior Securities</u></b>	33
<b><u>Item 4. Mine Safety Disclosures (Not applicable.)</u></b>	33
<b><u>Item 5. Other Information</u></b>	33
<b><u>Item 6. Exhibits</u></b>	35

**PART I — FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**SONOMA PHARMACEUTICALS, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Balance Sheets**  
(In thousands, except share and per share amounts)

	<b>December 31,</b>	<b>March 31,</b>
	<b>2016</b>	<b>2016</b>
	(Unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 18,983	\$ 7,469
Restricted cash (Note 4)	1,500	–
Accounts receivable, net	1,977	1,508
Inventories, net	2,066	1,595
Prepaid expenses and other current assets	362	1,505
Current portion of deferred consideration, net of discount	239	–
Current assets of discontinued operations (Note 4)	–	811
Total current assets	25,127	12,888
Property and equipment, net	798	850
Deferred consideration, net of discount, less current portion	1,509	–
Other assets	73	65
Total assets	\$ 27,507	\$ 13,803
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,092	\$ 1,337
Accrued expenses and other current liabilities	1,626	1,526
Deferred revenue	794	274
Current portion of long-term debt	12	114
Taxes payable	229	–
Current liabilities of discontinued operations (Note 4)	–	300
Total current liabilities	3,753	3,551
Long-term deferred revenue	531	–
Long-term debt, less current portion	48	–
Deferred tax liability	312	–
Long-term liabilities of discontinued operations (Note 4)	–	112
Total liabilities	4,644	3,663
Commitments and Contingencies (Note 6)		
Stockholders' Equity		
Convertible preferred stock, \$0.0001 par value; 714,286 shares authorized, none issued and outstanding at December 31, 2016 and March 31, 2016, respectively	–	–
Common stock, \$0.0001 par value; 12,000,000 shares authorized at December 31, 2016 and March 31, 2016, 4,257,754 (unaudited) and 4,196,873 shares issued and outstanding at December 31, 2016 and March 31, 2016, respectively (Note 7)	1	1
Additional paid-in capital	168,198	166,368
Accumulated deficit	(140,665)	(152,375)
Accumulated other comprehensive loss	(4,671)	(3,854)
Total stockholders' equity	22,863	10,140
Total liabilities and stockholders' equity	\$ 27,507	\$ 13,803

The accompanying footnotes are an integral part of these condensed consolidated financial statements.

**SONOMA PHARMACEUTICALS, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Comprehensive Income (Loss)**  
(In thousands, except per share amounts)  
(Unaudited)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>December 31,</b>		<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>Revenues</b>				
Product	\$ 3,174	\$ 2,212	\$ 8,158	\$ 5,708
Product licensing fees and royalties	–	44	–	231
Service	187	227	638	855
Total revenues	<u>3,361</u>	<u>2,483</u>	<u>8,796</u>	<u>6,794</u>
<b>Cost of revenues</b>				
Product	1,476	1,851	4,507	4,402
Service	179	177	568	715
Total cost of revenues	<u>1,655</u>	<u>2,028</u>	<u>5,075</u>	<u>5,117</u>
Gross profit	<u>1,706</u>	<u>455</u>	<u>3,721</u>	<u>1,677</u>
<b>Operating expenses</b>				
Research and development	487	486	1,226	1,365
Selling, general and administrative	4,784	4,158	12,557	11,411
Total operating expenses	<u>5,271</u>	<u>4,644</u>	<u>13,783</u>	<u>12,776</u>
Loss from operations	<u>(3,565)</u>	<u>(4,189)</u>	<u>(10,062)</u>	<u>(11,099)</u>
Interest expense	–	–	(2)	(1)
Interest income	6	–	8	1
Gain due to change in fair value of derivative liabilities	–	4	–	10
Tax benefit (Note 4)	4,040	–	4,040	–
Other income (expense), net	282	(29)	276	31
Income (loss) from continuing operations	<u>763</u>	<u>(4,214)</u>	<u>(5,740)</u>	<u>(11,058)</u>
Income from discontinued operations (net of tax) (Note 4)	15,465	1,065	17,450	3,806
Net income (loss)	<u>\$ 16,228</u>	<u>\$ (3,149)</u>	<u>\$ 11,710</u>	<u>\$ (7,252)</u>
<b>Net income (loss) per share: basic</b>				
Continuing operations	\$ 0.18	\$ (1.28)	\$ (1.36)	\$ (3.46)
Discontinued operations	3.66	0.32	4.15	1.19
	<u>\$ 3.84</u>	<u>\$ (0.96)</u>	<u>\$ 2.78</u>	<u>\$ (2.27)</u>
<b>Weighted-average number of shares used in per share calculations:</b>				
basic	<u>4,225</u>	<u>3,293</u>	<u>4,209</u>	<u>3,195</u>
<b>Net income (loss) per share: diluted</b>				
Continuing operations	\$ 0.18	\$ (1.28)	\$ (1.36)	\$ (3.46)
Discontinued operations	3.66	0.32	4.15	1.19
	<u>\$ 3.84</u>	<u>\$ (0.96)</u>	<u>\$ 2.78</u>	<u>\$ (2.27)</u>
<b>Weighted-average number of shares used in per share calculations:</b>				
diluted	<u>4,228</u>	<u>3,293</u>	<u>4,209</u>	<u>3,195</u>
<b>Other comprehensive income (loss)</b>				
Net income (loss)	\$ 16,228	\$ (3,149)	\$ 11,710	\$ (7,252)
Foreign currency translation adjustments	(416)	(68)	(817)	(392)
Comprehensive income (loss)	<u>\$ 15,812</u>	<u>\$ (3,217)</u>	<u>\$ 10,893</u>	<u>\$ (7,644)</u>

The accompanying footnotes are an integral part of these condensed consolidated financial statements.

**SONOMA PHARMACEUTICALS, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Cash Flows**  
(In thousands)  
(Unaudited)

	<b>Nine Months Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
	<b>(In thousands)</b>	
<b>Cash flows from operating activities</b>		
Net loss from continuing operations	\$ (5,740)	\$ (11,058)
Net income from discontinued operations, net of tax	17,450	3,806
Net income (loss)	11,710	(7,252)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	178	182
Gain on sale of Latin American assets, net of tax	(14,906)	–
Income tax benefit	(4,040)	–
Stock-based compensation	1,732	1,459
Service provider expenses settled with common stock	98	190
Gain due to change in fair value of derivative liabilities	–	(10)
Foreign currency transaction gains	(13)	(42)
Changes in operating assets and liabilities:		
Accounts receivable	(105)	(1,351)
Inventories	(644)	(319)
Prepaid expenses and other current assets	1,104	(106)
Accounts payable	(205)	569
Accrued expenses and other current liabilities	86	277
Deferred revenue	(467)	(621)
Net cash (used in) operating activities	<u>(5,472)</u>	<u>(7,024)</u>
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(195)	(353)
Proceeds from sale of long-term investment	–	4,538
Proceeds from sale of Latin American assets, net of costs	17,444	–
Deposits	(17)	(5)
Net cash provided by investing activities	<u>17,232</u>	<u>4,180</u>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common stock, net of offering costs	–	2,949
Proceeds from exercise of common stock purchase warrants	–	14
Principal payments on long-term debt	(119)	(87)
Net cash (used in) provided by financing activities	<u>(119)</u>	<u>2,876</u>
Effect of exchange rate on cash and cash equivalents	(127)	(55)
Net increase (decrease) in cash and cash equivalents	11,514	(23)
Cash and cash equivalents, beginning of period	7,469	6,136
Cash and cash equivalents, end of period	<u>\$ 18,983</u>	<u>\$ 6,113</u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for interest	<u>\$ 2</u>	<u>\$ –</u>
<b>Non-cash operating and financing activities:</b>		
Issuance of common stock to settle obligation	\$ –	\$ 96
<b>Sale to Invekra:</b>		
Assets acquired and liabilities assumed:		
Restricted cash	\$ 1,500	\$ –
Deferred consideration – current, net	239	–
Deferred consideration – long-term, net	1,509	–
Taxes payable	(229)	–
Deferred tax liability	(312)	–
Deferred revenue – current	(674)	–
Deferred revenue – long-term	(531)	–
Total non-cash items	<u>\$ 1,502</u>	<u>\$ –</u>

The accompanying footnotes are an integral part of these condensed consolidated financial statements.

**SONOMA PHARMACEUTICALS, INC. AND SUBSIDIARIES**  
**Notes to Condensed Consolidated Financial Statements**  
(Unaudited)

**Note 1. Organization and Recent Developments**

***Organization***

Sonoma Pharmaceuticals, Inc., formerly known as Oculus Innovative Sciences, Inc., (the “Company”) was incorporated under the laws of the State of California in April 1999 and was reincorporated under the laws of the State of Delaware in December 2006. The Company’s principal office is located in Petaluma, California. The Company is a specialty pharmaceutical company that develops and markets solutions for the treatment of dermatological conditions and advanced tissue care. The Company’s products, which are sold throughout the United States and 39 countries around the world, have improved patient outcomes for more than five million patients globally by reducing infections, itch, pain, scarring, odor and harmful inflammatory responses.

Effective December 6, 2016, the Company changed its name from Oculus Innovative Sciences, Inc. to Sonoma Pharmaceuticals, Inc.

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements as of December 31, 2016 and for the three and nine months then ended have been prepared in accordance with the accounting principles generally accepted in the United States of America for interim financial information and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (“SEC”) and on the same basis as the Company prepares its annual audited consolidated financial statements. The unaudited condensed consolidated balance sheet as of December 31, 2016, the condensed consolidated statements of comprehensive loss for the three and nine months ended December 31, 2016 and 2015, and the condensed consolidated statements of cash flows for the nine months ended December 31, 2016 and 2015 are unaudited, but include all adjustments, consisting only of normal recurring adjustments, which the Company considers necessary for a fair presentation of the financial position, operating results and cash flows for the periods presented. The results for the three and nine months ended December 31, 2016 are not necessarily indicative of results to be expected for the year ending March 31, 2017 or for any future interim period. The condensed consolidated balance sheet at March 31, 2016 has been derived from audited consolidated financial statements. However, it does not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete consolidated financial statements. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended March 31, 2016, and notes thereto included in the Company’s annual report on Form 10-K, which was filed with the SEC on June 21, 2016.

***Reverse Stock Split***

Effective June 24, 2016, the Company effected a reverse stock split of its common stock, par value \$0.0001 per share. Every 5 shares of common stock were reclassified and combined into one share of common stock. No fractional shares were issued as a result of the reverse stock split. Instead, stockholders entitled to receive fractional shares received cash in the amount equal to the closing price per share of the Company’s common stock as reported on the NASDAQ Capital Market as of 5:00 p.m. Eastern Time on June 24, 2016, multiplied by the fraction of one share owned by the stockholder. The reverse stock split reduced the number of shares of the Company’s common stock outstanding from 21,004,857 to 4,200,756. The total number of authorized shares of common stock was also proportionally decreased by a ratio of 1:5 and the par value per share of the common stock continued to be \$0.0001.

All common shares and per share amounts contained in the condensed consolidated financial statements have been retroactively adjusted to reflect a 1 for 5 reverse stock split.

**Note 2. Liquidity and Financial Condition**

The Company reported a net income of \$11,710,000 for the nine months ended December 31, 2016. At December 31, 2016 and March 31, 2016, the Company’s accumulated deficit amounted to \$140,665,000 and \$152,375,000, respectively. The Company had working capital of \$21,374,000 and \$9,337,000 as of December 31, 2016 and March 31, 2016, respectively.

On October 27, 2016, the Company, along with its Mexican subsidiary and manufacturer Oculus Technologies of Mexico, S.A. de C.V. (“OTM”), closed on an asset purchase agreement with Invekra, S.A.P.I de C.V. (“Invekra”), an affiliate of Laboratorios Sanfer S.A. de C.V., for the sale of certain of its Latin America assets. Specifically, the Company agreed to sell certain patents, patent applications, trademarks and territory rights for Mexico, the Caribbean and South America, excluding the sale of dermatology products in Brazil, as well as to build and deliver equipment that Invekra will use to produce its own product.

The aggregate purchase price that Invekra will pay for the assets is \$22,000,000, of which \$18,000,000 was paid upon closing, \$1,500,000 will be held in escrow until completion of the Company’s obligations to deliver certain equipment, and \$2,500,000 will be paid in Mexican currency in quarterly installments over a period of ten years from closing as consideration for the provision of certain services and providing technical assistance, calculated as three per cent on net sales of certain products in Latin America, excluding Mexico. Because the \$2,500,000 is to be paid in foreign currency, the Company may receive more or less than \$2,500,000 due to currency fluctuations.

The Company currently anticipates that its cash and cash equivalents will be sufficient to meet its working capital requirements to continue its sales and marketing and research and development efforts for at least 12 months from the date of filing this quarterly report.

### Note 3. Summary of Significant Accounting Policies

#### Use of Estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the dates of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. Significant estimates and assumptions include reserves and write-downs related to receivables and inventories, the recoverability of long-lived assets, the valuation allowance relating to the Company’s deferred tax assets, valuation of equity and derivative instruments, debt discounts, valuation of investments, determination of the relative selling prices of the components sold to Invekra, and the estimated amortization periods of upfront product licensing fees received from customers. Periodically, the Company evaluates and adjusts estimates accordingly. The allowance for doubtful accounts represents probable credit losses of \$37,000 and \$15,000 at December 31, 2016 and March 31, 2016, respectively. Additionally at December 31, 2016 and March 31, 2016 the Company has allowances of \$1,061,000 and \$653,000, respectively, related to potential discounts, returns, distributor fees and rebates. The allowances are included in Accounts Receivable, net in the accompanying condensed consolidated balance sheets.

#### Basic and Diluted Net Income (Loss) per common share

Basic earnings and loss per share for both continuing and discontinued operations are computed by dividing the net income or loss available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common shares and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of the incremental common shares issuable upon the exercise of stock options (using the treasury stock method) and warrants (using the if-converted method). Diluted loss per share excludes the shares issuable upon the exercise of stock options and warrants from the calculation of net loss per share as their effect would be anti-dilutive.

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Numerator:				
Income (loss) from continuing operations	763,000	(4,214,000)	(5,740,000)	(11,058,000)
Income from discontinued operations (net of tax)	15,465,000	1,065,000	17,450,000	3,806,000
Net income (loss)	<u>\$ 16,228,000</u>	<u>\$ (3,149,000)</u>	<u>\$ 11,710,000</u>	<u>\$ (7,252,000)</u>
Denominator:				
Weighted-average number of common shares outstanding - basic	4,225,000	3,293,000	4,209,000	3,195,000
Options to purchase common stock	3,000	–	–	–
Weighted-average number of common shares outstanding - diluted	<u>4,228,000</u>	<u>3,293,000</u>	<u>4,209,000</u>	<u>3,195,000</u>
Basic – income (loss) from continuing operations	\$ 0.18	\$ (1.28)	\$ (1.36)	\$ (3.46)
Basic – income from discontinued operations	3.66	0.32	4.15	1.19
	<u>\$ 3.84</u>	<u>\$ (0.96)</u>	<u>\$ 2.78</u>	<u>\$ (2.27)</u>
Diluted – income (loss) from continuing operations	\$ 0.18	\$ (1.28)	\$ (1.36)	\$ (3.46)
Diluted – income from discontinued operations	3.66	0.32	4.15	1.19
	<u>\$ 3.84</u>	<u>\$ (0.96)</u>	<u>\$ 2.78</u>	<u>\$ (2.27)</u>

The following securities were excluded from the weighted average dilutive common shares outstanding because their inclusion would have been antidilutive.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>December 31,</b>		<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Options to purchase common stock	848,000	740,000	851,000	740,000
Warrants to purchase common stock	1,365,000	1,265,000	1,365,000	1,265,000
	<u>2,213,000</u>	<u>2,005,000</u>	<u>2,216,000</u>	<u>2,005,000</u>

***Common Stock Purchase Warrants and Other Derivative Financial Instruments***

The Company classifies common stock purchase warrants and other free standing derivative financial instruments as equity if the contracts (i) require physical settlement or net-share settlement or (ii) give the Company a choice of net-cash settlement or settlement in its own shares (physical settlement or net-share settlement). The Company classifies any contracts that (i) require net-cash settlement (including a requirement to net cash settle the contract if an event occurs and if that event is outside the control of the Company), (ii) give the counterparty a choice of net cash settlement or settlement in shares (physical settlement or net-share settlement), or (iii) contain reset provisions as either an asset or a liability. The Company assesses classification of its freestanding derivatives at each reporting date to determine whether a change in classification between assets and liabilities is required. The Company determined that its freestanding derivatives, which principally consist of warrants to purchase common stock, satisfied the criteria for classification as equity instruments.

***Revenue Recognition and Accounts Receivable***

The Company generates revenue from sales of its products to a customer base including hospitals, medical centers, doctors, pharmacies, distributors and wholesalers. The Company sells products directly to end users and to distributors. The Company also entered into agreements to license its technology and products.

The Company also provides regulatory compliance testing and quality assurance services to medical device and pharmaceutical companies.

The Company records revenue when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectability of the sale is reasonably assured.

The Company requires all product sales to be supported by evidence of a sale transaction that clearly indicates the selling price to the customer, shipping terms and payment terms. Evidence of an arrangement generally consists of a contract or purchase order approved by the customer. The Company has ongoing relationships with certain customers from which it customarily accepts orders by telephone in lieu of purchase orders.

The Company recognizes revenue at the time it receives confirmation that the goods were either tendered at their destination, when shipped "FOB destination," or transferred to a shipping agent, when shipped "FOB shipping point." Delivery to the customer is deemed to have occurred when the customer takes title to the product. Generally, title passes to the customer upon shipment, but could occur when the customer receives the product based on the terms of the agreement with the customer.



The selling prices of all goods are fixed, and agreed to with the customer, prior to shipment. Selling prices are generally based on established list prices. The right to return product is customarily based on the terms of the agreement with the customer. The Company estimates and accrues for potential returns and records this as a reduction of revenue in the same period the related revenue is recognized. Additionally, distribution fees are paid to certain wholesale distributors based on contractually determined rates. The Company estimates and accrues the fee on shipment to the respective wholesale distributors and recognizes the fee as a reduction of revenue in the same period the related revenue is recognized. The Company also offers cash discounts to certain customers, generally 2% of the sales price, as an incentive for prompt payment. The Company accounts for cash discounts by reducing accounts receivable by the prompt pay discount amount and recognizes the discount as a reduction of revenue in the same period the related revenue is recognized. Additionally, the Company participates in certain rebate programs which provide discounted prescriptions to qualified patients. The Company contracts with a third-party to administer the program. The Company estimates and accrues for future rebates based on historical data for rebate redemption rates and the historical value of redemptions. Rebates are recognized as a reduction of revenue in the same period the related revenue is recognized.

The Company evaluates the creditworthiness of new customers and monitors the creditworthiness of its existing customers to determine whether an event or changes in their financial circumstances would raise doubt as to the collectability of a sale at the time in which a sale is made. Payment terms on sales made in the United States are generally 30 days and are extended up to 90 days for initial product launches, payment terms internationally generally range from prepaid prior to shipment to 90 days.

In the event a sale is made to a customer under circumstances in which collectability is not reasonably assured, the Company either requires the customer to remit payment prior to shipment or defers recognition of the revenue until payment is received. The Company maintains a reserve for amounts which may not be collectible due to risk of credit losses.

Product license revenue is generated through agreements with strategic partners for the commercialization of Microcyn® products. The terms of the agreements sometimes include non-refundable upfront fees. The Company analyzes multiple element arrangements to determine whether the elements can be separated. Analysis is performed at the inception of the arrangement and as each product is delivered. If a product or service is not separable, the combined deliverables are accounted for as a single unit of accounting and recognized over the performance obligation period.

When appropriate, the Company defers recognition of non-refundable upfront fees. If the Company has continuing performance obligations then such up-front fees are deferred and recognized over the period of continuing involvement.

The Company recognizes royalty revenues from licensed products upon the sale of the related products.

Revenue from consulting contracts is recognized as services are provided. Revenue from testing contracts is recognized as tests are completed and a final report is sent to the customer.

### ***Inventories***

Inventories are stated at the lower of cost, cost being determined on a standard cost basis (which approximates actual cost on a first-in, first-out basis), or market.

Due to changing market conditions, estimated future requirements, age of the inventories on hand and production of new products, the Company regularly reviews inventory quantities on hand and records a provision to write down excess and obsolete inventory to its estimated net realizable value. The Company recorded reserves to reduce the carrying amounts of inventories to their net realizable value in the amounts of \$183,000 and \$164,000 at December 31, 2016 and March 31, 2016.

### ***Income Taxes***

The Company is required to determine the aggregate amount of income tax expense or loss based upon tax statutes in jurisdictions in which it conducts business. In making these estimates, the Company adjusts its results determined in accordance with generally accepted accounting principles for items that are treated differently by the applicable taxing authorities. Deferred tax assets and liabilities resulting from these differences are reflected on its balance sheet for temporary differences in loss and credit carryforwards that will reverse in subsequent years. The Company also establishes a valuation allowance against deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not be realized. Valuation allowances are based, in part, on predictions that management must make as to the results in future periods. The outcome of events could differ over time which would require that the Company makes changes in its valuation allowance.

