

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

**FORM 10-Q**

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

For the quarterly period ended July 31, 2014

Commission file number 0-11254

**ITUS Corporation**

(Exact name of registrant as specified in its charter)

<u>Delaware</u> (State or other jurisdiction of incorporation or organization)	<u>11-2622630</u>  (I.R.S. Employer Identification No.)
900 Walt Whitman Road Melville, NY	<u>11747</u>
(Address of principal executive offices)	(Zip Code)

(631) 549-5900

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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 <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated (Do not check if a smaller filer <input type="checkbox"/> reporting company)	Smaller reporting company <input checked="" type="checkbox"/>

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

On September 1, 2014, the registrant had outstanding 216,842,190 shares of Common Stock, par value \$.01 per share, which is the registrant's only class of common stock.

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.****ITUS CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<u>(Unaudited)</u>	<u>(Unaudited)</u>	
	July 31, 2014	Pro forma at July 31, 2014 (1)	October 31, 2013
<b><u>ASSETS</u></b>			
<b>Current assets:</b>			
Cash and cash equivalents	\$ 3,651,564	\$ 3,651,564	\$ 898,172
Short-term investments in certificates of deposit	2,550,000	2,550,000	-
Accounts receivable	133,333	133,333	175,000
Prepaid expenses and other current assets	100,580	100,580	160,646
Total current assets	6,435,477	6,435,477	1,233,818
Investment in Videocon Industries Limited global depository receipts, at fair value	4,150,970	-	4,197,341
Patents, net of accumulated amortization of \$233,129	2,802,982	2,802,982	-
Property and equipment, net of accumulated depreciation of \$47,925 and \$45,654, respectively	9,906	9,906	8,379
Total assets	<u>\$ 13,399,335</u>	<u>\$ 9,248,365</u>	<u>\$ 5,439,538</u>
<b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>			
<b>Current liabilities:</b>			
Accounts payable and accrued expenses	\$ 1,304,571	\$ 1,153,488	\$ 1,276,470
Royalties and contingent legal fees payable	152,400	152,400	207,743
Derivative liability, at fair value	1,900,000	-	540,000
Loan payable to related party	5,000,000	-	-
Deferred revenue, non-refundable license fees	-	-	1,187,320
Total current liabilities	8,356,971	1,305,888	3,211,533
<b>Contingencies (Note 12)</b>			
Convertible debentures due November 2016, net of discount of \$1,743,858	1,756,142	-	-
Convertible debentures due January 2015, net of discount of \$891,402	-	-	548,598
Patent acquisition obligation	3,136,513	3,136,513	-
Loan payable to related party	-	-	5,000,000
Total liabilities	<u>13,249,626</u>	<u>4,442,401</u>	<u>8,760,131</u>

<b>Shareholders' equity:</b>			
Preferred stock, par value \$100 per share; 500,000, 496,500 and 500,000 shares authorized; no shares issued or outstanding at July 31, 2014, July 31, 2014 pro forma and October 31, 2013, respectively	-	-	-
Series A convertible preferred stock, par value \$100 per share; 0, 3,500 and 0 shares issued and outstanding at July 31, 2014, July 31, 2014 pro forma and October 31, 2013, respectively	-	350,000	-
Common stock, par value \$.01 per share; 600,000,000 shares authorized; 236,822,190, 219,342,190 and 209,276,745 shares issued and outstanding at July 31, 2014, July 31, 2014 pro forma and October 31, 2013, respectively	2,368,222	2,193,422	2,092,767
Additional paid-in capital	144,444,136	144,989,691	134,750,048
Loan receivable from related party	(5,000,000)	-	(5,000,000)
Accumulated deficit	(141,616,278)	(142,727,149)	(135,163,408)
Accumulated other comprehensive (loss)	(46,371)	-	-
<b>Total shareholders' equity</b>	<b>149,709</b>	<b>4,805,964</b>	<b>\$ (3,320,593)</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 13,399,335</b>	<b>\$ 9,248,365</b>	<b>\$ 5,439,538</b>

(1) Pro forma explanation:

On August 29, 2014, the Company (as defined below) terminated its business relationship with Videocon Industries Limited and its affiliates (collectively "Videocon"). The unaudited pro forma balance sheet as of July 31, 2014 gives effect to the termination, including the cancellation of loans receivable and payable of \$5,000,000 and the exchange of 1,495,845 global depository receipts formerly held by the Company and 20,000,000 shares of ITUS Corporation common stock formerly held by Videocon, as if all such transactions were effected on on July 31, 2014. The Company thereupon recorded the retirement of the 20,000,000 shares of its