### ***Financial Assets and Liabilities***

Financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses and other liabilities are carried at cost, which management believes approximates fair value due to the short-term nature of these instruments. The fair value of capital lease obligations and equipment loans approximates their carrying amounts as a market rate of interest is attached to their repayment. The Company measures the fair value of financial assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The Company uses three levels of inputs that may be used to measure fair value:



Level 1 – quoted prices in active markets for identical assets or liabilities

Level 2 – quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 – inputs that are unobservable (for example cash flow modeling inputs based on assumptions)

Level 3 liabilities are valued using unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the liabilities. For fair value measurements categorized within Level 3 of the fair value hierarchy, the Company's accounting and finance department, who report to the Chief Financial Officer, determine its valuation policies and procedures. The development and determination of the unobservable inputs for Level 3 fair value measurements and fair value calculations are the responsibility of the Company's accounting and finance department and are approved by the Chief Financial Officer.

As of December 31, 2016 and March 31, 2016, there were no transfers in or out of Level 3 from other levels in the fair value hierarchy.

#### ***Subsequent Events***

Management has evaluated subsequent events or transactions occurring through the date the condensed consolidated financial statements were issued (See Subsequent Events Note 12).

#### ***Recent Accounting Pronouncements***

In January 2016, the FASB issued ASU 2016-01 Financial Instruments-Overall, which address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Earlier application is permitted under specific circumstances. The Company is currently assessing the potential impact of this standard on its financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230). This amendment will provide guidance on the presentation and classification of specific cash flow items to improve consistency within the statement of cash flows. ASU 2016-15 is effective for fiscal years, and interim periods within those fiscal years beginning after December 15, 2017, with early adoption permitted. The Company is evaluating the effect that ASU 2016-15 will have on its financial statements and related disclosures.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash ("ASU 2016-18") that changes the presentation of restricted cash and cash equivalents on the statement of cash flows. Restricted cash and restricted cash equivalents will be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This ASU is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, but early adoption is permissible. The Company is currently evaluating the potential impact that ASU 2016-18 may have on its financial position and statement of cash flows.

Accounting standards that have been issued or proposed by the Financial Accounting Standards Board ("FASB"), SEC and/or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the condensed consolidated financial statements upon adoption.

#### **Note 4. Disposition of Latin American Operations**

##### ***Description of Sale to Invekra***

On October 27, 2016, the Company, along with its Mexican subsidiary and manufacturer Oculus Technologies of Mexico, S.A. de C.V. ("OTM"), closed on an asset purchase agreement with Invekra, S.A.P.I de C.V. ("Invekra"), an affiliate of Laboratorios Sanfer S.A. de C.V., for the sale of certain of its Latin America assets. Specifically, the Company agreed to sell certain patents, patent applications, trademarks and territory rights for Mexico, the Caribbean and South America, excluding the sale of dermatology products in Brazil, as well as to build and deliver equipment that Invekra will use to produce its own product.

The aggregate purchase price that Invekra will pay for the assets is \$22,000,000, of which \$18,000,000 was paid upon closing, \$1,500,000 will be held in escrow until completion of the Company's obligations to deliver certain equipment, and \$2,500,000 will be paid in Mexican currency in quarterly installments over a period of ten years from closing as consideration for the provision of certain services and providing technical assistance, calculated as three per cent on net sales of certain products in Latin America, excluding Mexico. Because the \$2,500,000 is to be paid in foreign currency, the Company may receive more or less than \$2,500,000 due to currency fluctuations.

In connection with the asset purchase agreement, the Company agreed to provide the technology, know-how and assistance to Invekra to enable Invekra to manufacture on its own the products as currently produced by the Company ("Technical Services Arrangement"), and continue to supply product to Invekra for a two year transition period from the Sale Date, subject to mutual extension ("Supply Agreement"). During the three and nine months ended December 31, 2016, the Company reported \$465,000 of Latin America product revenue related to the Supply Agreement with Invekra.

The Company will provide product under the Supply Agreement at a reduced price from its current price list, while Invekra builds its own manufacturing line. At the conclusion of the transition period, the Company will cease to be a supplier of product to Invekra. The Company is uncertain as to the duration of the transition period or when Invekra will complete the build out of its manufacturing line. Pursuant to the Supply Agreement the Company is subject to a potential penalty for failure to supply the products for a consecutive period of six months. The penalty, if triggered, will require the Company to make a one-time payment of \$2,000,000 to Invekra. The penalty decreases by 12.5% each quarter of the term of the supply period. The Company does not expect to incur this penalty. The Company will incur costs of approximately \$325,000 to fulfill its obligations to build and deliver certain production equipment to Invekra.

#### *Accounting for the disposition*

For accounting purposes, the Company determined that there were three discrete components of the sale to Invekra. These components were the intellectual property and territory rights, the services to be provided under the Technical Services Arrangement and the production equipment to be manufactured for Invekra.

The Company determined an arm's length selling price for each component of the sale and then allocated the net proceeds received to the components on a relative selling price basis. The Company estimated the selling prices of each component as described below:

<u>Component of Sale</u>	<u>Methodology to Estimate Selling Price</u>
Services under the Technical Services Arrangement	Based upon revenues expected from a market participant to provide technical services at expected service levels
Production equipment to be manufactured	Based upon an expected selling price derived from costs marked up to selling price at market participant margins
Intellectual property and territory rights	Based upon a discounted cash flow analysis of the benefit to Invekra of producing rather than purchasing its product and operating royalty free

The Company determined proceeds, net of estimated transaction costs and net of the discount to adjust for consideration to be received in the future. The total proceeds were as follows:

Cash received on October 27, 2016	\$ 18,000,000
Cash held in escrow until delivery of equipment	1,500,000
Face value of variable consideration (\$250,000 per year for ten years)	<u>2,500,000</u>
Total proceeds from sale	22,000,000
Transaction costs	<u>556,000</u>
Total proceeds, net of transaction costs	21,444,000
Discount on variable consideration (using a 7.5% discount rate)	<u>752,000</u>
Total proceeds, net of discount	<u><u>\$ 20,692,000</u></u>

Proceeds were allocated to the components of the sale based upon their relative selling prices are as follows:

Services under the Technical Services Arrangement	\$ 708,000
Production equipment to be manufactured	497,000
Intellectual property and territory rights	<u>19,487,000</u>
Total proceeds	<u>\$ 20,692,000</u>

The proceeds related to the intellectual property and territory rights were included in gain on sale on the date of the sale. The proceeds allocated to the services under the Technical Services Agreement were recorded in deferred revenue as of the date of the sale and will be recognized as technical services are provided. The proceeds related to the production equipment to be manufactured were included in deferred gain and will be recognized upon delivery of the equipment.

#### *Discontinued operations*

As of December 31, 2016, the Company determined that the sale of its Latin American operations to Invekra qualified as a sale of a component of its business and, as such, all such activity prior to consummation of the sale is required to be included in discontinued operations on the Company's statement of operations. This includes the direct labor and materials for the product delivered to Invekra, the revenue on the sales to Invekra and the gain on the sale to Invekra, net of tax.

The carrying value of the assets and liabilities of discontinued operations on the condensed consolidated balance sheets as of December 31, 2016 and March 31, 2016 were as follows:

	<u>December 31,</u> <u>2016</u>	<u>March 31,</u> <u>2016</u>
<b>Assets</b>		
Accounts receivable (net)	\$ —	\$ 766,000
Inventories	—	<u>45,000</u>
Total current assets of discontinued operations	<u>\$ —</u>	<u>\$ 811,000</u>
<b>Liabilities</b>		
Deferred Revenue	\$ —	\$ 300,000
Total current liabilities of discontinued operations	<u>\$ —</u>	<u>\$ 300,000</u>
Deferred Revenue, less current portion	\$ —	\$ 112,000
Total Long-term liabilities of discontinued operations	<u>\$ —</u>	<u>\$ 112,000</u>

The operations of its Latin American business included in discontinued operations is summarized as follows:

	<u>Three Months Ended</u> <u>December 31,</u>		<u>Nine Months Ended</u> <u>December 31,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Revenues	\$ 621,000	\$ 1,336,000	\$ 3,105,000	\$ 4,760,000
Cost of Revenues	<u>62,000</u>	<u>271,000</u>	<u>561,000</u>	<u>954,000</u>
Income from discontinued operations before tax	559,000	1,065,000	2,544,000	3,806,000
Gain on disposal of discontinued operations before income taxes	<u>19,487,000</u>	—	<u>19,487,000</u>	—
Total income from discontinued operations, before tax	<u>20,046,000</u>	<u>1,065,000</u>	<u>22,031,000</u>	<u>3,806,000</u>
Income Tax benefit (expense)	(4,581,000)	—	(4,581,000)	—
Income from discontinued operations, net of tax	<u>\$ 15,465,000</u>	<u>\$ 1,065,000</u>	<u>\$ 17,450,000</u>	<u>\$ 3,806,000</u>

**Note 5. Condensed Consolidated Balance Sheets*****Inventories, net***

Inventories, net consist of the following:

	<b>December 31, 2016</b>	<b>March 31, 2016</b>
Raw materials	\$ 1,369,000	\$ 1,059,000
Finished goods	697,000	536,000
	<u>\$ 2,066,000</u>	<u>\$ 1,595,000</u>

***Notes Payable***

On January 25, 2016, the Company entered into a note agreement for \$146,000 with an interest rate of 6.25% per annum. This instrument was issued in connection with financing insurance premiums. The note was payable in monthly installments of \$16,000. During the three months ended December 31, 2016, the Company made the final payment of \$17,000. During the nine months ended December 31, 2016, the Company made principal and interest payments of \$114,000 and \$1,000, respectively.

On August 10, 2016, the Company entered into a note agreement for \$26,000 with an interest rate of 2.49% per year, and a monthly payment of \$432. This instrument was issued in connection with the financing of an automobile. During the three months ended December 31, 2016, the Company made principal and interest payments related to this note in the amounts of \$1,149 and \$147, respectively. During the nine months ended December 31, 2016, the Company made principal and interest payments related to this note in the amounts of \$3,531 (includes a first installment payment of \$2,000) and \$197, respectively. The remaining balance of this note amounted to \$23,000 at December 31, 2016, of which \$5,000 is included in the current portion of long-term debt in the accompanying condensed consolidated balance sheet.

On September 27, 2016, the Company entered into a note agreement for \$38,000 with an interest rate of 0%, and monthly payment of \$630. This instrument was issued in connection with the financing of an automobile. During the three months ended December 31, 2016, the Company made principal payments related to this note of \$1,000. The remaining balance of this note amounted to \$37,000 at December 31, 2016, of which \$7,000 is included in the current portion of long-term debt in the accompanying condensed consolidated balance sheet.

**Note 6. Commitments and Contingencies*****Legal Matters***

The Company, on occasion, may be involved in legal matters arising in the ordinary course of its business including matters involving proprietary technology. While management believes that such matters are currently insignificant, matters arising in the ordinary course of business for which the Company is or could become involved in litigation may have a material adverse effect on its business, financial condition or results of operations.

***Employment Agreements***

On July 26, 2016, the Company entered into a new employment agreement with Jim Schutz, its President and Chief Executive Officer to update his agreements and responsibilities. The terms of the new employment agreement provide for a continued annual base salary of \$250,000 or such other amount as the Board of Directors may set. In addition, Mr. Schutz is eligible to receive an annual bonus, the payment, type and amount of which is in the sole discretion of the Compensation Committee. Mr. Schutz also receives certain benefits, such as participation in our health and welfare plans, vacation and reimbursement of expenses.

As of December 31, 2016 the Company had employment agreements in place with five of its key executives. The agreements provide, among other things, for the payment of nine to twenty-four months of severance compensation for terminations under certain circumstances. With respect to these agreements, at December 31, 2016, aggregated annual salaries would be \$1,185,000 and potential severance payments to these key executives would be \$1,435,000 if triggered.

## **Note 7. Stockholders' Equity**

### ***Authorized Capital***

The Company is authorized to issue up to 12,000,000 shares of common stock with a par value of \$0.0001 per share and 714,286 shares of convertible preferred stock with a par value of \$0.0001 per share.

### ***Common Stock Issued Services Provider***

On April 24, 2009, the Company entered into an agreement with Advocos LLC, a contract sales organization that served as part of the Company's sales force, for the sale of the Company's wound care products in the United States. Pursuant to the agreement, the Company agreed to pay the contract sales organization a monthly fee and potential bonuses that was based on achievement of certain levels of sales. The Company agreed to issue the contract sales organization cash or shares of common stock to settle fees for its services. During the nine months ended December 31, 2015, the Company issued 135,485 shares of common stock, with a fair market value of \$203,000, in connection with this agreement. The Company has determined that the fair value of the common stock was more readily determinable than the fair value of the services rendered. During the nine months ended December 31, 2015, the Company recorded \$107,000 of expense related to stock issued pursuant to this agreement and settled \$96,000 of fees accrued in prior periods. The expense was recorded as selling, general and administrative expense in the accompanying condensed consolidated statement of comprehensive loss for the nine months ended December 31, 2015. This agreement was terminated on September 28, 2016. Pursuant to the termination agreement the Company paid outstanding fees of \$111,000, issued 14,390 shares of common stock with a fair value of \$69,000, and transferred certain assets valued at \$62,000 related to a product line the Company deemed to be non-core and immaterial to its operations. The expense was recorded as selling, general and administrative expense in the accompanying condensed consolidated statement of comprehensive loss for the nine months ended December 31, 2016.

On August 1, 2016, the Company entered into an agreement with CorProminence, LLC. for financial advisory services. Pursuant to the agreement, the Company agreed to pay CorProminence, LLC. common stock as compensation for services provided. The Company determined that the fair value of the common stock was more readily determinable than the fair value of the services rendered. Accordingly, the Company recorded the fair market value of the stock as expense. During the three and nine months ended December 31, 2016, the Company issued 6,411 shares of common stock in connection with this agreement. During the three and nine months ended December 31, 2016, the Company recorded \$29,000 of expense related to this agreement. The expense was recorded as selling, general and administrative expense in the accompanying condensed consolidated statements of comprehensive income (loss).

## **Note 8. Stock-Based Compensation**

### ***Performance Based Awards Program***

The Company's Compensation Committee approved a short-term performance based bonus program for fiscal 2016 with predetermined objectives related to revenue and expense targets. In the event the fiscal 2016 objectives were met, eighty-percent of the options would have vested on June 30, 2016. On August 21, 2015, certain executives and senior managers were granted an aggregate of 75,500 stock options in connection with this program. The stock options have an exercise price of \$5.80 and expire ten years from the date of grant. At March 31, 2016, it was determined targets were met related to 50,400 stock options which vested on June 30, 2016. At March 31, 2016, 10,000 stock options expired due to targets that were not met. The vesting of the remaining 15,100 stock options was at the discretion of the Company's Compensation Committee to be determined during the three months ended June 30, 2016. The Company's Compensation Committee determined 14,772 of the 15,100 discretionary stock options vested at June 30, 2016 and 228 of the discretionary stock options expired unvested.

The Company also approved a long-term market-based stock option bonus program for senior managers. Vesting of the stock options granted as part of this program is contingent upon the achievement of four separate target stock prices. The market-based options vest based on the 30 trading day trailing average of the stock price of the Company's common stock with options vesting in 25% increments at each of the target stock prices. On the last day of each quarter, the chief executive officer and/or chief financial officer will determine if any of the target stock prices have been met by evaluating the period between the quarter end date and the grant date of the option. In the event that a target stock price has been met, the senior manager will be notified that such options have vested. At the end of five years from the date of the grant, if the stock target prices have not been met, then the unvested portion of the option will expire. On August 21, 2015, certain senior managers were granted an aggregate of 23,750 stock options in connection with this program. The stock options have an exercise price of \$5.80 and if they vest will expire ten years from the date of grant. None of these options vested as of December 31, 2016.

### Stock-Based Compensation

The Company issues service, performance and market-based stock options to employees and non-employees. The Company estimates the fair value of service and performance stock option awards using the Black-Scholes option pricing model. The Company estimates the fair value of market-based stock option awards using a Monte-Carlo simulation. Compensation expense for stock option awards is amortized on a straight-line basis over the awards' vesting period. Compensation expense includes the impact of an estimate for forfeitures for all stock options.

The expected term of the stock options represents the average period the stock options are expected to remain outstanding and is based on the expected term calculated using the approach prescribed by the Securities and Exchange Commission's Staff Accounting Bulletin No. 110 for "plain vanilla" options. The expected stock price volatility for the Company's stock options was determined by using an average of the historical volatilities of the Company and its industry peers. The Company will continue to analyze the stock price volatility and expected term assumptions as more data for the Company's common stock and exercise patterns become available. The risk-free interest rate assumption is based on the U.S. Treasury instruments whose term was consistent with the expected term of the Company's stock options. The expected dividend assumption is based on the Company's history and expectation of dividend payouts. The Company estimates forfeitures based on historical experience and reduces compensation expense accordingly. The estimated forfeiture rates used during the nine months ended December 31, 2016 ranged from 5.24% to 6.01%. The estimated forfeiture rates used during the nine months ended December 31, 2015 ranged from 1.18% to 1.81%.

The Company estimated the fair value of employee and non-employee stock options using the Black-Scholes option pricing model. The fair value of employee stock options is being amortized on a straight-line basis over the requisite service periods of the respective awards. The fair value of employee stock options was estimated using the following weighted-average assumptions:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Expected life	5.22 years	7.04 years	5.75 years	6.30 years
Risk-free interest rate	1.86%	1.90%	1.83%	1.70%
Dividend yield	0.00%	0.00%	0.00%	0.00%
Volatility	130%	89%	126%	89%
Fair value of options granted	\$ 4.18	\$ 4.75	\$ 4.08	\$ 4.40

Share-based awards compensation expense is as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Cost of service revenue	\$ 63,000	\$ 72,000	\$ 197,000	\$ 189,000
Research and development	77,000	107,000	201,000	268,000
Selling, general and administrative	774,000	374,000	1,334,000	1,002,000
Total stock-based compensation	<u>\$ 914,000</u>	<u>\$ 553,000</u>	<u>\$ 1,732,000</u>	<u>\$ 1,459,000</u>

At December 31, 2016, there were unrecognized compensation costs of \$695,000 related to stock-based awards which are expected to be recognized over a weighted-average amortization period of 1.36 years.

### Stock-Based Award Activity

Stock-based awards outstanding at December 31, 2016 under the various plans are as follows:

Plan	Awards Outstanding
2006 Plan	171,000
2011 Plan	580,000
2016 Plan	100,000
	<u>851,000</u>
Awards available for grant as of December 31, 2016	<u>1,265,000</u>



Stock options award activity is as follows:

	<u>Number of Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at April 1, 2016	753,000	\$ 21.47		
Options granted	135,000	4.76		
Options exercised	-	-		
Options forfeited	(16,000)	7.34		
Options expired	(21,000)	20.15		
Outstanding at December 31, 2016	<u>851,000</u>	<u>\$ 18.63</u>	<u>7.54</u>	<u>\$ 46,000</u>
Exercisable at December 31, 2016	<u>678,000</u>	<u>\$ 21.41</u>	<u>7.27</u>	<u>\$ 33,000</u>

The aggregate intrinsic value of stock options is calculated as the difference between the exercise price of the underlying stock options and the fair value of the Company's common stock, or \$5.04 per share at December 31, 2016.

Restricted stock award activity is as follows:

	<u>Number of Shares</u>	<u>Weighted Average Award Date Fair Value per Share</u>
Unvested restricted stock awards outstanding at April 1, 2016	-	\$ -
Restricted stock awards granted	31,000	4.81
Restricted stock awards vested	(31,000)	4.81
Restricted stock awards forfeited	-	-
Unvested restricted stock awards outstanding at December 31, 2016	<u>-</u>	<u>\$ -</u>

Restricted stock awards were issued to non-employee directors and certain executive officers in the nine months ended December 31, 2016.

No income tax benefit has been recognized relating to stock-based compensation expense and no tax benefits have been realized from exercised stock options.

The Company did not capitalize any cost associated with stock-based compensation.

The Company issues new shares of common stock upon exercise of stock based awards.

#### **Note 9. Income Taxes**

The Company's effective tax rate was 123.28% and 41.31% for the three and nine months ended December 31, 2016, respectively. For the three and nine months ended December 31, 2015, the effective tax rates were 0%. The change in the effective tax rates from continuing operations for the three and nine months ended December 31, 2016 compared to the same period last year is primarily due to the intra-period allocation of total tax expense between continuing operations and discontinued operations from the sale to Invekra.

The Company accounts for the tax effects of discontinued operations as a discrete item and therefore recognizes the full tax effects of discontinued operations in the same period that the pretax income or loss from discontinued operations is recognized. In accordance with the intra-period allocation rules, as a result of having a full valuation allowance on deferred income taxes on the Company's entire operations, a tax benefit is recorded in continuing operations for the benefit of the utilization of the deferred tax assets resulting from the income from discontinued operations.

During the three and nine months ended December 31, 2016, the Company recorded income tax expense of \$4,581,000 within discontinued operations. This income tax expense was recognized in connection with the gain on sale of the IP and territory rights and the operations through the sale date, associated with the Latin American operations. The Company was able to utilize certain net operating loss carryovers (“NOLs”) of approximately \$4,040,000 in order to reduce the amount of its income tax obligations. The Company had previously established a full valuation allowance against the deferred income tax assets, which included these NOLs. During the three and nine months ended December 31, 2016, the Company recorded an income tax benefit of \$4,040,000 within its continuing operations, representing the release of the valuation allowance for the NOLs utilized to offset the gain and income reflected in discontinued operations. The NOLs in certain jurisdictions did not fully offset the income tax obligations incurred. As a result, as of December 31, 2016, the Company recorded current income tax payable of \$229,000 and deferred income tax liability of \$312,000.

The Company has completed a study to assess whether or not a change in control for income tax purposes has occurred. The Company has determined, based on the results of the study, that no such change in control has occurred for purposes of Internal Revenue Code section 382 and as a result, the Company’s income tax net operating loss carryforwards were not limited under such provision. The Company incurred losses for both financial reporting and income tax purposes for the year ended March 31, 2016 and through September 30, 2016. The Company, after weighing both positive and negative evidence, had fully reserved its deferred tax assets since it was more likely than not that such benefits would not be realized in future periods. Except as disclosed below in connection with the utilization of net operating loss carryforwards in connection with the gain on the sale to Invekra, as of December 31, 2016, the Company has fully reserved its deferred tax assets. The Company will evaluate its deferred tax assets in future periods in order to determine whether any changes in circumstances could affect the realization of their future benefit. If it is determined in future periods that portions of the Company’s deferred income tax assets satisfy the realization standards, the valuation allowance will be reduced accordingly.

As a result of certain realization requirements of Accounting Standards Codification Topic 718, the Company’s deferred tax assets and liabilities do not include certain deferred tax assets at December 31, 2016 that arose directly from tax deductions related to equity compensation in excess of compensation recognized for financial reporting purposes. Equity will be increased by approximately \$533,000 if and when such deferred tax assets are ultimately realized.

**Note 10. Segment and Geographic Information**

The Company generates product revenues from wound care products that are sold into the human and animal healthcare markets, and the Company generates service revenues from laboratory testing services, which are provided to medical device manufacturers.

The Company operates a single segment business for product revenues, which consists of three geographical sales territories as follows:

	<b>Three Months Ended December 31,</b>		<b>Nine Months Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
	<b>Geographic region</b>			
United States	\$ 1,671,000	\$ 1,010,000	\$ 4,741,000	\$ 2,983,000
Latin America	465,000	–	465,000	–
Europe and Rest of World	1,038,000	1,202,000	2,952,000	2,725,000
	<u>3,174,000</u>	<u>2,212,000</u>	<u>8,158,000</u>	<u>5,708,000</u>
Product license fees and royalties	–	44,000	–	231,000
Total product related revenues	<u>\$ 3,174,000</u>	<u>\$ 2,256,000</u>	<u>\$ 8,158,000</u>	<u>\$ 5,939,000</u>

During the three and nine months ended December 31, 2016, the Company reported \$465,000 of Latin America product revenue related to the Supply Agreement with Invekra.

In connection with the Company’s sale of its Latin American business to Invekra, product revenues were reclassified from continuing operations to discontinued operations as follows:

	<b>Three Months Ended December 31,</b>		<b>Nine Months Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
	<b>Product revenues</b>			
Product revenues	\$ 359,000	\$ 1,260,000	\$ 2,693,000	\$ 4,085,000
Product license fees and royalties	262,000	76,000	412,000	675,000
Total product related revenues	<u>\$ 621,000</u>	<u>\$ 1,336,000</u>	<u>\$ 3,105,000</u>	<u>\$ 4,760,000</u>

The following table shows the Company's product license fees and royalties revenues by partner:

Partner	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2016	2015	2016	2015
Exeltis	\$ –	\$ 44,000	\$ –	\$ 202,000
Innovacyn	–	–	–	29,000
Total product license fees and royalties	<u>\$ –</u>	<u>\$ 44,000</u>	<u>\$ –</u>	<u>\$ 231,000</u>

The Company's service revenues amounted to \$187,000 and \$227,000 for the three months ended December 31, 2016 and 2015, respectively.

The Company's service revenues amounted to \$638,000 and \$855,000 for the nine months ended December 31, 2016 and 2015, respectively.

**Note 11. Significant Customer Concentrations**

For the three months ended December 31, 2016, one customer represented 22%, one customer represented 16%, one customer represented 13% and one customer represented 10% of net revenue. For the three months ended December 31, 2015, one customer represented 33% and one customer represented 10% of net revenue.

For the nine months ended December 31, 2016, one customer represented 27% of net revenue. For the nine months ended December 31, 2015, one customer represented 35% of net revenue.

At December 31, 2016, one customer represented 30%, one customer represented 26%, one customer represented 23%, one customer represented 16% and one customer represented 13% of the net accounts receivable balance. At March 31, 2016, one customer represented 33% of the net accounts receivable balance.

**Note 12. Subsequent Events**

*Amendment to Code of Business Conduct*

On January 17, 2017, the Company's board of directors adopted changes to the Company's code of conduct. The code of conduct governs the conduct of all the Company's employees, directors and officers, including management. The changes to the code of conduct were made to update the code to current best practices. In addition to some clerical changes, the code of conduct now explicitly requires employees, directors and officers to act honestly and ethically in dealing with customers, business partners and others. Furthermore, the code of conduct now explicitly extends the confidentiality and conflicts of interest requirements to directors and prohibits company loans. The code of conduct also updated the disclosure, reporting and enforcement provisions. No waivers have been granted under the code of conduct to date.

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

*The following discussion of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and notes to those statements included elsewhere in this Quarterly Report on Form 10-Q as of December 31, 2016 and our audited consolidated financial statements for the year ended March 31, 2016 included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on June 21, 2016.*

*This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in this report, the words “anticipate,” “suggest,” “estimate,” “plan,” “project,” “continue,” “ongoing,” “potential,” “expect,” “predict,” “believe,” “intend,” “may,” “will,” “should,” “could,” “would,” “proposal,” and similar expressions are intended to identify forward-looking statements.*

*Forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to the risks described in our Annual Report on Form 10-K including: our ability to become profitable; the progress and timing of our development programs and regulatory approvals for our products; the benefits and effectiveness of our products; the ability of our products to meet existing or future regulatory standards; the progress and timing of clinical trials and physician studies; our expectations related to the use of our cash reserves; our expectations and capabilities relating to the sales and marketing of our current products and our product candidates; our ability to gain sufficient reimbursement from third-party payors; our ability to compete with other companies that are developing or selling products that are competitive with our products; the establishment of strategic partnerships for the development or sale of products; the risk our research and development efforts do not lead to new products; the timing of commercializing our products; our ability to penetrate markets through our sales force, distribution network, and strategic business partners to gain a foothold in the market and generate attractive margins; the expansion of our sales force and distribution network; the ability to attain specified revenue goals within a specified time frame, if at all, or to reduce costs; the outcome of discussions with the U.S. Food and Drug Administration, or FDA, and other regulatory agencies; the content and timing of submissions to, and decisions made by, the FDA and other regulatory agencies, including demonstrating to the satisfaction of the FDA the safety and efficacy of our products; our ability to manufacture sufficient amounts of our product candidates for clinical trials and products for commercialization activities; our ability to protect our intellectual property and operate our business without infringing on the intellectual property of others; our ability to continue to expand our intellectual property portfolio; our expectations about the outcome of litigation and controversies with third parties; the risk we may need to indemnify our distributors or other third parties; risks attendant with conducting a significant portion of our business outside the United States; our ability to comply with complex federal and state fraud and abuse laws, including state and federal anti-kickback laws; risks associated with changes to health care laws; our ability to attract and retain qualified directors, officers and employees; our expectations relating to the concentration of our revenue from international sales; our ability to expand to and commercialize products in markets outside the wound care market; and the impact of the Sarbanes-Oxley Act of 2002 and any future changes in accounting regulations or practices in general with respect to public companies. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based, except as required by law.*

### **Our Business**

We are a specialty pharmaceutical company dedicated to identifying, developing and commercializing unique, affordable differentiated therapies to improve the lives of patients with dermatologic diseases or conditions. Our products, which are sold throughout the United States and internationally, have improved patient outcomes for more than five million patients globally by treating and reducing certain topical skin diseases including acne, atopic dermatitis, scarring, infections, itch, pain and harmful inflammatory responses. On December 6, 2016, we changed our name from Oculus Innovative Sciences, Inc. to Sonoma Pharmaceuticals, Inc.

We currently focus on the development and commercialization of therapeutic solutions in medical dermatology to treat or reduce skin conditions, such as acne, atopic dermatitis and scarring. These diseases impact millions of patients worldwide and can have significant, multi-dimensional effects on patients’ quality of life, including their physical, functional and emotional well-being.

Since our founding in 1999, we built our business by developing and promoting products via partnerships for multiple therapeutic indications, with a primary focus on advanced tissue care. Starting in 2013, with a new Board of Directors and new management team, we pivoted to focus on one specialty pharmaceutical area, medical dermatology, and created our own sales force in the United States to promote our unique, affordable, differentiated prescription dermatology products.

Some of our key products in the United States are:

- Celacyn®, a prescription hypochlorous acid based scar management gel clinically proven to soften and flatten raised scars while reducing redness and discoloration.
- Ceramax™ Skin Barrier Cream helps manage dry itchy skin, minor skin irritations, rashes, and inflammation caused by various skin conditions.
- Alevicyn™, a prescription hypochlorous acid based atopic dermatitis product line clinically proven to reduce pruritus (itch) and pain associated with various dermatoses.
- Mondoxyne™, a prescription oral tetracycline antibiotic used for the treatment of certain bacterial infections, including acne.
- Microcyn® (sold under a variety of brand names), a line of products based on electrically charged oxychlorine small molecules designed to target a wide range of pathogens including viruses, fungi, spores and bacteria, including antibiotic-resistant strains.

Our key product outside the United States is:

- Microcyn® or Microdacyn60® (sold under a variety of brand names), a line of products based on electrically charged oxychlorine small molecules designed to target a wide range of pathogens including viruses, fungi, spores and bacteria, including antibiotic-resistant strains.

To date, we have obtained 15 clearances from the U.S. Food and Drug Administration, or FDA, that permit us to sell our products as medical devices for Section 510(k) of the Federal Food, Drug and Cosmetic Act in the United States.

Outside the United States, we sell products for dermatological and advanced tissue care with a European Conformity marking (known as Conformité Européenne or CE) covering 25 of our products, and various approvals in China, Southeast Asia, South Korea, India, Australia, New Zealand, and the Middle East.

On October 27, 2016, we, along with our Mexican subsidiary and manufacturer Oculus Technologies of Mexico, S.A. de C.V., closed on an asset purchase agreement with Invekra, S.A.P.I de C.V., an affiliate of Laboratorios Sanfer S.A. de C.V., for the sale of certain of our Latin America assets. Specifically, we agreed to sell certain patents, patent applications, trademarks and territory rights for Mexico, the Caribbean and South America, excluding the sale of dermatology products in Brazil, as well as to build and deliver equipment that Invekra will use to produce its own product.

The aggregate purchase price that Invekra will pay for the assets is \$22,000,000, of which \$18,000,000 was paid upon closing, \$1,500,000 will be held in escrow until completion of our obligation to deliver certain equipment, and \$2,500,000 will be paid in Mexican currency in quarterly installments over a period of ten years from closing as consideration for the provision of certain services and providing technical assistance, calculated as three per cent on net sales of certain products in Latin America, excluding Mexico. Since the \$2,500,000 is to be paid in foreign currency, we may receive more or less than \$2,500,000 due to currency fluctuations.

As a result of the asset purchase agreement and arrangement, we expect our revenues in Latin America will decrease significantly. Pursuant to the arrangement, going forward we will receive a royalty of 3% on all Latin American net revenues (outside of Mexico), with a minimum payment of \$250,000 per year for the next ten years, to be paid quarterly in Mexican pesos. Due to currency fluctuations, we may not receive the full \$250,000 in U.S. dollars. Additionally, while Invekra sets up their manufacturing, we will continue to supply Invekra with product at a reduced price.

We believe that the sale of the Latin America assets is in line with our overall turnaround strategy to focus on our core dermatology business and generate cash from our non-core businesses to support the higher margin and higher-growth dermatology business. As a result of the sale of our Latin America assets, we expect our Latin America revenues will decrease and our total revenues will decrease in the short-term until our U.S. based dermatology revenues increase longer-term. We believe focusing on higher margin dermatology products, utilizing an internal sales force, allows us to better control and grow our future results rather than relying on external partners for marketing and sales. We intend to use the proceeds from the sale of the Latin America assets to increase our direct sales force and grow our product line and continue to expand our markets and Company.

## Our Strategy

Our strategy is to in-license, acquire, develop and commercialize unique, affordable and differentiated therapies that we believe advance the standard of care for patients with dermatological diseases. The key components of our strategy are to:

- **Expand our Internal U.S. Sales Force:** We continue to hire additional experienced sales people who have established relationships with dermatologists in their territories and are expecting to have a sales force of 30 by the end of March 2017.
- **Develop and Launch New Dermatology Products:** We currently sell eight prescription dermatology products in the United States, and have a strong product pipeline of new products, including an oral anti-infective for severe acne and Ceramax™, which utilizes a “state of the art” skin repair technology.
- **Create a Competitive Pricing Strategy:** We have and will continue to develop a unique product pricing strategy, which we believe solves many of the challenges associated with the prescription dermatology market’s current pricing and rebate programs.
- **Develop a Pharmaceutical Line:** We plan to acquire or develop pharmaceutical products with affordable clinical trials to increase our market presence and create innovator patent protection.

Our plan is to evolve into a leading dermatology company, providing innovative and cost-effective solutions to patients, while generating strong, consistent revenue growth and maximizing long-term shareholder value.

## Additional Information

Investors and others should note that we announce material financial information using our company website ([www.sonomapharma.com](http://www.sonomapharma.com)), our investor relations website ([ir.sonomapharma.com](http://ir.sonomapharma.com)), SEC filings, press releases, public conference calls and webcasts. The information on, or accessible through, our websites is not incorporated by reference in this Quarterly Report on Form 10-Q.

## Comparison of the Three Months Ended December 31, 2016 and 2015

### *Results of Continuing Operations*

#### *Revenues*

Total revenues for the three months ended December 31, 2016 of \$3,361,000 increased by \$878,000 or 35%, as compared to \$2,483,000 for the three months ended December 31, 2015. Product revenues for the three months ended December 31, 2016 of \$3,174,000 increased by \$962,000 or 43% when compared to the same period in the prior year. This increase was the result of strong growth in the United States, offset by a decline in Europe and the Rest of the World. Product licensing fees and royalties decreased \$44,000, related to the loss of our former partner, Exeltis.

Product revenues in the United States for the three months ended December 31, 2016 of \$1,671,000, increased by \$661,000, or 65%, when compared to the same period in the prior year. This increase was mostly the result of higher sales of our dermatology and animal health products. We currently have a direct sales force team of 28 sales people focused on selling our dermatology product portfolio of eight products, for the treatment of atopic dermatitis, scar management, surgical procedures, an oral anti-infective for severe acne, and Ceramax™, which utilizes a “state of the art” skin repair technology. In addition, sales to a new animal health care partner increased during the period compared to the prior year. Going forward, while we expect sales of both our U.S. dermatology and animal health product lines will continue to grow, we expect sales of our dermatology product lines to grow faster and thus, the percentage of animal sales as a part of our overall sales decrease. Management has determined that our core focus will continue to be prescription dermatology sales. We believe focusing on higher margin dermatology products and utilizing an internal sales force, allows us to better control and grow our future results rather than relying on external partners for marketing and sales.

Product revenue in Europe and the Rest of the World for the three months ended December 31, 2016 of \$1,038,000, decreased by \$164,000, or 14%, as compared to the same period in the prior year, with decreases in Europe, Middle East and India, partially offset by increases in Asia.

As a result of the asset purchase agreement and arrangement we entered into on October 27, 2016 with Invekra, we expect our revenues in Latin America will decrease significantly. Pursuant to the arrangement, going forward we will receive a royalty of 3% on all Latin American net revenues (outside of Mexico), with a minimum payment of \$250,000 per year for the next ten years, to be paid quarterly in Mexican pesos. Additionally, while Invekra sets up their manufacturing capabilities, we will continue to supply Invekra with product at a reduced price. During the three months ended December 31, 2016, we reported \$465,000 of Latin America product revenue related to Invekra.

The following table shows our product revenues by geographic region:

	<b>Three months ended December 31,</b>			
	<b>2016</b>	<b>2015</b>	<b>\$ Change</b>	<b>% Change</b>
United States	\$ 1,671,000	\$ 1,010,000	\$ 661,000	65%
Latin America	465,000	–	465,000	100%
Europe and Rest of the World	1,038,000	1,202,000	(164,000)	(14%)
	<u>3,174,000</u>	<u>2,212,000</u>	<u>962,000</u>	<u>43%</u>
Product license fees and royalties	–	44,000	(44,000)	(100%)
Total	<u>\$ 3,174,000</u>	<u>\$ 2,256,000</u>	<u>\$ 918,000</u>	<u>41%</u>

In the three months ended December 31, 2016, product license fees and royalties revenue declined \$44,000 as a result of loss of royalties related to our former dermatology partner Exeltis.

Service revenues for the three months ended December 31, 2016 and 2015 were \$187,000 and \$227,000, respectively.

#### ***Gross Profit***

For the three months ended December 31, 2016, we reported total revenues of \$3,361,000 and total cost of revenues of \$1,655,000, resulting in total gross profit of \$1,706,000 or 51% of total revenues, compared to gross profit of \$455,000 or 18% of total revenues, for the same period in the prior year. The increase in gross profit was primarily due to the reclassification, in the prior period, of Latin America product and license revenue and related variable cost of goods sold from continuing operations to discontinued operations.

For the three months ended December 31, 2016, we reported product revenues of \$3,174,000 and cost of product revenues of \$1,476,000, resulting in product gross profit of \$1,698,000, or 53% of product revenues, compared to product gross profit of \$361,000, or 16% of product revenues, for the same period in the prior year. The increase in gross profit was primarily due to the reclassification, in the prior period, of Latin America product and license revenue and related variable cost of goods sold from continuing operations to discontinued operations. Additionally, as dermatology product revenues increase as an overall percentage of our product revenues, we expect our margins will improve due to higher gross margins associated with our dermatology products.

For the three months ended December 31, 2016, we reported service revenues of \$187,000 and cost of service revenues of \$179,000, resulting in service gross profit of \$8,000, or 4% of service revenues, compared to service gross profit of \$50,000, or 22% of service revenues, for the same period in the prior year.

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

We reported research and development expense of \$487,000 for the three months ended December 31, 2016, an increase of \$1,000 when compared to the same period in the prior year.

#### ***Selling, General and Administrative Expense***

We reported selling, general and administrative expenses of \$4,784,000 for the three months ended December 31, 2016, an increase of \$626,000, or 15%, when compared to the same period in the prior year. The increase for the three months ended December 31, 2016 was primarily the result of higher selling expenses related to our dermatology division primarily related to the addition of headcount and sampling and higher stock-compensation expenses.

We expect selling, general and administrative expenses to increase as we add new territories and people to our direct sales force.

#### ***Interest Expense***

Interest expense was negligible for the three months ended December 31, 2016 and 2015.

#### ***Interest Income***

Interest income was negligible for the three months ended December 31, 2016 and 2015. We expect interest income to increase in future periods due to increased cash on hand.

#### ***Gain due to Change in Fair Value of Derivative Liabilities***

In connection with our December 9, 2013 and February 26, 2014 registered direct offerings we issued a series of common stock purchase warrants, which contained cash settlement provisions. During the quarter ended December 31, 2015, we recorded a gain due to a decrease in the fair value of our derivative liabilities of \$4,000, primarily due to a decrease in our common stock price and the decreasing contractual term of the warrants during the period.

#### ***Other Income (Expense), net***

Other income, net of \$282,000 for the three months ended December 31, 2016, increased \$311,000, from \$29,000 of other expense, net for the same period in the prior year. The increase in other income, net for the three months ended December 31, 2016 was primarily related to foreign exchange gains in Mexico.

#### ***Net income from Continuing Operations***

Net income from continuing operations for the three months ended December 31, 2016 was \$763,000 compared to a loss of \$4,214,000, for the same period in the prior year. The increase in net income of \$4,977,000 is the primarily the result of a tax benefit recorded during the current period of \$4,040,000 and the reclassification of Latin America product and license revenue and related variable cost of goods sold from continuing operations to discontinued operations in the prior period.

### **Comparison of the Nine Months Ended December 31, 2016 and 2015**

#### ***Results of Continuing Operations***

##### ***Revenues***

Total revenues for the nine months ended December 31, 2016 of \$8,796,000 increased by \$2,002,000 or 29%, as compared to \$6,794,000 for the nine months ended December 31, 2015. Product revenues for the nine months ended December 31, 2016 of \$8,158,000 increased by \$2,450,000 or 43% when compared to the same period in the prior year. This increase was the result of strong growth in the United States and growth in Europe and the Rest of the World. Product licensing fees and royalties decreased \$231,000 related to the loss of our former partners Innovacyn and Exeltis.

Product revenues in the United States for the nine months ended December 31, 2016 of \$4,741,000, increased by \$1,758,000, or 59%, when compared to the same period in the prior year. This increase was mostly the result of higher sales of our dermatology and animal health products.

Product revenue in Europe and the Rest of the World for the nine months ended December 31, 2016 of \$2,952,000, increased by \$227,000, or 8%, as compared to the same period in the prior year, with increases in Europe, Asia and Middle East.

As a result of the asset purchase agreement and arrangement we entered into on October 27, 2016 with Invekra, we expect our revenues in Latin America will decrease significantly. Pursuant to the arrangement, going forward we will receive a royalty of 3% on all Latin American net revenues (outside of Mexico), with a minimum payment of \$250,000 per year for the next ten years, to be paid quarterly in Mexican pesos.

Additionally, while Invekra sets up their manufacturing, we will continue to supply Invekra with product at a reduced price. During the nine months ended December 31, 2016, we reported \$465,000 of Latin America product revenue related to Invekra.



The following table shows our product revenues by geographic region:

	Nine months ended December 31,			
	2016	2015	\$ Change	% Change
United States	\$ 4,741,000	\$ 2,983,000	\$ 1,758,000	59%
Latin America	465,000	–	465,000	(100%)
Europe and Rest of the World	2,952,000	2,725,000	227,000	8%
	8,158,000	5,708,000	2,450,000	43%
Product license fees and royalties	–	231,000	(231,000)	(100%)
Total	<u>\$ 8,158,000</u>	<u>\$ 5,939,000</u>	<u>\$ 2,219,000</u>	<u>37%</u>

In the nine months ended December 31, 2016, product license fees and royalties revenue declined primarily as a result of a decrease in revenue related to our former dermatology partner Exeltis.

Service revenues for the nine months ended December 31, 2016 of \$638,000 decreased by \$217,000 when compared to \$855,000 in the prior period. This decrease was due to a decrease in the number of tests and services provided by our lab services business.

### ***Gross Profit***

For the nine months ended December 31, 2016, we reported total revenues of \$8,796,000 and total cost of revenues of \$5,075,000, resulting in total gross profit of \$3,721,000 or 42% of total revenues, compared to a gross profit of \$1,677,000 or 25% of total revenues, for the same period in the prior year. The increase in gross profit was primarily due to the reclassification, in the prior period, of Latin America product and license revenue and related variable cost of goods sold from continuing operations to discontinued operations.

For the nine months ended December 31, 2016, we reported product revenues of \$8,158,000 and cost of product revenues of \$4,507,000, resulting in product gross profit of \$3,651,000, or 45% of product revenues, compared to product gross profit of \$1,306,000, or 23% of product revenues, for the same period in the prior year. The increase in gross profit was primarily due to the reclassification, in the prior period, of Latin America product and license revenue and related variable cost of goods sold from continuing operations to discontinued operations. Additionally, as dermatology product revenues increase as an overall percentage of our product revenues, we expect our margins will improve due to higher gross margins associated with our dermatology products.

For the nine months ended December 31, 2016, we reported service revenues of \$638,000 and cost of service revenues of \$568,000, resulting in service gross profit of \$70,000, or 11% of service revenues, compared to service gross profit of \$140,000, or 16% of service revenues, for the same period in the prior year. The decrease in service gross profit was primarily related to lower service revenue in the current period and the mix of tests and services performed.

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

We reported research and development expense of \$1,226,000 for the nine months ended December 31, 2016, a decrease of \$139,000, or 10%, when compared to the same period in the prior year. The decrease is largely due to a decrease in development milestone payments and license fees related to a dermatology product from the prior period.

### ***Selling, General and Administrative Expense***

We reported selling, general and administrative expenses of \$12,557,000 for the nine months ended December 31, 2016, an increase of \$1,146,000, or 10%, when compared to the same period in the prior year. The increase for the nine months ended December 31, 2016 was primarily due to higher sales expenses related to our dermatology division and higher stock compensation charges.

We expect selling, general and administrative expenses to increase as we add territories and people to our direct sales force.

### ***Interest Expense***

Interest expense was negligible for the nine months ended December 31, 2016 and 2015.

### ***Interest Income***

Interest income was negligible for the nine months ended December 31, 2016 and 2015. We expect interest income to increase in future periods due to increased cash on hand.

### ***Gain due to Change in Fair Value of Derivative Liabilities***

In connection with our December 9, 2013 and February 26, 2014 registered direct offerings we issued a series of common stock purchase warrants, which contained cash settlement provisions. During the nine months ended December 31, 2015, we recorded a gain due to a decrease in the fair value of our derivative liabilities of \$10,000, primarily due to a decrease in our common stock price, offset by the expiration of warrants and the decreasing contractual term of outstanding warrants.

### ***Other Income, net***

Other income, net of \$276,000 for the nine months ended December 31, 2016, increased \$245,000, from \$31,000 of other income, net for the same period in the prior year. The increase in other income, net for the three months ended December 31, 2016 was primarily related to foreign exchange gains in Mexico.

### ***Net Loss from Continuing Operations***

Net loss from continuing operations for the nine months ended December 31, 2016 was \$5,740,000 compared to \$11,058,000, for the same period in the prior year. The decrease in net loss of \$5,318,000 is primarily the result of a tax benefit recorded during the current period of \$4,040,000 and the reclassification of Latin America product and license revenue and related variable cost of goods sold from continuing operations to discontinued operations in the prior period.

### **Comparison of Three and Nine Months Ended December 31, 2016 and 2015**

#### ***Discontinued Operations, net of Tax***

During the three months ended December 31 2016 our Board of Directors took actions to divest certain assets related to our Latin American business. On October 27, 2016 we closed on an asset purchase agreement with Invekra, S.A.P.I de C.V., an affiliate of Laboratorios Sanfer S.A. de C.V., for the sale of certain of our Latin America assets. We decided to divest our Latin American business, resulting in a strategic shift that had a major effect on our operations and financial results. Therefore, the divested Latin American operations meet the criteria to be reported as discontinued operations.

The related assets, liabilities, results of operations and cash flows for our Latin American business are classified as discontinued operations for all periods presented.

Income from discontinued operations, net of tax for the three months ended December 31, 2016 and 2015 includes \$559,000 and \$1,065,000, respectively, of gross profit reclassified from continuing operations to discontinued operations during the periods.

Income from discontinued operations for the nine months ended December 31, 2016 and 2015 includes \$2,544,000 and \$3,806,000, respectively, of gross profit reclassified from continuing operations to discontinued operations during the periods.

Gain on disposal of discontinued operations for the three and nine months ended December 31, 2016, includes \$19,487,000 of gain in each period primarily from the gain on sale of intellectual property assets of our discontinued Latin American business.

Additionally, for the three and nine months ended December 31, 2016 the Company recorded income tax expense related to the transaction in the amount of \$4,581,000 in each of the periods.

The following summarizes operations of our Latin American business included in discontinued operations:

	<b>Three Months Ended December 31,</b>		<b>Nine Months Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Revenues	\$ 621,000	\$ 1,336,000	\$ 3,105,000	\$ 4,760,000
Cost of Revenues	62,000	271,000	561,000	954,000
Income from discontinued operations before tax	559,000	1,065,000	2,544,000	3,806,000
Gain on disposal of discontinued operations before income taxes	19,487,000	–	19,487,000	–
Total income from discontinued operations, before tax	20,046,000	1,065,000	22,031,000	3,806,000
Income Tax benefit (expense)	(4,581,000)	–	(4,581,000)	–
Income from discontinued operations, net of tax	<u>\$ 15,465,000</u>	<u>\$ 1,065,000</u>	<u>\$ 17,450,000</u>	<u>\$ 3,806,000</u>

## Liquidity and Capital Resources

We had net income of \$11,710,000 for the nine months ended December 31, 2016. At December 31, 2016 and March 31, 2016, our accumulated deficit amounted to \$140,665,000 and \$152,375,000, respectively. At December 31, 2016 and March 31, 2016, our working capital amounted to \$21,374,000 and \$9,337,000, respectively.

On October 27, 2016, we, along with our Mexican subsidiary and manufacturer Oculus Technologies of Mexico, S.A. de C.V., closed on an asset purchase agreement with Invekra, S.A.P.I de C.V., an affiliate of Laboratorios Sanfer S.A. de C.V., for the sale of certain of our Latin America assets for an aggregate purchase price of \$22,000,000, with \$18,000,000 paid in cash upon closing, \$1,500,000 held in escrow until completion of our obligations to deliver certain equipment and technology, and \$2,500,000 to be paid in Mexican currency in quarterly installments over a period of ten years from closing as consideration for the provision of certain services and providing technical assistance, calculated as three per cent on net sales of certain products in Latin America, excluding Mexico. Since the \$2,500,000 is paid in foreign currency, we may receive more or less than \$2,500,000 due to currency fluctuations.

We currently anticipate that our cash and cash equivalents, including the proceeds from the sale to Invekra, will be sufficient to meet our working capital requirements to continue our sales and marketing and research and development efforts for at least 12 months from the date of filing this quarterly report.

## Sources of Liquidity

As of December 31, 2016 we had cash and cash equivalents of \$18,983,000 which includes \$18,000,000 of unrestricted cash we received from the sale to Invekra. Additionally, we incurred approximately \$556,000 of transaction costs related to the sale. Since our inception, substantially all of our operations have been financed through sales of equity securities. Other sources of financing that we have used to date include our revenues, as well as various loans.

Since January 1, 2015, substantially all of our operations have been financed through the following transactions:

- proceeds of \$14,000 received from the exercise of common stock purchase warrants and options;
- net proceeds of \$5,444,000 received from an underwritten public offering on January 26, 2015;
- net proceeds of \$5,335,000 received from the sale of Ruthigen common stock;
- net proceeds of \$2,994,000 received from an underwritten public offering on March 18, 2016; and
- net proceeds of \$4,491,000 received from the sale of common stock through our At the Market Issuance Sales Agreement as of December 31, 2016.

On October 27, 2016, we, along with our Mexican subsidiary and manufacturer Oculus Technologies of Mexico, S.A. de C.V., closed on an asset purchase agreement with Invekra, S.A.P.I de C.V., an affiliate of Laboratorios Sanfer S.A. de C.V., for the sale of certain of our Latin America assets for an aggregate purchase price of \$22,000,000, with \$18,000,000 paid in cash upon closing, \$1,500,000 held in escrow until completion of our obligations to deliver certain equipment and technology, and \$2,500,000 to be paid in Mexican currency in quarterly instalments over a period of ten years from closing as consideration for the provision of certain services and providing technical assistance, calculated as three per cent on net sales of certain products in Latin America, excluding Mexico. Because the \$2,500,000 is paid in foreign currency, we may receive more or less than \$2,500,000 due to currency fluctuations.

## Cash Flows

As of December 31, 2016, we had cash and cash equivalents of \$18,983,000, compared to \$7,469,000 as of March 31, 2016.

Net cash used in operating activities during the nine months ended December 31, 2016 was \$5,472,000, primarily due to our net income in the period of \$11,710,000 which was offset by adjustments to net income related to our gain on sale of our Latin American assets to, net of tax, of \$14,906,000 and the income tax benefit realized of \$4,040,000.

Net cash used in operating activities during the nine months ended December 31, 2015 was \$7,024,000, primarily due to our net loss of \$7,252,000. Additionally during the nine months ended December 31, 2015 we had an increase in accounts receivable of \$1,351,000 primarily due to increased product revenues, offset by \$1,459,000 in stock related compensation.

Net provided by investing activities was \$17,232,000 for the nine months ended December 31, 2016, consisting of primarily proceeds from the sale of our Latin American Assets, net of costs, of \$17,444,000, offset by \$195,000 related to equipment purchases and \$17,000 related to changes in long-term assets.

Net cash provided by investing activities was \$4,180,000 for the nine months ended December 31, 2015, consisting of \$4,538,000 received from the sale of 1,650,000 of our shares of Ruthigen common stock, offset by \$353,000 related to equipment purchases and \$5,000 related to changes in long-term assets.

Net cash used in financing activities was \$119,000 for the nine months ended December 31, 2016, primarily related to principal payments on debt.

Net cash provided by financing activities was \$2,876,000 for the nine months ended December 31, 2015, primarily related to \$2,949,000 of net proceeds received from At-the-Market Issuances of common stock which was offset by principal payments on debt in the amount of \$87,000.

### **Operating Capital and Capital Expenditure Requirements**

We had net income of 11,710,000 for the nine months ended December 31, 2016. At December 31, 2016 and March 31, 2016, our accumulated deficit amounted to \$140,665,000 and \$152,375,000, respectively. At December 31, 2016 and March 31, 2016, our working capital amounted to \$21,374,000 and \$9,337,000, respectively.

On October 27, 2016, we, along with our Mexican subsidiary and manufacturer Oculus Technologies of Mexico, S.A. de C.V., closed on an asset purchase agreement with Invekra, S.A.P.I de C.V., an affiliate of Laboratorios Sanfer S.A. de C.V., for the sale of certain of our Latin America assets for an aggregate purchase price of \$22,000,000, with \$18,000,000 paid in cash upon closing, \$1,500,000 held in escrow until completion of our obligations to deliver certain equipment and technology, and \$2,500,000 to be paid in Mexican currency in quarterly installments over a period of ten years from closing as consideration for the provision of certain services and providing technical assistance, calculated as three per cent on net sales of certain products in Latin America, excluding Mexico. Since the \$2,500,000 is paid in foreign currency, we may receive more or less than \$2,500,000 due to currency fluctuations.

We may need to raise additional capital from external sources in order to continue the longer term efforts contemplated under our business plan. We expect to continue incurring losses for the foreseeable future and may need to raise additional capital to pursue our product development initiatives and to penetrate markets for the sale of our products.

Our future funding requirements will depend on many factors, including:

- Our current and future revenues;
- the scope, rate of progress and cost of our research and development activities;
- future clinical trial results;
- the terms and timing of any collaborative, licensing and other arrangements that we may establish;
- the cost and timing of regulatory approvals;
- the cost and delays in product development as a result of any changes in regulatory oversight applicable to our products;
- the cost and timing of establishing sales, marketing and distribution capabilities;
- the effect of competing technological and market developments;
- the cost of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights; and
- the extent to which we acquire or invest in businesses, products and technologies.

## **Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. Significant estimates and assumptions include reserves and write-downs related to receivables and inventories, the recoverability of long-lived assets, the valuation allowance related to our deferred tax assets, valuation of equity and derivative instruments, debt discounts, valuation of investments and the estimated amortization periods of upfront product licensing fees received from customers.

## **Off-Balance Sheet Transactions**

We currently have no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

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

As a smaller reporting company, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information required by this Item.

## **Item 4. Controls and Procedures**

### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Accordingly, our disclosure controls and procedures have been designed to meet reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management was necessarily required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2016.

### **Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the three months ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II — OTHER INFORMATION

### Item 1. Legal Proceedings

On occasion, we may be involved in legal matters arising in the ordinary course of our business including matters involving proprietary technology. While management believes that such matters are currently insignificant, matters arising in the ordinary course of business for which we are or could become involved in litigation may have a material adverse effect on our business, financial condition or results of comprehensive loss.

### Item 1A. Risk Factors

Except as discussed below, there have been no material changes from risk factors previously disclosed in our annual report on Form 10-K for the fiscal year ended March 31, 2016, as filed with the SEC on June 21, 2016 and the quarterly report on Form 10-Q for the quarter ended September 30, 2016.

*We cannot currently estimate the effect of any changes or a repeal of the Affordable Care Act will have on our business.*

Our results of operations and financial condition could be affected by changes in healthcare spending and policy. The healthcare industry is subject to changing political, regulatory and other influences. In March 2010, the President signed the Patient Protection and Affordable Care Act, or PPACA, into law, which made major changes in how healthcare is delivered and reimbursed, and increased access to health insurance benefits to the uninsured and underinsured population of the United States. The PPACA in particular affected third-party payors. Our business may be adversely impacted if the PPACA is repealed in its entirety or certain aspects of the PPACA that are beneficial to our business are repealed or changed as a result of recent political changes. Because of the continued uncertainty about the implementation of the PPACA, including the potential for further legal challenges or repeal of that legislation, we cannot quantify or predict with any certainty the likely impact of the PPACA or its repeal on our business model, prospects, financial condition or results of operations. We also anticipate that Congress, state legislatures, and third-party payors may continue to review and assess alternative healthcare delivery and payment systems and may in the future propose and adopt legislation or policy changes or implementations effecting additional fundamental changes in the healthcare delivery system. We cannot assure you as to the ultimate content, timing, or effect of changes, nor is it possible at this time to estimate the impact of any such potential legislation.

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

We did not issue any unregistered securities since November 4, 2016.

### Item 3. Default Upon Senior Securities

We did not default upon any senior securities during the quarter ended December 31, 2016.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

#### *Amendment to Code of Business Conduct*

On January 17, 2017, our board of directors adopted changes to our code of conduct. The code of conduct governs the conduct of all our employees, directors and officers, including management. The changes to the code of conduct were made to update the code to current best practices. In addition to some clerical changes, the code of conduct now explicitly requires employees, directors and officers to act honestly and ethically in dealing with customers, business partners and others. Furthermore, the code of conduct now explicitly extends the confidentiality and conflicts of interest requirements to directors and prohibits company loans. The code of conduct also updated the disclosure, reporting and enforcement provisions. No waivers have been granted under the code of conduct to date.

**Item 6. Exhibits**

**Exhibit Index**

**Exhibit No. Description**

- | Exhibit No. | Description   |
|-------------|---|
| 3.1         | Restated Certificate of Incorporation of Oculus Innovative Sciences, Inc., effective January 30, 2006 (included as Exhibit 3.1 of the Company's Annual Report on Form 10-K filed June 20, 2007, and incorporated herein by reference).  |
| 3.2         | Certificate of Amendment of Restated Certificate of Incorporation of Oculus Innovative Sciences, Inc., effective October 22, 2008 (included as Exhibit A in the Company's Definitive Proxy Statement on Schedule 14A filed July 21, 2008, and incorporated herein by reference).  |
| 3.3         | Amended and Restated Bylaws, as Amended of Oculus Innovative Sciences, Inc., effective November 3, 2010 (included as Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q filed November 4, 2010, and incorporated herein by reference).                                    |
| 3.4         | Certificate of Designation of Series A 0% Convertible Preferred Stock, effective April 24, 2012 (included as Exhibit 4.2 to the Company's Current Report on Form 8-K filed April 25, 2012, and incorporated herein by reference).   |
| 3.5         | Certificate of Amendment of Restated Certificate of Incorporation of Oculus Innovative Sciences, Inc., as amended, effective March 29, 2013 (included as Exhibit 3.1 to the Company's Current Report on Form 8-K filed March 22, 2013, and incorporated herein by reference).     |
| 3.6         | Certificate of Amendment of Restated Certificate of Incorporation of Oculus Innovative Sciences, Inc., as amended, effective December 4, 2014 (included as Exhibit 3.1 to the Company's Current Report on Form 8-K filed December 8, 2014, and incorporated herein by reference). |
| 3.7         | Certificate of Amendment of Restated Certificate of Incorporation of Oculus Innovative Sciences, Inc., as amended, effective October 22, 2015 (included as Exhibit 3.1 to the Company's Current Report on Form 8-K filed October 26, 2015, and incorporated herein by reference). |
| 3.8         | Certificate of Amendment of Restated Certificate of Incorporation of Oculus Innovative Sciences, Inc., as amended, effective June 24, 2016 (included as Exhibit 3.1 to the Company's Current Report on Form 8-K filed June 28, 2016, and incorporated herein by reference).       |
| 3.9         | Certificate of Designation of Series B Preferred Stock, effective October 18, 2016 (included as Exhibit 3.1 to the Company's Current Report on Form 8-K filed October 21, 2016, and incorporated herein by references).   |
| 3.10        | Certificate of Amendment of Restated Certificate of Incorporation of Sonoma Pharmaceuticals, Inc., as amended, effective December 6, 2016 (included as Exhibit 3.1 to the Company's Current Report on Form 8-K filed December 7, 2016, and incorporated herein by reference).     |
| 3.11        | Amended and Restated Bylaws, as amended, of Sonoma Pharmaceuticals, Inc., effective December 6, 2016 (included as Exhibit 3.2 to the Company's Current Report on Form 8-K filed December 7, 2016, and incorporated herein by reference).  |
| 4.1         | Specimen Common Stock Certificate (included as Exhibit 4.1 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).  |
| 4.2         | Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 4.4 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).       |
| 4.3         | Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 4.5 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).       |
| 4.4         | Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 4.11 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).      |
| 4.5         | Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 4.12 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).      |

- 4.6 Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed August 13, 2007, and incorporated herein by reference).
- 4.7 Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 4.1 to the Company's Current Report on Form 8-K filed March 28, 2008, and incorporated herein by reference).
- 4.8 Warrant issued to Dayl Crow, dated March 4, 2009 (included as Exhibit 4.16 to the Company's Annual Report on Form 10-K filed June 11, 2009, and incorporated herein by reference).
- 4.9 Form of Common Stock Purchase Warrant for April 2009 offering (included as Exhibit 4.15 to the Company's Registration Statement on Form S-1 (File No. 333-158539) declared effective on July 24, 2009, and incorporated herein by reference).
- 4.10 Form of Common Stock Purchase Warrant for July 2009 offering (included as Exhibit 4.15 to the Company's Registration Statement on Form S-1 (File No. 333-158539), as amended, declared effective on July 24, 2009, and incorporated herein by reference).
- 4.11 Certificate of Designation of Preferences, Rights and Limitations of Series A 0% Convertible Preferred Stock, filed with the Delaware Secretary of State on April 24, 2012 (included as Exhibit 4.2 to the Company's Current Report on Form 8-K, filed April 25, 2012, and incorporated herein by reference).
- 4.12 Form of Common Stock Purchase Warrant for April 2012 offering (included as Exhibit 4.1 to the Company's Current Report on Form 8-K, filed April 25, 2012, and incorporated herein by reference).
- 4.13 Form of Underwriters Warrant to be issued to the Underwriters in connection with the March 2013 Offering (included as Exhibit 4.1 to the Company's Current Report on Form 8-K, filed March 7, 2013, and incorporated herein by reference).
- 4.14 Warrant issued to Dawson James Securities, Inc., dated December 9, 2013 (included as Exhibit 4.14 to the Company's 10-Q filed February 14, 2014 and incorporated herein by reference).
- 4.15 Form of Series A Common Stock Purchase Warrant for February 2014 offering (included as Exhibit 4.1 to the Company's Current Report on Form 8-K filed February 26, 2014 and incorporated herein by reference).
- 4.16 Form of Series B Common Stock Purchase Warrant for February 2014 offering (included as Exhibit 4.2 to the Company's Current Report on Form 8-K filed February 26, 2014 and incorporated herein by reference).
- 4.17 Warrant issued to Dawson James Securities, Inc., dated February 26, 2014 (included as Exhibit 4.3 to the Company's Current Report on Form 8-K filed February 26, 2014 and incorporated herein by reference).
- 4.18 Warrant Agreement, including Form of Warrant entered into by and between Oculus Innovative Sciences, Inc. and Computershare, Inc. and Computershare Trust Company, N.A., dated January 20, 2015 (included as Exhibit 4.1 to the Company's Current Report on Form 8-K filed January 26, 2015 and incorporated herein by reference).
- 4.19 Underwriters Warrant issued to Maxim Partners LLC on January 26, 2015 (included as Exhibit 4.2 to the Company's Current Report on Form 8-K filed January 26, 2015 and incorporated herein by reference).
- 4.20 Underwriters Warrant issued to Robert D. Keyser, Jr. on January 26, 2015 (included as Exhibit 4.3 to the Company's Current Report on Form 8-K filed January 26, 2015 and incorporated herein by reference).
- 4.21 Underwriters Warrant issued to R. Douglas Armstrong on January 26, 2015 (included as Exhibit 4.4 to the Company's Current Report on Form 8-K filed January 26, 2015 and incorporated herein by reference).
- 4.22 Underwriters Warrant issued to Dawson James Securities, Inc. on January 26, 2015 (included as Exhibit 4.5 to the Company's Current Report on Form 8-K filed January 26, 2015 and incorporated herein by reference).
- 4.23 Underwriters Warrant issued to Dawson James Securities, Inc. on January 26, 2015 (included as Exhibit 4.6 to the Company's Current Report on Form 8-K filed January 26, 2015 and incorporated herein by reference).
- 4.24 Warrant Agreement, including Form of Warrant entered into by and between Oculus Innovative Sciences, Inc. and Computershare, Inc. and Computershare Trust Company, N.A., dated March 18, 2016 (included as Exhibit 4.1 to the Company's Current Report on Form 8-K filed March 18, 2016, and incorporated herein by reference).
- 4.25 Form of Warrant issued to Dawson James Securities, Inc. on March 31, 2016 (included as Exhibit 4.25 to the Company's annual report on Form 10-K filed June 21, 2016, and incorporated herein by reference).
- 4.26 Section 382 Rights Agreement, dated as of October 18, 2016, between Oculus Innovative Sciences, Inc. and Computershare Inc., which includes the Form of Certificate of Designation of Series B Preferred Stock as Exhibit A, the Form of Right Certificate as Exhibit B and the Summary of Rights to Purchase Preferred Stock as Exhibit C (included as Exhibit 4.1 to the Company's Current Report on Form 8-K filed October 21, 2016, and incorporated herein by reference).



- 10.1 Form of Indemnification Agreement between Oculus Innovative Sciences, Inc. and its officers and directors (included as Exhibit 10.1 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.2 Office Lease Agreement, dated October 26, 1999, between Oculus Innovative Sciences, Inc. and RNM Lakeville, L.P. (included as Exhibit 10.7 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.3 Amendment No. 1 to Office Lease Agreement, dated September 15, 2000, between Oculus Innovative Sciences, Inc. and RNM Lakeville L.P. (included as Exhibit 10.8 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.4 Amendment No. 2 to Office Lease Agreement, dated July 29, 2005, between Oculus Innovative Sciences, Inc. and RNM Lakeville L.P. (included as Exhibit 10.9 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.5 Amendment No. 3 to Office Lease Agreement, dated August 23, 2006, between Oculus Innovative Sciences, Inc. and RNM Lakeville L.P. (included as Exhibit 10.23 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.6 Office Lease Agreement, dated May 18, 2006, between Oculus Technologies of Mexico, S.A. de C.V. and Antonio Sergio Arturo Fernandez Valenzuela (translated from Spanish) (included as Exhibit 10.10 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.7 Office Lease Agreement, dated July 2003, between Oculus Innovative Sciences, B.V. and Artikona Holding B.V. (translated from Dutch) (included as Exhibit 10.11 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.8 Form of Director Agreement (included as Exhibit 10.20 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.9 Framework Agreement, dated June 16, 2005, by and among Javier Orozco Gutierrez, Quimica Pasteur, S de R.L., Jorge Paulino Hermosillo Martin, Oculus Innovative Sciences, Inc. and Oculus Technologies de Mexico, S.A. de C.V. (included as Exhibit 10.25 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.10 Mercantile Consignment Agreement, dated June 16, 2005, between Oculus Technologies de Mexico, S.A. de C.V., Quimica Pasteur, S de R.L. and Francisco Javier Orozco Gutierrez (included as Exhibit 10.26 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.11 Partnership Interest Purchase Option Agreement, dated June 16, 2005, by and between Oculus Innovative Sciences, Inc. and Javier Orozco Gutierrez (included as Exhibit 10.27 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.12 Termination of Oculus Innovative Sciences, Inc. and Oculus Technologies de Mexico, S.A. de C.V.'s Agreements with Quimica Pasteur, S de R.L. by Jorge Paulino Hermosillo Martin (translated from Spanish) (included as Exhibit 10.28 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.13 Termination of Oculus Innovative Sciences, Inc. and Oculus Technologies de Mexico, S.A. de C.V.'s Agreements with Quimica Pasteur, S de R.L. by Francisco Javier Orozco Gutierrez (translated from Spanish) (included as Exhibit 10.29 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.14 Employment Agreement by and between Oculus Innovative Sciences, Inc. and Hojabr Alimi, dated January 1, 2004 (included as Exhibit 10.14 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.15 Employment Agreement by and between Oculus Innovative Sciences, Inc. and Jim Schutz, dated January 1, 2004 (included as Exhibit 10.15 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.16 Employment Agreement by and between Oculus Innovative Sciences, Inc. and Robert Miller, dated June 1, 2004 (included as Exhibit 10.16 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).

- 10.17 Amended and Restated Oculus Innovative Sciences, Inc. 2006 Stock Incentive Plan and related form stock option plan agreements (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed May 2, 2007, and incorporated herein by reference).
- 10.18 Amendment No. 4 to Office Lease Agreement, dated September 13, 2007, by and between Oculus Innovative Sciences, Inc. and RNM Lakeville L.P. (included as Exhibit 10.43 to the Company's Annual Report on Form 10-K filed June 13, 2008, and incorporated herein by reference).
- 10.19 Amendment to Office Lease Agreement, effective February 15, 2008, by and between Oculus Innovative Sciences Netherlands B.V. and Artikona Holding B.V. (translated from Dutch) (included as Exhibit 10.44 to the Company's Annual Report on Form 10-K filed June 13, 2008, and incorporated herein by reference).
- 10.20 Purchase Agreement by and between Oculus Innovative Sciences, Inc. and Robert Burlingame, dated January 26, 2009 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed January 29, 2009, and incorporated herein by reference).
- 10.21 Purchase Agreement by and between Oculus Innovative Sciences, Inc. and Non-Affiliated Investors, dated January 26, 2009 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed January 29, 2009, and incorporated herein by reference).
- 10.22 Revenue Sharing Distribution Agreement by and between Oculus Innovative Sciences, Inc. and VetCure, Inc., dated January 26, 2009 (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed January 29, 2009, and incorporated herein by reference).
- 10.23 Purchase Agreement by and between Oculus Innovative Sciences, Inc., Robert Burlingame and Seamus Burlingame, dated February 24, 2009 (included as Exhibit 10.4 to the Company's Current Report on Form 8-K filed February 27, 2009, and incorporated herein by reference).
- 10.24 Amendment No. 1 to Revenue Sharing Distribution Agreement by and between Oculus Innovative Sciences, Inc. and VetCure, Inc., dated February 24, 2009 (included as Exhibit 10.5 to the Company's Current Report on Form 8-K filed February 27, 2009, and incorporated herein by reference).
- 10.25 Consultant Agreement by and between Oculus Innovative Sciences, Inc. and Robert C. Burlingame, dated April 1, 2009 (included as Exhibit 10.52 to the Company's Annual Report on Form 10-K filed June 11, 2009, and incorporated herein by reference).
- 10.26 Microcyn U.S. Commercial Launch Agreement by and between Oculus Innovative Sciences, Inc. and Advocos, dated April 24, 2009 (included as Exhibit 10.53 to the Company's Annual Report on Form 10-K filed June 11, 2009, and incorporated herein by reference).
- 10.27 Amendment No. 5 to Office Lease Agreement by and between Oculus Innovative Sciences, Inc. and RNM Lakeville, LLC, dated May 18, 2009 (included as Exhibit 10.54 to the Company's Annual Report on Form 10-K filed June 11, 2009, and incorporated herein by reference).
- 10.28 Engagement Agreement by and between Oculus Innovative Sciences, Inc. and Dawson James Securities, Inc., dated April 10, 2009 (included as Exhibit 10.55 to the Company's Registration Statement on Form S-1 (File No. 333-158539), as amended, declared effective on July 24, 2009, and incorporated herein by reference).
- 10.29 Amendment and Clarification of Engagement Letter by and between Oculus Innovative Sciences, Inc. and Dawson James Securities, Inc., dated July 2, 2009 (included as Exhibit 10.56 to the Company's Registration Statement on Form S-1 (File No. 333-158539), as amended, declared effective on July 24, 2009, and incorporated herein by reference).
- 10.30 Second Amendment and Clarification of Engagement Letter by and between Oculus Innovative Sciences, Inc. and Dawson James Securities, Inc., dated July 10, 2009 (included as Exhibit 10.57 to the Company's Registration Statement on Form S-1 (File No. 333-158539), as amended, declared effective on July 24, 2009, and incorporated herein by reference).
- 10.31† Warrant Purchase Agreement by and between Oculus Innovative Sciences, Inc. and Dawson James Securities, Inc., dated July 13, 2009 (included as Exhibit 10.58 to the Company's Registration Statement on Form S-1 (File No. 333-158539), as amended, declared effective on July 24, 2009, and incorporated herein by reference).
- 10.32 Amendment No. 2 to Revenue Sharing, Partnership and Distribution Agreement between Oculus Innovative Sciences, Inc. and Vetericyn, Inc., dated July 24, 2009 (refiled as Exhibit 10.44 to the Company's Quarterly Report on Form 10-Q/A for the quarter ended September 30, 2010 filed April 29, 2011, and incorporated herein by reference).
- 10.33 Loan and Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing V, Inc., dated May 1, 2010 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed May 6, 2010, and incorporated herein by reference).

- 10.34† Supplement to the Loan and Security Agreement between Oculus Innovative Sciences, Inc., and Venture Lending & Leasing V, Inc., dated May 1, 2010 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed May 6, 2010, and incorporated herein by reference).
- 10.35† Amendment No. 3 to Revenue Sharing, Partnership and Distribution Agreement between Oculus Innovative Sciences, Inc. and Vetericyn, Inc., dated June 1, 2010 (refiled as Exhibit 10.44 to the Company's Quarterly Report on Form 10-Q/A for the quarter ended June 30, 2010 filed April 29, 2011, and incorporated herein by reference).
- 10.36 Amendment No. 1 to Exhibit A to the Revenue Sharing Distribution Agreement and to the Revenue Sharing, Partnership and Distribution Agreement as Revised and Amended, June 1, 2010, dated September 1, 2010 (included as Exhibit 10.46 to the Company's Quarterly Report on Form 10-Q filed November 4, 2010, and incorporated herein by reference).
- 10.37 Continuous Offering Program Agreement between Oculus Innovative Sciences, Inc. and Rodman & Renshaw, LLC, dated September 3, 2010 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed September 17, 2010, and incorporated herein by reference).
- 10.38† Purchase Agreement by and between Oculus Innovative Sciences, Inc. and accredited investors, dated February 6, 2009 (refiled as Exhibit 10.32 to the Company's Quarterly Report on Form 10-Q filed November 4, 2010, and incorporated herein by reference).
- 10.39† Distribution Agreement between Oculus Innovative Sciences, Inc. and Tianjin Ascent Import and Export Company, Ltd., dated January 28, 2011 (included as Exhibit 10.47 to the Company's Quarterly Report on Form 10-Q filed February 4, 2011, and incorporated herein by reference).
- 10.40† Exclusive Sales and Distribution Agreement between Oculus Innovative Sciences, Inc. and Quinnova Pharmaceuticals, Inc., dated February 14, 2011 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed February 18, 2011, and incorporated herein by reference).
- 10.41 Exclusive Co-Promotion Agreement between Oculus Innovative Sciences, Inc. and Quinnova Pharmaceuticals, Inc., dated February 14, 2011 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed February 18, 2011, and incorporated herein by reference).
- 10.42 Product Option Agreement between Oculus Innovative Sciences, Inc. and AmDerma Pharmaceuticals, LLC, dated February 14, 2011 (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed February 18, 2011, and incorporated herein by reference).
- 10.43 Amendment No. 6 to Office Lease Agreement by and between Oculus Innovative Sciences, Inc. and RNM Lakeville, L.P., dated April 26, 2011 (included as Exhibit 10.52 to the Company's Annual Report on Form 10-K filed June 3, 2011, and incorporated herein by reference).
- 10.44 Loan and Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing VI, Inc., dated June 29, 2011 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed July 6, 2011, and incorporated herein by reference).
- 10.45 Supplement to the Loan and Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing VI, Inc., dated June 29, 2011 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed July 6, 2011, and incorporated herein by reference).
- 10.46 Amendment No. 1 to the Loan and Security Agreement and Supplement to the Loan and Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing V, Inc., dated June 29, 2011 (included as Exhibit 10.4 to the Company's Current Report on Form 8-K filed July 6, 2011, and incorporated herein by reference).
- 10.47 Intellectual Property Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing VI, Inc., dated June 29, 2011 (included as Exhibit 10.5 to the Company's Current Report on Form 8-K filed July 6, 2011, and incorporated herein by reference).
- 10.48 Intellectual Property Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing V, Inc., dated June 29, 2011 (included as Exhibit 10.6 to the Company's Current Report on Form 8-K filed July 6, 2011, and incorporated herein by reference).
- 10.49† Oculus Innovative Sciences, Inc. 2011 Stock Incentive Plan (included as Exhibit A in the Company's Definitive Proxy Statement on Schedule 14A filed July 29, 2011, and incorporated herein by reference).
- 10.50† Distribution Agreement between Oculus Innovative Sciences, Inc. and Shanghai Sunvic Technology Co. Ltd., dated June 26, 2011 (included as Exhibit 10.58 to the Company's Quarterly Report on Form 10-Q filed August 4, 2011 and incorporated herein by reference).

- 10.51 Patent License Agreement-Exclusive between Oculus Innovative Sciences, Inc. and agencies of the United States Public Health Service within the Department of Health and Human Services, dated August 22, 2011 (included as Exhibit 10.60 to the Company's Quarterly Report on Form 10-Q filed November 3, 2011, and incorporated herein by reference).
- 10.52† Securities Purchase Agreement by and between the Company and the Purchasers, dated April 22, 2012 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed April 25, 2012, and incorporated herein by reference).
- 10.53† Collaboration Agreement between Oculus Innovative Sciences, Inc. and AmDerma Pharmaceuticals, LLC, dated June 21, 2012 (included as Exhibit 10.53 to the Company's Annual Report on Form 10-K filed June 21, 2012 and incorporated herein by reference).
- 10.54† License, Exclusive Distribution and Supply Agreement by and between Oculus Innovative Sciences, Inc. and Oculus Technologies of Mexico, S.A. de C.V., and, More Pharma Corporation, S. de R.L. de C.V., dated August 9, 2012 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed August 15, 2012, and incorporated herein by reference).
- 10.55 Exclusive Distribution and Supply Agreement by and between Oculus Innovative Sciences, Inc. and Oculus Technologies of Mexico, S.A. de C.V., and, More Pharma Corporation, S. de R.L. de C.V., dated August 9, 2012 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed August 15, 2012, and incorporated herein by reference).
- 10.56 Amendment No. 7 to Office Lease Agreement by and between Oculus Innovative Sciences, Inc. and 1125-1137 North McDowell, LLC, dated October 10, 2012 (included as Exhibit 10.58 to the Company's Quarterly Report on Form 10-Q filed November 8, 2012, and incorporated herein by reference).
- 10.57 Stock Purchase Agreement by and between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing V, LLC and Venture Lending & Leasing VI, LLC, dated October 30, 2012 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed November 1, 2012, and incorporated herein by reference).
- 10.58 Letter Agreement by and between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing V, Inc., dated October 30, 2012 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed November 1, 2012, and incorporated herein by reference).
- 10.59 Letter Agreement by and between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing VI, Inc., dated October 30, 2012 (included as Exhibit 10.3 to the Company's Current Report on Form 8-K, filed November 1, 2012, and incorporated herein by reference).
- 10.60 Side Letter Agreement to the Stock Purchase Agreement dated April 22, 2012 by and between Oculus Innovative Sciences, Inc., on one hand, and Sabby Healthcare Volatility Master Fund, Ltd. and Sabby Volatility Warrant Master Fund, Ltd. on the other hand, dated October 29, 2012 (included as Exhibit 10.4 to the Company's Current Report on Form 8-K, filed November 1, 2012, and incorporated herein by reference).
- 10.61 Offer of Employment Letter between Oculus Innovative Sciences, Inc. and Sameer Harish, effective as of February 1, 2013 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed February 4, 2013, and incorporated herein by reference).
- 10.62 Employment Agreement by and between Ruthigen, Inc. and Hojabr Alimi, dated March 21, 2013 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed March 22, 2013, and incorporated herein by reference).
- 10.63 License and Supply Agreement by and between Oculus Innovative Sciences, Inc. and Ruthigen, Inc., dated May 23, 2013 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed June 7, 2013, and incorporated herein by reference).
- 10.64 Shared Services Agreement by and between Oculus Innovative Sciences, Inc. and Ruthigen, Inc., dated May 23, 2013 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed June 7, 2013, and incorporated herein by reference).
- 10.65 Amendment to Offer of Employment Letter between Oculus Innovative Sciences, Inc. and Sameer Harish, dated May 23, 2013 (included as Exhibit 10.4 to the Company's Current Report on Form 8-K, filed June 7, 2013, and incorporated herein by reference).
- 10.66 Employment Agreement by and between Oculus Innovative Sciences, Inc. and Jim Schutz, dated June 20, 2013 (included as Exhibit 10.68 to the Company's Annual Report on Form 10-K, filed June 25, 2013 and incorporated herein by reference).

- 10.67 Employment Agreement by and between Oculus Innovative Sciences, Inc. and Robert Miller, dated June 20, 2013 (included as Exhibit 10.69 to the Company's Annual Report on Form 10-K, filed June 25, 2013 and incorporated herein by reference).
- 10.68 Separation Agreement by and between Oculus Innovative Sciences, Inc. and Ruthigen, Inc., dated August 2, 2013 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed August 8, 2013 and incorporated herein by reference).
- 10.69 Amendment No. 1 to License and Supply Agreement by and between Oculus Innovative Sciences, Inc. and Ruthigen, Inc., dated October 9, 2013 (included as Exhibit 10.64 to the Company's 10-Q filed November 19, 2013 and incorporated herein by reference).
- 10.70 Amendment No. 2 to License and Supply Agreement by and between Oculus Innovative Sciences, Inc. and Ruthigen, Inc., dated November 6, 2013 (included as Exhibit 10.65 to the Company's 10-Q filed November 19, 2013 and incorporated herein by reference).
- 10.71 Letter Agreement by and between Oculus Innovative Sciences, Inc., Venture Lending & Leasing V, Inc., and Venture Lending & Leasing VI, Inc., dated November 6, 2013 (filed as Exhibit 10.66 to the Company's 10-Q filed November 19, 2013 and incorporated herein by reference).
- 10.72 Form of Securities Purchase Agreement by and between Oculus Innovative Sciences, Inc. and the Purchasers, dated December 4, 2013 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed December 6, 2013, and incorporated herein by reference).
- 10.73 Funding Agreement by and between Oculus Innovative Sciences, Inc. and Ruthigen, Inc., dated January 31, 2014 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed February 6, 2014, and incorporated herein by reference).
- 10.74 Amended Separation Agreement by and between Oculus Innovative Sciences, Inc. and Ruthigen, Inc., dated January 31, 2014 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed February 6, 2014, and incorporated herein by reference).
- 10.75 Amendment No. 3 to License and Supply Agreement by and between Oculus Innovative Sciences, Inc. and Ruthigen, Inc., dated January 31, 2014 (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed February 6, 2014 and incorporated herein by reference).
- 10.76 Amendment No. 1 to Shared Services Agreement by and between Oculus Innovative Sciences, Inc. and Ruthigen, Inc., dated January 31, 2014 (included as Exhibit 10.4 to the Company's Current Report on Form 8-K filed February 6, 2014).
- 10.77 Letter Agreement by and between Oculus Innovative Sciences, Inc. and Hojabr Alimi, dated January 31, 2014 (included as Exhibit 10.6 to the Company's Current Report on Form 8-K filed February 6, 2014).
- 10.78 Form of Securities Purchase Agreement by and between Oculus Innovative Sciences, Inc. and the Purchasers, dated February 21, 2014 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed February 26, 2014 and incorporated herein by reference).
- 10.79 At-the-Market Issuance Sales Agreement, dated April 2, 2014, by and between Oculus Innovative Sciences, Inc. and MLV & Co. LLC (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed April 2, 2014 and incorporated herein by reference).
- 10.80 Lease Agreement by and between Oculus Innovative Sciences, Inc. and 2500 York, L.P., dated July 9, 2014 (included as Exhibit 10.82 to the Company's Quarterly Report on Form 10-Q filed August 12, 2014, and incorporated by reference).
- 10.81 Securities Purchase Agreement, dated January 8, 2015, by and between Oculus Innovative Sciences, Inc. and two investors, Ruthigen, Inc. and Dawson James Securities, Inc. (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed January 12, 2015 and incorporated herein by reference).
- 10.82 Underwriting Agreement entered into by and between Oculus Innovative Sciences, Inc. and Maxim Group LLC as representative of the underwriters named on Schedule A thereto, dated January 20, 2015 (included as Exhibit 1.1 to the Company's Current Report on Form 8-K filed January 26, 2015 and incorporated herein by reference).
- 10.83† Sales Representation Contract, dated February 1, 2015, by and between Oculus Innovative Sciences, Inc. and SLA Brands, Inc. (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 2, 2015 and incorporated herein by reference).

10.84	Securities Purchase Follow-Up Agreement, dated March 13, 2015, by and between Oculus Innovative Sciences, Inc., two investors, Ruthigen, Inc. and Dawson James Securities, Inc. (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 16, 2015 and incorporated herein by reference).
10.85	Securities Purchase Agreement, dated March 13, 2015, by and between Oculus Innovative Sciences, Inc., several investors, Ruthigen, Inc. and Dawson James Securities, Inc. (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed March 16, 2015 and incorporated herein by reference).
10.86	Agreement, dated March 13, 2015, by and between Oculus Innovative Sciences, Inc. and Pulmatrix, Inc. (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed March 16, 2015 and incorporated herein by reference).
10.87	Agreement, dated March 13, 2015, by and between Oculus Innovative Sciences, Inc. and Ruthigen, Inc. (included as Exhibit 10.4 to the Company's Current Report on Form 8-K filed March 16, 2015 and incorporated herein by reference).
10.88†	Amendment No. 1 to Sales Representation Contract, dated November 6, 2015, by and between Oculus Innovative Sciences, Inc. and SLA Brands, Inc. (included as Exhibit 10.88 to the Company's Quarterly Report on Form 10-Q filed February 16, 2016, and incorporated herein by reference).
10.89	Underwriting Agreement entered into by and between Oculus Innovative Sciences, Inc. and Dawson James Securities, Inc. as representative of the underwriters named on Schedule 1 thereto, dated March 18, 2016 (included as Exhibit 1.1 to the Company's Current Report on Form 8-K filed March 18, 2016 and incorporated herein by reference).
10.90	Employment Agreement by and between Oculus Innovative Sciences, Inc. and Jim Schutz, dated July 26, 2016 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed July 29, 2016, and incorporated herein by reference).
10.91†	Asset Purchase Agreement dated October 27, 2016, between Oculus Innovative Sciences, Inc. and Invekra, S.A.P.I de C.V. (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed October 31, 2016, and incorporated herein by reference).
10.92†	Amendment Agreement to Acquisition Option dated October 27, 2016, by and between More Pharma Corporation S. de R.L. de C.V. and Oculus Technologies of Mexico, S.A. de C.V. (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed October 31, 2016, and incorporated herein by reference).
10.93	Employment Agreement by and between Oculus Innovative Sciences, Inc. and Robert Miller, dated November 30, 2016 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed December 1, 2016, and incorporated herein by reference).
10.94	Employment Agreement by and between Oculus Innovative Sciences, Inc. and Bruce Thornton, dated November 30, 2016 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed December 1, 2016, and incorporated herein by reference).
10.95	Employment Agreement by and between Oculus Innovative Sciences, Inc. and Robert Northey, dated November 30, 2016 (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed December 1, 2016, and incorporated herein by reference).
10.96	Employment Agreement by and between Oculus Innovative Sciences, Inc. and Jeffrey Day, dated November 30, 2016 (included as Exhibit 10.4 to the Company's Current Report on Form 8-K filed December 1, 2016, and incorporated herein by reference).
10.97*	Employment Agreement by and between Sonoma Pharmaceuticals, Inc. and Marc Umscheid, dated December 31, 2016.
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase.
101.LAB*	XBRL Taxonomy Extension Label Linkbase.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase.

\* Filed herewith.

† Confidential treatment has been granted with respect to certain portions of this agreement.

Copies of above exhibits not contained herein are available to any stockholder, upon payment of a reasonable per page fee, upon written request to: Chief Financial Officer, Sonoma Pharmaceuticals, Inc., 1129 N. McDowell Blvd., Petaluma, California 94954.

**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.

**SONOMA PHARMACEUTICALS, INC.**

Date: February 17, 2017

By: /s/ Jim Schutz  
Jim Schutz  
Chief Executive Officer  
(Principal Executive Officer)

Date: February 17, 2017

By: /s/ Robert Miller  
Robert Miller  
Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)

## EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT (this "Agreement") is entered into by and between Marc Umscheid (the "Executive"), and Sonoma Pharmaceuticals, Inc., a Delaware corporation (the "Corporation"), as of December 31, 2016 (the "Effective Date").

### RECITALS

**WHEREAS**, the Corporation desires that the Executive be employed by the Corporation as its Chief Strategy and Growth Officer and Chief Marketing Officer, and to carry out the duties and responsibilities described below, all on the terms and conditions set forth herein;

**WHEREAS**, the Executive is willing to accept such employment on such terms and conditions.

**NOW, THEREFORE**, in consideration of the foregoing premises and the mutual covenants and promises of the parties herein, the receipt and sufficiency of which are hereby acknowledged by each of the parties, the Corporation and the Executive hereto agree as follows:

#### 1. Employment and Duties.

1.1 Position. On the terms and subject to the conditions set forth herein, the Corporation agrees to continue to employ the Executive as its Chief Strategy and Growth Officer and Chief Marketing Officer for the Term of Employment (as defined in *Section 2*). The Executive does hereby accept and agree to such employment, on the terms and conditions expressly set forth in this Agreement. The Executive shall, if requested, also serve as a member of the Board of Directors of the Corporation (the "Board") or as an officer or director of any affiliate of the Corporation for no additional compensation.

1.2 Duties. During the Term of Employment (as defined in *Section 2*), the Executive shall serve the Corporation as its Chief Strategy and Growth Officer and Chief Marketing Officer. The Executive shall, without limitation and without limiting the Executive's other duties to the Corporation, and without limiting the authority of the Corporation's Board of Directors, be responsible for the general supervision, direction and control of the business and affairs of the Corporation and have such other duties and responsibilities as the Board shall designate that are consistent with the Executive's position as Chief Strategy and Growth Officer and Chief Marketing Officer of the Corporation. The Executive shall perform all of such duties and responsibilities in accordance with the legal directives of the Board and in accordance with the practices and policies of the Corporation as in effect from time to time throughout the Term of Employment (as defined in *Section 2*) (including, without limitation, the Corporation's insider trading and ethics policies, as they may change from time to time). While employed as Chief Strategy and Growth Officer and Chief Marketing Officer of the Corporation, the Executive shall report exclusively to the Chief Executive Officer. Throughout the Term of Employment (as defined in *Section 2*), the Executive shall not serve on the boards of directors or advisory boards of any other entity, except for any wholly or majority owned subsidiaries of the Corporation, unless such service is expressly approved by the Board.

1.3 No Other Employment; Minimum Time Commitment. Throughout the Term of Employment, the Executive shall both (i) devote substantially all of the Executive's business time, energy and skill to the performance of the Executive's duties for the Corporation, and (ii) hold no other job. The Executive agrees that any investment or direct involvement in, or any appointment to or continuing service on the board of directors or similar body of, any corporation or other entity, other than wholly or majority owned subsidiaries of the Corporation, must be first approved in writing by the Corporation. The foregoing provisions of this *Section 1.3* shall not prevent the Executive from investing in non-competitive, publicly-traded securities to the extent permitted by *Section 6(b)*.

1.4 No Breach of Contract. The Executive hereby represents to the Corporation that: (i) the execution and delivery of this Agreement by the Executive and the Corporation and the performance by the Executive of the Executive's duties hereunder shall not constitute a breach of, or otherwise contravene, the terms of any other agreement or policy to which the Executive is a party or otherwise bound; (ii) the Executive has no information (including, without limitation, confidential information and trade secrets) of any other person or entity which the Executive is not legally and contractually free to disclose to the Corporation; and (iii) the Executive is not bound by any confidentiality, trade secret or similar agreement (other than this Agreement) with any other person or entity.



1.5 Place of Performance. The principal place of Executive's employment shall be the Corporation's principal executive offices, currently located in Petaluma, California, though such principal place of employment of the Executive may be moved from time to time upon mutual agreement by the Executive and the Corporation. The Executive agrees that the Executive will be regularly present at the Corporation's principal executive offices, or such other location as the parties may designate, and that the Executive may be required to travel from time to time in the course of performing the Executive's duties for the Corporation.

1.6 Performance Review. During the Term of Employment, the Compensation Committee of the Corporation, in its sole discretion, will review Executive's performance every six (6) months beginning on the Effective Date. The Compensation Committee will determine the performance goals and factors after consultation with the Executive in its sole discretion and its decision shall be binding on all persons.

2. Term of Employment. The "Term of Employment" shall commence on the Effective Date, and shall continue in full force and effect until the Termination Date pursuant to *Section 5.8*. This Agreement shall govern the terms of Executive's employment hereunder on and after the Effective Date.

### 3. Compensation.

3.1 Base Salary. As of the Effective Date and during the Term of Employment, the Corporation shall pay to the Executive a base salary at the rate of \$213,000.00 per year, subject to increase (but not decrease) by the Board (the "Base Salary"). The Executive's Base Salary shall be paid in accordance with the Corporation's regular payroll practices in effect from time to time, but no less frequently than monthly.

3.2 Annual Bonus. For each fiscal year during the Term of Employment, Executive shall be eligible to receive an annual bonus (the "Annual Bonus"). However, the decision to provide any Annual Bonus and the amount and terms of any Annual Bonus shall be in the sole and absolute discretion of the Compensation Committee of the Board. If the Compensation Committee decides to award an Annual Bonus to Executive, it will independently negotiate a supplement to this Agreement with Executive setting forth the terms and conditions of the Annual Bonus. Executive must be employed by the Corporation on the day that any Annual Bonus is paid. However, the Board of Directors or the Compensation Committee, as appropriate, may in its sole discretion agree to pay a pro rata or full Annual Bonus, and if such Annual Bonus is granted, then determine the amount, form and payment schedule.

3.3 Equity Awards. During the Term of Employment, Executive shall be eligible to participate in the Company's 2011 Equity Incentive Plan and 2016 Equity Incentive Plan or any successor plan, subject to the terms of such plans, as determined by the Board or the Compensation Committee, in its discretion.

3.4. Indemnification. (a) In the event that the Executive is made a party or threatened to be made a party to any action, suit, or proceeding, whether civil, criminal, administrative or investigative (a "Proceeding"), other than any Proceeding initiated by the Executive or the Corporation related to any contest or dispute between the Executive and the Corporation or any of its affiliates with respect to this Agreement or the Executive's employment hereunder, by reason of the fact that the Executive is or was a director or officer of the Corporation, or any affiliate of the Corporation, or is or was serving at the request of the Corporation as a director, officer, member, employee or agent of another corporation or a partnership, joint venture, trust or other enterprise, the Executive shall be indemnified and held harmless by the Corporation to the maximum extent permitted under applicable law and the Corporation's articles and bylaws, as may be amended from time to time, from and against any liabilities, costs, claims and expenses, including all costs and expenses incurred in defense of any Proceeding (including attorneys' fees).

(b) During the Term of Employment and for a period of six (6) years thereafter, the Corporation or any successor to the Corporation shall purchase and maintain, at its own expense, directors' and officers' liability insurance providing coverage to the Executive on terms that are no less favorable than the coverage provided to other directors and similarly situated executives of the Corporation.

3.5 Clawback Provisions. Any incentive-based compensation, or any other compensation, paid to the Executive pursuant to this Agreement or any other agreement or arrangement with the Corporation which is subject to recovery under any law, government regulation or stock exchange listing requirement, will be subject to such deductions and clawback as may be required to be made pursuant to such law, government regulation or stock exchange listing requirement (or any policy adopted by the Corporation pursuant to any such law, government regulation or stock exchange listing requirement). The Corporation will make any determination for clawback or recovery in accordance with any applicable law or regulation.

#### 4. Benefits.

4.1 Health and Welfare. During the Term of Employment, Executive shall be entitled to participate in all employee pension and welfare benefit plans and programs made available by the Corporation to the Corporation's senior-level employees generally, as such plans or programs may be in effect from time to time.

4.2 Reimbursement of Business Expenses. Executive is authorized to incur reasonable expenses in carrying out the Executive's duties for the Corporation under this Agreement and entitled to reimbursement for all such expenses the Executive incurs during the Term of Employment in connection with carrying out the Executive's duties for the Corporation, subject to the Corporation's reasonable expense reimbursement policies in effect from time to time. The Corporation shall reimburse the Executive to the extent required by the preceding sentence.

4.3 Vacation and Other Leave. During the Term of Employment, Executive shall accrue and be entitled to take paid vacation in accordance with the Corporation's standard vacation policies in effect from time to time, including the Corporation's policies regarding vacation accruals. The Executive shall also be entitled to all other holiday and leave pay generally available to all other employees of the Corporation.

#### 5. Termination.

The Term of Employment and the Executive's employment hereunder may be terminated by either the Corporation or the Executive at any time and for any reason; provided that, unless otherwise provided herein, either party shall be required to give the other party at least 30 calendar days advance written notice of any termination of the Executive's employment in accordance with *Sections 5.7 and 5.8*. Upon termination of the Executive's employment during the Term of Employment, the Executive shall be entitled to the compensation and benefits described in this *Section 5* and shall have no further rights to any compensation or any other benefits from the Company or any of its affiliates.

##### 5.1 Definitions. For purposes of this Agreement:

(a) "Accrued Amounts" shall mean:

- (i) any accrued but unpaid Base Salary and accrued but unused vacation which shall be paid within one (1) week following the Termination Date (as defined below);
- (ii) reimbursement for unreimbursed business expenses properly incurred by the Executive, which shall be subject to and paid in accordance with the Corporation's expense reimbursement policy; and
- (iii) such employee benefits (including equity compensation), if any, to which the Executive may be entitled under the Corporation's employee benefit plans as of the Termination Date; provided that, in no event shall the Executive be entitled to any payments in the nature of severance or termination payments except as specifically provided herein.

(b) "Change in Control" shall mean the occurrence of any of the following after the Effective Date:

- (i) one person (or more than one person acting as a group) acquires ownership of stock of the Company that, together with the stock held by such person or group, constitutes more than 50% of the total fair market value or total voting power of the stock of such corporation; provided that, a Change in Control shall not occur if any person (or more than one person acting as a group) owns more than 50% of the total fair market value or total voting power of the Company's stock and acquires additional stock;

(ii) a majority of the members of the Board are replaced during any twelve-month period by directors whose appointment or election is not endorsed by a majority of the Board before the date of appointment or election; or

(iii) the sale of all or substantially all of the Company's assets.

Notwithstanding the foregoing, a Change in Control shall not occur unless such transaction constitutes a change in the ownership of the Company, a change in effective control of the Company, or a change in the ownership of a substantial portion of the Company's assets under Section 409A.

For purposes of the definition of "Change of Control", the following definitions shall be applicable:

(i) The term "person" shall mean any individual, corporation or other entity and any group as such term is used in Section 13(d) (3) or 14(d) (2) of the Exchange Act.

(ii) Any person shall be deemed to be the beneficial owner of any shares of capital stock of the Corporation:

a. which that person owns directly whether or not of record, or

b. which that person has the right to acquire pursuant to any agreement or understanding or upon exercise of conversion rights, warrants, or options, or otherwise, or

c. which are beneficially owned, directly or indirectly (including shares deemed owned through application of clause (b) above, by an "affiliate" or "associate" (as defined in the rules of the Securities and Exchange Commission under the Securities Act of 1933, as amended) of that person, or

d. which are beneficially owned, directly or indirectly (including shares deemed owned through application of clause (b) above), by any other person with which that person or his "affiliate" or "associate" (defined as aforesaid) has any agreement, arrangement, or understanding for the purpose of acquiring, holding, voting or disposing of capital stock of the Corporation.

(iii) The outstanding shares of capital stock of the Corporation shall include shares deemed owned through application of clause (ii) (b), (c), and (d) above, but shall not include any other shares which may be issuable pursuant to any agreement or upon exercise of conversion rights, warrants or options, or otherwise, but which are not actually outstanding.

(c) "Cause" shall mean:

(i) the Executive's willful failure to perform his duties (other than any such failure resulting from incapacity due to physical or mental illness);

(ii) the Executive's willful failure to comply with any valid and legal directive of the Board communicated to him in writing;

(iii) the Executive's willful engagement in dishonesty, illegal conduct or gross misconduct, which is, in each case, materially injurious to the Company or its affiliates;

(iv) the Executive's embezzlement, misappropriation or fraud, whether or not related to the Executive's employment with the Corporation;

- (v) the Executive's conviction of or plea of guilty or *nolo contendere* to a crime that constitutes a felony (or state law equivalent) or a crime that constitutes a misdemeanor involving moral turpitude;
- (vi) the Executive's violation of a material policy of the Corporation that has been provided to Executive (documents made public on the Company's website or through filings with the U.S. Securities and Exchange Commission are deemed provided to the Executive);
- (vii) the Executive's willful unauthorized disclosure of Confidential Information (as defined below);
- (viii) the Executive's material breach of any material obligation under this Agreement or any other written agreement between the Executive and the Corporation; or
- (ix) any material failure by the Executive to comply with the Corporation's written policies or rules, as they may be in effect from time to time during the Employment Term, if such failure causes material, reputational or financial harm to the Company.

For purposes of this provision, no act or failure to act on the part of the Executive shall be considered "willful" unless it is done, or omitted to be done, by the Executive in bad faith or without reasonable belief that the Executive's action or omission was in the best interests of the Company. Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or upon the advice of counsel for the Corporation shall be conclusively presumed to be done, or omitted to be done, by the Executive in good faith and in the best interests of the Corporation. In all cases the Company shall notify the Executive in writing of the basis for any for Cause termination by providing a detailed description of the alleged facts and circumstances giving rise to Cause. In addition, with respect to clauses (i), (ii), (vi), (viii) and (ix) Executive shall be given a period of at least 30 days to cure and only if Executive fails to cure within such time period will a termination be for Cause.

(d) "Disability" shall mean the Executive's inability, due to physical or mental incapacity, to substantially perform his duties and responsibilities under this Agreement, with or without reasonable accommodation, for 90 calendar days out of any three hundred sixty-five (365) calendar day period, but only if the Executive is considered disabled within the meaning of Treasury Regulation section 1.409A-3(i)(4). Without limiting the circumstances in which the Executive may be determined to be disabled as defined in Treasury Regulation section 1.409A-3(i)(4), the Executive will be presumed to be disabled if determined to be totally disabled by the Social Security Administration or if determined to be disabled in accordance with a disability insurance program, provided the definition of disability applied under such disability insurance program complies with the requirements of Treasury Regulation section 1.409A-3(i)(4). Any question as to the existence of the Executive's Disability as to which the Executive and the Corporation cannot agree shall be determined in writing by a qualified independent physician mutually acceptable to the Executive and the Corporation. If the Executive and the Corporation cannot agree as to a qualified independent physician, each shall appoint such a physician and those two physicians shall select a third who shall make such determination in writing. The determination of Disability made in writing to the Corporation and the Executive shall be final and conclusive for all purposes of this Agreement.

(e) "Good Reason" shall mean the occurrence of any of the following, in each case during the Employment Term without the Executive's written consent:

- (i) a reduction in the Executive's then current Base Salary;
- (ii) only after a sale of the Corporation, a relocation of the Executive's principal place of employment by more than 50 miles, unless the new principal place of employment is closer to Executive's principal residence;
- (iii) the Corporation's failure to obtain an agreement from any successor to the Corporation to assume and agree to perform this Agreement in the same manner and to the same extent that the Corporation would be required to perform if no succession had taken place, except where such assumption occurs by operation of law; or
- (iv) a material, adverse change in the Executive's title, authority, duties or responsibilities (other than temporarily while the Executive is physically or mentally incapacitated or as required by applicable law).

The Executive cannot terminate his employment for Good Reason unless he has provided written notice to the Corporation of the existence of the circumstances providing grounds for termination for Good Reason within 30 business days of the initial existence of such grounds and the Corporation has had at least 30 business days from the date on which such notice is provided to cure such circumstances. If the Executive does not terminate his employment for Good Reason within 30 calendar days after the expiration of the cure period, then the Executive will be deemed to have waived his right to terminate for Good Reason with respect to such grounds.

#### 5.2 Termination for Cause or Without Good Reason.

The Executive's employment hereunder may be terminated by the Corporation for Cause or by the Executive without Good Reason. If the Executive's employment is terminated, by the Corporation for Cause or by the Executive without Good Reason, the Executive shall be entitled to receive the Accrued Amounts.

#### 5.3 Termination Without Cause or for Good Reason.

The Term of Employment and the Executive's employment hereunder may be terminated by the Executive for Good Reason or by the Corporation without Cause. In the event of such termination, the Executive shall be entitled to receive the Accrued Amounts and subject to the Executive's compliance with *Section 6*, *Section 7*, *Section 8* and *Section 9* of this Agreement and his execution of a release of claims in favor of the Company, its affiliates and their respective officers and directors in a form attached hereto (the "Release") and such Release becoming effective within the applicable time period set forth in the Release, (the "Release Execution Period"), the Executive shall be entitled to receive the following:

- (a) a lump sum payment equal to one time the Executive's Base Salary, which shall be paid on the 30<sup>th</sup> day following the Termination Date; and
- (b) upon determination by the Corporation's Board of Directors or Compensation Committee, as appropriate, to be made in its sole discretion as to whether to grant a bonus, and if such bonus is granted, the amount, form and payment schedule. For the avoidance of doubt, Executive shall not be entitled to any bonus solely for reason of termination, unless the Board of Directors or the Compensation Committee, as appropriate, in its sole discretion awards a bonus to Executive.
- (c) If the Executive timely and properly elects health continuation coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), the Company shall reimburse the Executive for the monthly COBRA premium paid by the Executive for himself and his dependents. Such reimbursement shall be paid to the Executive on the 10<sup>th</sup> day of the month immediately following the month in which the Executive timely remits the premium payment ("COBRA Premium Reimbursements"). The Executive shall be eligible to receive such COBRA Premium Reimbursement until the earliest of: (i) the twelve-month anniversary of the Termination Date; (ii) the date the Executive is no longer eligible to receive COBRA continuation coverage; and (iii) the date on which the Executive becomes eligible to receive substantially similar coverage from another employer or other source. Notwithstanding the foregoing, if the Company's making payments under this *Section 5.3(b)* would violate the nondiscrimination rules applicable to non-grandfathered plans under the Affordable Care Act (the "ACA"), or result in the imposition of penalties under the ACA and the related regulations and guidance promulgated thereunder), the parties agree to reform this *Section 5.3(b)* in a manner as is necessary to comply with the ACA.
- (d) Consistent with the terms of any equity incentive plan of the Company, as approved by the stockholders, as applicable:
  - (i) all outstanding time-based equity-based compensation awards granted to the Executive during the Term of Employment shall become fully vested and exercisable for the remainder of their full term; and
  - (ii) all outstanding performance-based equity compensation awards granted to the Executive during the Term of Employment shall remain outstanding and shall vest or be forfeited in accordance with the terms of the applicable award agreements, if the applicable performance goals are satisfied. The determination whether such performance goals are satisfied shall be in the sole discretion of the Compensation Committee or the Board, as the case may be.

#### 5.4 Death or Disability.

(a) The Executive's employment hereunder shall terminate automatically upon the Executive's death during the Term of Employment, and the Corporation may terminate the Executive's employment on account of the Executive's Disability.

(b) If the Executive's employment is terminated during the Term of Employment on account of the Executive's death or Disability, the Executive (or the Executive's estate and/or beneficiaries, as the case may be) shall be entitled to receive the Accrued Amounts. In addition, Executive's spouse and other dependents shall be entitled to COBRA Premium Reimbursements upon timely request to the Corporation for such benefits. Notwithstanding any other provision contained herein, all payments made in connection with the Executive's Disability shall be provided in a manner which is consistent with federal and state law. The Corporation may deduct, from all payments made hereunder, all applicable taxes and other appropriate deductions.

#### 5.5 Change in Control Termination.

(a) Notwithstanding any other provision contained herein, if the Executive's employment hereunder is terminated by the Executive for Good Reason or without Cause (other than on account of the Executive's death or Disability), in each case within three (3) months prior to or twelve (12) months following a Change in Control, the Executive shall be entitled to receive the Accrued Amounts and subject to the Executive's compliance with *Section 6, Section 7, Section 8, Section 9* and *Section 10* of this Agreement and his execution of a Release which becomes effective by the end of the Release Execution Period, the Executive shall be entitled to receive a lump sum payment equal to one time the sum of the Executive's Base Salary, which shall be paid on the 30<sup>th</sup> day following the Termination Date; and

(b) If the Executive timely and properly elects health continuation coverage under COBRA, the Corporation shall reimburse the Executive for the monthly COBRA premium paid by the Executive for himself and his dependents. Such reimbursement shall be paid to the Executive on the 10<sup>th</sup> day of the month immediately following the month in which the Executive timely remits the premium payment. The Executive shall be eligible to receive such reimbursement until the earliest of: (i) the twelve-month anniversary of the Termination Date; (ii) the date the Executive is no longer eligible to receive COBRA continuation coverage; and (iii) the date on which the Executive becomes eligible to receive substantially similar coverage from another employer or other source. Notwithstanding the foregoing, if the Corporation's making payments under this *Section 5.5(b)* would violate the nondiscrimination rules applicable to non-grandfathered plans under the ACA, or result in the imposition of penalties under the ACA, the parties agree to reform this *Section 5.5(b)* in a manner as is necessary to comply with the ACA.

(c) Consistent with the terms of any equity incentive plan of the Company, as approved by the stockholders, as applicable:

(i) all outstanding time-based equity-based compensation awards granted to the Executive during the Term of Employment shall become fully vested and exercisable for the remainder of their full term; and

(ii) all outstanding performance-based equity compensation awards granted to the Executive during the Term of Employment shall remain outstanding and shall vest or be forfeited in accordance with the terms of the applicable award agreements, if the applicable performance goals are satisfied. The determination whether such performance goals are satisfied shall be in the sole discretion of the Compensation Committee or the Board, as the case may be.

5.6 Release; Exclusive Remedy.

(a) The Executive agrees that the payments contemplated by *Section 5* shall constitute the exclusive and sole remedy for any termination of his employment and the Executive covenants not to assert or to pursue any other remedies, at law or in equity, with respect to any termination of employment. The Corporation and Executive acknowledge and agree that there is no duty of the Executive to mitigate damages under this Agreement. All amounts paid to the Executive pursuant to *Section 5* shall be paid without regard to whether the Executive has taken or takes actions to mitigate damages.

(b) As used herein, “Release” shall mean a written release, discharge and covenant not to sue entered into by the Executive in favor of the Corporation in the form as in Exhibit A hereto.

5.7 Notice of Termination. Any termination of the Executive’s employment hereunder by the Company or by the Executive during the Term of Employment (other than termination pursuant to *Section 5.4* on account of the Executive’s death) shall be communicated by written notice of termination (the “Notice of Termination”) to the other party hereto in accordance with *Section 14(j)*. The Notice of Termination shall specify:

- (a) The termination provision of this Agreement relied upon;
- (b) To the extent applicable, the facts and circumstances claimed to provide a basis for termination of the Executive’s employment under the provisions so indicated; and
- (c) The applicable Termination Date.

5.8 Termination Date. The Executive’s Termination Date shall be:

- (a) If the Executive’s employment hereunder terminates on account of the Executive’s death, the date of the Executive’s death;
- (b) If the Executive’s employment hereunder is terminated on account of the Executive’s Disability, the date that it is determined that the Executive has a Disability;
- (c) If the Corporation terminates the Executive’s employment hereunder for Cause, the date the Notice of Termination is delivered to the Executive;
- (d) If the Corporation terminates the Executive’s employment hereunder without Cause, the date specified in the Notice of Termination, which shall be no less than 30 calendar days following the date on which the Notice of Termination is delivered; provided that, the Corporation shall have the option to provide the Executive with a lump sum payment equal to 30 calendar days’ Base Salary in lieu of such notice, which shall be paid in a lump sum on the Executive’s Termination Date and for all purposes of this Agreement, the Executive’s Termination Date shall be the date on which such Notice of Termination is delivered; and
- (e) If the Executive terminates his employment hereunder with or without Good Reason, the date specified in the Executive’s Notice of Termination, which shall be no less than 30 calendar days following the date on which the Notice of Termination is delivered.

Notwithstanding anything contained herein, the Termination Date shall not occur until the date on which the Executive incurs a Separation from Service within the meaning of *Section 409A*.

5.9 Resignation From Boards and Committees. Upon or promptly following any termination of Executive’s employment with the Corporation, the Executive agrees to resign, as of the date of such termination, from (i) each and every board of directors (or similar body, as the case may be) of the Corporation and each of its affiliates on which the Executive may then serve, including, but not limited to, the Board (and any committees thereof), and (ii) each and every office of the Corporation and each of its affiliates that the Executive may then hold, and all positions that he may have previously held with the Corporation and any of its affiliates.

5.10 Section 409A of the Internal Revenue Code.

(a) This Agreement is intended to comply with *Section 409A* of the Internal Revenue Code of 1986 (“Section 409A”) and shall be construed and interpreted consistent with that intent. In the event that any payment or benefit payable under *Section 5* of this Agreement is not compliant with *Section 409A* and any taxes, penalties or interest are imposed on the Executive under *Section 409A* as a result of such noncompliance (the “Section 409A Penalties”), the Corporation shall put the Executive in an after tax economic position equivalent to the position the Executive would have been in without the imposition of such *Section 409A Penalties*. The Executive shall notify the Corporation in writing of any claim by the Internal Revenue Service or state tax authorities that, if successful, would require the payment of any such *Section 409A Penalties* or related state tax statutes. The Executive’s right to be put in an equivalent after tax economic position is subject to the Executive providing such notification no later than ten (10) business days after Executive is informed in writing of such claim. If the Corporation desires to contest such claim, Executive shall (i) cooperate with the Corporation in good faith in order to effectively contest such claim and (ii) permit the Corporation to participate in any proceedings relating to such claim. The Corporation shall control all proceedings taken in connection with such contest; provided, however, that the Corporation shall bear and pay directly all costs and expenses (including additional interest and penalties) incurred in connection with such contest. This section shall also apply to any taxes, penalties, or interest imposed by any state that are calculated in a manner similar to taxes, penalties, or interest imposed by *Section 409A(a)(1)(B)*, including those amounts imposed by the California Revenue and Taxation Code (R&TC) *Sections 17501 and 24601*.

(b) If and to the extent that any payment or benefit under this Agreement, or any plan or arrangement of the Corporation, is determined by the Corporation to constitute “non-qualified deferred compensation” subject to Section 409A and is payable to the Executive by reason of the Executive’s termination of employment, then (a) such payment or benefit shall be made or provided to the Executive only upon a “separation from service” as defined for purposes of Section 409A under applicable regulations (a “Separation from Service”) and (b) if the Executive is a “specified employee” (within the meaning of Section 409A and as determined by the Corporation), such payment or benefit shall not be made or provided before the date that is six (6) months after the date of the Executive’s Separation from Service (or the Executive’s earlier death). For the purposes of clarity, the first payment thereof will include a catch-up payment covering the amount that would have otherwise been paid to the Executive during the period between the termination of Executive’s employment and the first payment date but for the application of this provision, and the balance of the installments (if any) will be payable in accordance with their original schedule.

(c) To the extent any expense reimbursement or in-kind benefit is determined to be subject to Section 409A, the amount of any such expenses eligible for reimbursement or in-kind benefits provided in one taxable year shall not affect the expenses eligible for reimbursement or in-kind benefits provided in any other taxable year (except under any lifetime limit applicable to expenses for medical care), in no event shall any expenses be reimbursed after the last day of the calendar year following the calendar year in which the Executive incurred such expenses, and in no event shall any right to reimbursement or in-kind benefits be subject to liquidation or exchange for another benefit.

(d) To the extent that any provision of this Agreement is ambiguous as to its compliance with Section 409A, the provision will be read in such a manner so that all payments hereunder comply with Section 409A. To the extent any payment under this Agreement may be classified as a “short-term deferral” within the meaning of Section 409A, such payment shall be deemed a short-term deferral, even if it may also qualify for an exemption from Section 409A under another provision of Section 409A. Payments pursuant to this section are intended to constitute separate payments for purposes of Section 1.409A-2(b)(2) of the Treasury Regulations.

#### 6. Non-Competition.

The Executive acknowledges and recognizes the highly competitive nature of the businesses of the Corporation, the amount of sensitive and confidential information involved in the discharge of the Executive’s position with the Corporation, and the harm to the Corporation that would result if such knowledge or expertise was disclosed or made available to a competitor. Based on that understanding, the Executive hereby expressly agrees as follows:

(a) As a result of the particular nature of the Executive’s relationship with the Corporation, in the capacities identified earlier in this Agreement, for the Term of Employment and for a period of two (2) years after termination for Cause, the Executive hereby agrees that he will not, directly or indirectly, (i) engage in any business for the Executive’s own account or otherwise derive any personal benefit from any business that competes with the business of the Corporation or any of its affiliates (the Corporation and its affiliates are referred to, collectively, as the “Company Group”), (ii) enter the employ of, or render any services to, any person engaged in any business that competes with the business of any entity within the Company Group, (iii) acquire a financial interest in any person engaged in any business that competes with the business of any entity within the Company Group, directly or indirectly, as an individual, partner, member, shareholder, officer, director, principal, agent, trustee or consultant, or (iv) interfere with business relationships (whether formed before or after the Effective Date) between the Corporation, any of its respective affiliates or subsidiaries, and any customers, suppliers, officers, employees, partners, members or investors of any entity within the Company Group. For purposes of this Agreement, businesses in competition with the Company Group shall include, without limitation, businesses which any entity within the Company Group may conduct operations, and any businesses which any entity within the Company Group has specific plans to conduct operations in the future and as to which the Executive is aware of such planning, whether or not such businesses have or have not as of that date commenced operations.



(b) Notwithstanding anything to the contrary in this Agreement, the Executive may, directly or indirectly, own, solely as an investment, securities of any Person, other than a business that competes with the business of the Company Group, which are publicly traded on a national or regional stock exchange or on the over-the-counter market if the Executive (i) is not a controlling Person of, or a member of a group that controls, such Person, and (ii) does not, directly or indirectly, beneficially own one percent (1%) or more of any class of securities of such Person. Executive may indirectly, through a mutual or exchange traded fund, own, solely as an investment, securities of a business that competes with the business of the Company Group, which are publicly traded on a national or regional stock exchange or on the over-the-counter market if the Executive (i) is not a controlling Person of, or a member of a group that controls, such Person, and (ii) does not, directly or indirectly, beneficially own one percent (1%) or more of any class of securities of such business. For purposes of this *Section 6(b)*, “Person” shall have the meaning ascribed to such terms in Section 3(a)(9) of the Exchange Act and used in Sections 13(d) and 14(d) thereof, including a “group” as described in Section 13(d) thereof.

#### 7. Confidential Information.

As a material part of the consideration for the Corporation’s commitment to the terms of this Agreement, the Executive hereby agrees that the Executive will not at any time (whether during or after the Executive’s employment with the Corporation), other than in the course of the Executive’s duties hereunder, or unless compelled by lawful process after written notice to the Corporation of such notice along with sufficient time for the Corporation to try and overturn such lawful process, disclose or use for the Executive’s own benefit or purposes or the benefit or purposes of any other person, firm, partnership, joint venture, association, corporation or other business organization, entity or enterprise, any trade secrets, or other confidential data or information relating to customers, development programs, costs, marketing, trading, investment, sales activities, promotion, credit and financial data, financing methods, or plans of any entity within the Company Group; provided, however, that the foregoing shall not apply to information which is generally known to the industry or the public, other than as a result of the Executive’s breach of this covenant. The Executive further agrees that the Executive will not retain or use for his own account, at any time, any trade names, trademark or other proprietary business designation used or owned in connection with the business of any entity within the Company Group.

#### 8. Proprietary Rights.

(a) Inventions. All inventions, policies, systems, developments or improvements conceived, designed, implemented and/or made by the Executive, either alone or in conjunction with others, at any time or at any place during the Term of Employment, whether or not reduced to writing or practice during such Term of Employment, which directly or indirectly relate to the business of any entity within the Company Group, or which were developed or made in whole or in part using the facilities and/or capital of any entity within the Company Group, shall be the sole and exclusive property of the Company Group. The Executive shall promptly give notice to the Corporation of any such invention, development, patent or improvement, and shall at the same time, without the need for any request by any person or entity within the Company Group, assign all of the Executive’s rights to such invention, development, patent and/or improvement to the Company Group. The Executive shall sign all instruments necessary for the filing and prosecution of any applications for, or extensions or renewals of, letters patent of the United States or any foreign country that any entity in the Company Group desires to file.

(b) Work Product. The Executive acknowledges and agrees that all writings, works of authorship, technology, inventions, discoveries, ideas and other work product of any nature whatsoever, that are created, prepared, produced, authored, edited, amended, conceived or reduced to practice by the Executive individually or jointly with others during the Term of the Executive’s employment by the Corporation and relating in any way to the business or contemplated business, research or development of the Corporation (regardless of when or where the Work Product is prepared or whose equipment or other resources is used in preparing the same) and all printed, physical and electronic copies, all improvements, rights and claims related to the foregoing, and other tangible embodiments thereof (collectively, “Work Product”), as well as any and all rights in and to copyrights, trade secrets, trademarks (and related goodwill), patents and other intellectual property rights therein arising in any jurisdiction throughout the world and all related rights of priority under international conventions with respect thereto, including all pending and future applications and registrations therefor, and continuations, divisions, continuations-in-part, reissues, extensions and renewals thereof (collectively, “Intellectual Property Rights”), shall be the sole and exclusive property of the Corporation.

For purposes of this Agreement, Work Product includes, but is not limited to, Company Group information, including plans, publications, research, strategies, techniques, agreements, documents, contracts, terms of agreements, negotiations, know-how, computer programs, computer applications, software design, web design, work in process, databases, manuals, results, developments, reports, graphics, drawings, sketches, market studies, formulae, notes, communications, algorithms, product plans, product designs, styles, models, audiovisual programs, inventions, unpublished patent applications, original works of authorship, discoveries, experimental processes, experimental results, specifications, customer information, client information, customer lists, client lists, manufacturing information, marketing information, advertising information, and sales information.

(c) Work Made for Hire; Assignment. All copyrightable work by the Executive during the Term of Employment that relates to the business of any entity in the Company Group is intended to be “work made for hire” as defined in Section 101 of the Copyright Act of 1976, and shall be the property of the Company Group. If the copyright to any such copyrightable work is not the property of the Company Group by operation of the law, the Executive will, without further consideration, assign to the Company Group all right, title and interest in such copyrightable work and will assist the entities in the Company Group and their nominees in every way, at the Company Group’s expense, to secure, maintain and defend for the Company Group’s benefit, copyrights and any extensions and renewals thereof on any and all such work including translations thereof in any and all countries, such work to be and to remain the property of the Company Group whether copyrighted or not.

(d) Further Assurances; Power of Attorney. During and after the Executive’s employment, the Executive agrees to reasonably cooperate with the Corporation to (i) apply for, obtain, perfect and transfer to the Company Group the Work Product as well as an Intellectual Property Right in the Work Product in any jurisdiction in the world; and (ii) maintain, protect and enforce the same, including, without limitation, executing and delivering to the Corporation any and all applications, oaths, declarations, affidavits, waivers, assignments and other documents and instruments as shall be requested by the Corporation. The Executive hereby irrevocably grants the Corporation power of attorney to execute and deliver any such documents on the Executive’s behalf in the Executive’s name and to do all other lawfully permitted acts to transfer the Work Product to the Corporation and further the transfer, issuance, prosecution and maintenance of all Intellectual Property Rights therein, to the full extent permitted by law, if the Executive does not promptly cooperate with the Corporation’s request (without limiting the rights the Corporation shall have in such circumstances by operation of law). The power of attorney is coupled with an interest and shall not be effected by the Executive’s subsequent incapacity.

(e) No License. The Executive understands that this Agreement does not, and shall not be construed to, grant the Executive any license or right of any nature with respect to any Work Product or Intellectual Property Rights or any Confidential Information, materials, software or other tools made available to the Executive by the Corporation.

#### 9. Anti-Solicitation

In light of the amount of sensitive and confidential information involved in the discharge of the Executive’s duties, and the harm to the Corporation that would result if such knowledge or expertise were disclosed or made available to a competitor, and as a reasonable step to help protect the confidentiality of such information, the Executive promises and agrees that during the Term of Employment and for a period of two (2) years thereafter, the Executive will not use the Company’s confidential information to, directly or indirectly, individually or as a consultant to, or as an employee, officer, shareholder, director or other owner or participant in any business, influence or attempt to influence the customers, vendors, suppliers, joint venturers, associates, consultants, agents, or partners of any entity within the Company Group, either directly or indirectly, to divert their business away from the Company Group, to any individual, partnership, firm, corporation or other entity then in competition with the business of any entity within the Company Group, and he will not otherwise materially interfere with any business relationship of any entity within the Company Group.

10. Non-Solicitation of Employees.

In light of the amount of sensitive and confidential information involved in the discharge of the Executive's duties, and the harm to the Corporation that would result if such knowledge or expertise were disclosed or made available to a competitor, and as a reasonable step to help protect the confidentiality of such information, the Executive promises and agrees that during the Term of Employment and for a period of two (2) years thereafter, the Executive will not, directly or indirectly, individually or as a consultant to, or as an employee, officer, shareholder, director, or other owner of or participant in any business, solicit (or assist in soliciting) any person who is then, or at any time within six (6) months prior thereto was, an employee of an entity within the Company Group, who earned annually \$25,000 or more as an employee of such entity during the last six (6) months of his or her own employment to work for (as an employee, consultant or otherwise) any business, individual, partnership, firm, corporation, or other entity whether or not engaged in competitive business with any entity in the Company Group.

11. Return of Property.

The Executive agrees to truthfully and faithfully account for and deliver to the Corporation all property belonging to the Corporation, any other entity in the Company Group, or any of their respective affiliates, which the Executive may receive from or on account of the Corporation, any other entity in the Company Group, or any of their respective affiliates, and upon the termination of the Term of Employment, or the Corporation's demand, the Executive shall immediately deliver to the Corporation all such property belonging to the Corporation, any other entity in the Company Group, or any of their respective affiliates.

12. Withholding Taxes.

Notwithstanding anything else herein to the contrary, the Corporation may withhold (or cause there to be withheld, as the case may be) from any amounts otherwise due or payable under or pursuant to this Agreement such federal, state and local income, employment, or other taxes as may be required to be withheld pursuant to any applicable law or regulation.

13. Cooperation in Litigation.

The Executive agrees that, during the Term of Employment or after the termination of the Executive's employment, he will reasonably cooperate with the Corporation, subject to his reasonable personal and business schedules, in any litigation which arises out of events occurring prior to the termination of his employment, including but not limited to, serving as a witness or consultant and producing documents and information relevant to the case or helpful to the Corporation. The Corporation agrees to reimburse the Executive for all reasonable costs and expenses he incurs in connection with his obligations under this *Section 13* and, in addition, to reasonably compensate the Executive for time actually spent in connection therewith following the termination of his employment with the Corporation.

14. Miscellaneous.

(a) Assignment. This Agreement is personal in its nature and neither of the parties hereto shall, without the consent of the other, assign or transfer this Agreement or any rights or obligations hereunder; provided, however, that in the event of a merger, consolidation, or transfer or sale of all or substantially all of the assets of the Corporation with or to any other individual(s) or entity, this Agreement shall, subject to the provisions hereof, be binding upon and inure to the benefit of such successor and such successor shall discharge and perform all the promises, covenants, duties, and obligations of the Corporation hereunder.

(b) Number and Gender. Where the context requires, the singular shall include the plural, the plural shall include the singular, and any gender shall include all other genders.

(c) Section Headings. The section headings of, and titles of paragraphs and subparagraphs contained in, this Agreement are for the purposes of convenience only, and they neither form a part of this Agreement nor are they to be used in the construction or interpretation thereof.

(d) Governing Law. This Agreement, and all questions relating to its validity, interpretation, performance and enforcement, as well as the legal relations hereby created between the parties hereto, shall be governed by and construed under, and interpreted and enforced in accordance with, the laws of the State of California, notwithstanding any California or other conflict of law provision to the contrary. This Agreement is intended to comply with Section 409A of the Internal Revenue Code of 1986 and the regulations promulgated thereunder. Any action or proceeding by either of the parties to enforce this Agreement shall be brought only in a state or federal court located in the state of California, Sonoma county. The parties hereby irrevocably submit to the exclusive jurisdiction of such courts and waive the defense of inconvenient forum to the maintenance of any such action or proceeding in such venue.

(e) Severability. If any provision of this Agreement or the application thereof is held invalid, the invalidity shall not affect other provisions or applications of this Agreement which can be given effect without the invalid provisions or applications and to this end the provisions of this Agreement are declared to be severable.

(f) Entire Agreement. This Agreement replaces and supersedes prior employment agreements, including the employment agreement executed by and between the Executive and the Corporation dated January 1, 2004 and June 20, 2013. This Agreement embodies the entire agreement of the parties hereto respecting the matters within its scope. Any prior negotiations, correspondence, agreements, proposals or understandings relating to the subject matter hereof shall be deemed to have been merged into this Agreement, and to the extent inconsistent herewith, such negotiations, correspondence, agreements, proposals, or understandings shall be deemed to be of no force or effect. There are no representations, warranties, or agreements, whether express or implied, or oral or written, with respect to the subject matter hereof, except as expressly set forth herein.

(g) Modifications. This Agreement may not be amended, modified or changed (in whole or in part), except by a formal definitive written agreement expressly referring to this Agreement, which agreement is executed by both of the parties hereto.

(h) Waiver. Neither the failure nor any delay on the part of a party to exercise any right, remedy, power or privilege under this Agreement shall operate as a waiver thereof, nor shall any single or partial exercise of any right, remedy, power or privilege preclude any other or further exercise of the same or of any right, remedy, power or privilege, nor shall any waiver of any right, remedy, power or privilege with respect to any occurrence be construed as a waiver of such right, remedy, power or privilege with respect to any other occurrence. No waiver shall be effective unless it is in writing and is signed by the party asserted to have granted such waiver.

(i) Resolution of Disputes.

(i) Any controversy arising out of or relating to the Executive's employment (whether or not before or after the expiration of the Term of Employment), any termination of the Executive's employment, this Agreement or the enforcement or interpretation of this Agreement, or because of an alleged breach, default, or misrepresentation in connection with any of the provisions of this Agreement, including (without limitation) any state or federal statutory claims, shall be submitted to arbitration in Santa Rosa, California, before a sole arbitrator (the "Arbitrator") selected from the American Arbitration Association ("AAA"), and shall be conducted in accordance with the provisions of California Code of Civil Procedure §§ 1280 *et seq.* as the exclusive remedy of such dispute; provided, however, that provisional injunctive relief may, but need not, be sought in a court of law while arbitration proceedings are pending, and any provisional injunctive relief granted by such court shall remain effective until the matter is finally determined by the Arbitrator. Final resolution of any dispute through arbitration may include any remedy or relief that the Arbitrator deems just and equitable, including any and all remedies provided by applicable state or federal statutes. At the conclusion of the arbitration, the Arbitrator shall issue a written decision that sets forth the essential findings and conclusions upon which the Arbitrator's award or decision is based. Any award or relief granted by the Arbitrator hereunder shall be final and binding on the parties hereto and may be enforced by any court of competent jurisdiction.

(ii) The parties acknowledge and agree that they are hereby waiving any rights to trial by jury in any action, proceeding or counterclaim brought by either of the parties against the other in connection with any matter whatsoever arising out of or in any way connected with any of the matters referenced in the first sentence of *Section 14(i)(i)*.

(iii) The parties agree that the Corporation shall be responsible for payment of the forum costs of any arbitration hereunder, including the Arbitrator's fee. The parties further agree that in any proceeding with respect to such matters, the prevailing party will be entitled to recover its reasonable attorney's fees and costs from the non-prevailing party (other than forum costs associated with the arbitration which in any event shall be paid by the Corporation).

(iv) Without limiting the remedies available to the parties and notwithstanding the foregoing provisions of this *Section 14*, the Executive and the Corporation acknowledge that any breach of any of the covenants or provisions contained in *Sections 5.9*, and *Sections 6* through *11* could result in irreparable injury to either of the parties hereto for which there might be no adequate remedy at law, and that, in the event of such a breach or threat thereof, the non-breaching party shall be entitled to obtain a temporary restraining order and/or a preliminary injunction and a permanent injunction restraining the other party hereto from engaging in any activities prohibited by any covenant or provision in *Sections 5.9*, and *Sections 6* through *11* or such other equitable relief as may be required to enforce specifically any of the covenants or provisions of *Sections 5.9*, and *Sections 6* through *11*.

(j) Publicity.

The Executive hereby irrevocably consents during the term of this Agreement to any and all uses and displays, by the Company Group and its agents, representatives and licensees, of the Executive's name, voice, likeness, image, appearance and biographical information in, on or in connection with any pictures, photographs, audio and video recordings, digital images, websites, television programs and advertising, other advertising and publicity, sales and marketing brochures, books, magazines, other publications, CDs, DVDs, tapes and all other printed and electronic forms and media throughout the world, at any time during or after the period of his employment by the Company, for all legitimate commercial and business purposes of the Company Group ("Permitted Uses") without further consent from or royalty, payment or other compensation to the Executive. The Executive hereby forever waives and releases the Company Group and its directors, officers, employees and agents from any and all claims, actions, damages, losses, costs, expenses and liability of any kind, arising under any legal or equitable theory whatsoever at any time during or after the period of his employment by the Company, arising directly or indirectly from the Company Group's and its agents', representatives' and licensees' exercise of their rights in connection with any Permitted Uses. At the end of the term of this Agreement, the Company shall have no obligation to remove any previously-published displays described in this paragraph.

(k) Notices.

(i) All notices, requests, demands and other communications required or permitted under this Agreement shall be in writing and shall be deemed to have been duly received if (i) delivered by hand or by courier, effective upon delivery, (ii) given by facsimile or electronic version, when transmitted if transmitted on a business day and during normal business hours of the recipient, and otherwise delivered on the next business day following transmission, or (iii) sent by registered or certified mail, postage prepaid, return receipt requested, 5 business days after being deposited in the U.S. postal mail. Any notice shall be duly addressed to the parties as follows:

(i) If to the Corporation:

Sonoma Pharmaceuticals, Inc.  
Chairman of the Board or any Independent Director  
1129 North McDowell Boulevard  
Petaluma, California 94954  
Fax: +1 (707) 283-0551

(ii) If to the Executive:

Marc Umscheid  
At the address on file with the Corporation

(ii) Any party may alter the address to which communications or copies are to be sent by giving notice of such change of address in conformity with the provisions of this Section 24 for the giving of notice.

(l) Legal Counsel; Mutual Drafting. Each party recognizes that this is a legally binding contract and acknowledges and agrees that they have had the opportunity to consult with legal counsel of their choice. Each party has cooperated in the drafting, negotiation and preparation of this Agreement. Hence, in any construction to be made of this Agreement, the same shall not be construed against either party on the basis of that party being the drafter of such language.

(m) Provisions that Survive Termination. The provisions of *Sections 3.4, 3.5, 5 through 13*, and this *Section 14* shall survive any termination of the Term of Employment.

(n) Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed an original as against any party whose signature appears thereon, and all of which together shall constitute one and the same instrument. This Agreement shall become binding when one or more counterparts hereof, individually or taken together, shall bear the signatures of all of the parties reflected hereon as the signatories. Photographic copies of such signed counterparts may be used in lieu of the originals for any purpose.

(o) Tolling. Should the Executive violate any of the terms of the restrictive covenant obligations articulated herein, the obligation at issue will run from the first date on which the Executive ceases to be in violation of such obligation.

*[Signature Page Follows]*

**IN WITNESS WHEREOF**, the Corporation and the Executive have executed this Employment Agreement as of the Effective Date.

**CORPORATION**

Sonoma Pharmaceuticals, Inc.,  
a Delaware corporation

By: /s/ Jim Schutz

Name: Jim Schutz

Title: Chief Executive Officer of  
Sonoma Pharmaceuticals, Inc.

**EXECUTIVE**

By: /s/ Marc Umscheid

Name: Marc Umscheid

**EXHIBIT A — RELEASE**

1. Definitions. I intend all words used in this Release to have their plain meanings in ordinary English. Technical legal words are not needed to describe what I mean. Specific terms I use in this Release have the following meanings:

A. “I,” “me,” and “my” include me, Marc Umscheid, and anyone who has or obtains any legal rights or claims through me, including my heirs and estate, and each of my descendants, dependents, executors, administrators, assigns and successors.

B. “Employer,” as used in this Release, shall at all times mean Sonoma Pharmaceuticals, Inc. and “Released Party” or “Released Parties”, individual and collectively, means the Employer and the Employer’s parent, past or present subsidiaries, affiliates, each of any present or former officers, directors, shareholders, employees, agents or attorneys, trustees, insurers, successors, predecessors, assigns, or personal representatives.

C. “My Claims” mean actions or causes of action, suits, claims, charges, complaints, contracts (whether oral or written, express or implied from any source), and promises, whatsoever, in law or equity, that I ever had, may now have or hereafter can, shall or may have against the Employer or other Released Party as of the date of the execution of this Release, including all unknown, undisclosed and unanticipated losses, wrongs, injuries, debts, claims or damages to me for, upon, or by reason of any matter, cause or thing whatsoever, that are in any way related to my employment with or separation (termination of employment) from the Employer.

By signing this Release, I am agreeing to release any actual and potential claim, known or unknown, I have or may potentially have, in law or in equity, either as an individual or standing in the shoes of the government, under any federal, state or local law, administrative regulation or legal principle (except as provided in Paragraph 4 of this Release). The following listing of laws and types of claims is not meant to, and shall not be interpreted to, exclude any particular law or type of claim, law, regulation or legal principle not listed. I understand I am releasing all my Claims, including, but not limited to, claims for invasion of privacy; breach of written or oral, express or implied, contract; fraud or misrepresentation; and any claim under Section 1981 of the Civil Rights Act of 1866, Title VII of the Civil Rights Act of 1964, Age Discrimination in Employment Act of 1967 (“ADEA”), 29 U.S.C. § 626, as amended, the Older Workers Benefit Protection Act of 1990 (“OWBPA”), 29 U.S.C. 626(f), Title VII of the Civil Rights Act of 1964 (“Title VII”), 42 U.S.C. § 2000e, et seq., the Americans with Disabilities Act Amendments Act (“ADAAA”), 29 U.S.C. § 2101, et seq., the Family and Medical Leave Act (“FMLA”), 29 U.S.C. § 2601 et seq., the Employee Retirement Income Security Act of 1974 (“ERISA”), as amended, 29 U.S.C. §§ 1001, et seq., Equal Pay Act (“EPA”), 29 U.S.C. § 206(d), the Worker Adjustment and Retraining Notification Act (“WARN”), 29 U.S.C. § 2101 et seq., the False Claims Act, 31 U.S.C. § 3729 et seq., the California Fair Employment and Housing Act, the California Family Rights Act, any other state human rights or fair employment practices act, and any other federal, state, or local statute, law, rule, regulation, ordinance or order. This includes, but is not limited to, claims for violation of any civil rights laws based on protected class status; claims for assault, battery, defamation, intentional or negligent infliction of emotional distress, breach of the covenant of good faith and fair dealing, promissory estoppel, negligence, negligent hiring, retention or supervision, retaliation, constructive discharge, violation of whistleblower protection laws, unjust enrichment, payment of any kind, including any other claim for severance pay, bonus or incentive pay, sick leave, holiday pay, vacation pay, life insurance, health or medical insurance or any other fringe benefit, medical expenses, or disability, violation of public policy, and all other claims for unlawful employment practices, and all other common law or statutory claims. To the maximum extent permitted by law, I agree that I will not seek and waive any right to accept any relief or award from any charge or action against the Employer before any federal, state, or local administrative agency or federal state or local court whether filed by me or on my behalf with respect to any claim or right covered by this Release.

2. Agreement to Release My Claims. Except as stated in Paragraph 4, I agree to give up all My Claims, waive any rights thereunder, and forever discharge the Employer and all Released Parties of and from any and all liability to me for actions or causes of action, suits, or Claims. To the maximum extent permitted by law, I agree that I will not seek and I waive any right to accept any relief or award from any charge or action against the Employer or other Released Party before any federal, state, or local administrative agency or federal state or local court whether filed by me or on my behalf with respect to any claim or right covered by this Release. I also agree to withdraw any and all of my charges and lawsuits against Employer or other Released Party, except that I may, but am not required to, withdraw or dismiss, or attempt to withdraw or dismiss, any charges that I may have pending against the Employer or other Released Party with the EEOC or other civil rights enforcement agency.



I represent and warrant that I have not transferred or otherwise assigned my Claims, or parts thereof, to any person or entity, other than the Employer. I will defend, indemnify and hold harmless the Employer from and against any claim (including the payment of attorneys' fees and costs actually incurred whether or not litigation is commenced) that is directly or indirectly based on or in connection with or arising out of any such assignment or transfer made, purported or claimed.

In exchange for my agreement to release my Claims, I am receiving satisfactory Consideration (compensation) from the Employer to which I am not otherwise entitled by law, contract, or under any Employer policy. The consideration I am receiving is a full and fair payment for the release of all my Claims. The Employer and the Released Parties do not owe me anything in addition to what I will be receiving.

3. Older Workers Benefit Protection Act. [This section may be revised if Executive terminates employment as part of a "group" termination.] The Older Workers Benefit Protection Act ("OWBPA") applies to individuals age 40 and older and sets forth certain criteria for such individuals to waive their rights under the Age Discrimination in Employment Act ("ADEA") in connection with an exit incentive program or other employment termination program. I understand and have been advised that this Release of My Claims is subject to the terms of the OWBPA. The OWBPA provides that an individual cannot waive a right or claim under the ADEA unless the waiver is knowing and voluntary. I have been advised of this law, and I agree that I am signing this Release voluntarily, and with full knowledge of its consequences. I understand that the Employer is giving me at least twenty-one (21) calendar days from the date I received a copy of this Release to decide whether I want to sign it. I acknowledge that I have been advised to use this time to consult with an attorney about the effect of this Release. If I sign this Release before the end of the twenty-one (21) day period it will be my personal, voluntary decision to do so, and will be done with full knowledge of my legal rights. I agree that material and/or immaterial changes to the Separation Agreement or this Release will not restart the running of this consideration period.

4. Exclusions from Release. My Claims do not include my rights, if any, to claim the following: unemployment insurance or workers compensation benefits; claims for my vested post-termination benefits under any 401(k) or similar tax-qualified retirement benefit plan; my COBRA rights; and my rights to enforce the terms of this Release.

A. Nothing in this Release interferes with my right to file a charge with the Equal Employment Opportunity Commission ("EEOC") or other local civil rights enforcement agency, or participate in any manner in an EEOC investigation or proceeding under Title VII, the ADA, the ADEA, or the EPA. I, however, understand that I am waiving my right to recover individual relief including, but not limited to, back pay, front pay, reinstatement, attorneys' fees, and/or punitive damages, in any administrative or legal action whether brought by the EEOC or other civil rights enforcement agency, me or any other party.

B. Nothing in this Release interferes with my right to challenge the knowing and voluntary nature of this Release under the ADEA and/or OWBPA, if I have rights under such laws.

C. I agree that the Employer and the Released Parties reserve any and all defenses, which any of them has or might have against any claims brought by me. This includes, but is not limited to, the Employer's or other Released Party's right to seek available costs and attorneys' fees, and to have any monetary award granted to me, if any, reduced by the amount of money that I received in consideration for this Release.

D. Nothing in this Release releases any claims for indemnification by Executive pursuant to any indemnification agreement, statute or otherwise or claims for coverage under any D&O or other similar insurance policy.

5. Effective Date; Right to Rescind or Revoke. I understand that insofar as this Release relates to my rights under the Age Discrimination in Employment Act ("ADEA"), it shall not become effective or enforceable until seven (7) calendar days after I sign it. I also have the right to rescind (or revoke) this Release insofar as it extends to potential claims under the ADEA by written notice to Employer within seven (7) calendar days following my signing this Release (the "Rescission Period"). Any such rescission (or revocation) must be in writing and hand-delivered to Employer or, if sent by mail, postmarked within the applicable time period, sent by certified mail, return receipt requested, and addressed as follows:

A. post-marked within the seven (7) calendar day Rescission Period;

B. properly addressed to

[INSERT NAME AND ADDRESS]; and

C. sent by certified mail, return receipt requested.

6. I Understand the Terms of this Release. I have had the opportunity to read this Release carefully and understand all its terms. I have had the opportunity to review this Release with my own attorney. In agreeing to sign this Release, I have not relied on any statements or explanations made by the Employer or its attorneys. I understand and agree that this Release and the attached Agreement contain all the agreements between the Employer (and any other Released Party) and me. We have no other written or oral agreements. I understand this Release is a very important legal document and I agree to be bound by the terms of this Release.

Dated: \_\_\_\_\_, 20\_\_

\_\_\_\_\_  
Marc Umscheid

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

I, Jim Schutz, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sonoma Pharmaceuticals, Inc. for the quarter ended December 31, 2016;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 17, 2017

By: /s/ Jim Schutz  
Jim Schutz  
Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

I, Robert Miller, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sonoma Pharmaceuticals, Inc. for the quarter ended December 31, 2016;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 17, 2017

By: /s/ Robert Miller  
Robert Miller  
Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)

**CERTIFICATION PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), the undersigned officers of Sonoma Pharmaceuticals, Inc., a Delaware corporation (the "Company"), do hereby certify, to such officers' knowledge, that:

The Quarterly Report on Form 10-Q for the quarter ended December 31, 2016 (the "Form 10-Q") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 17, 2017

By: /s/ Jim Schutz  
Jim Schutz  
Chief Executive Officer  
(Principal Executive Officer)

Date: February 17, 2017

By: /s/ Robert Miller  
Robert Miller  
Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)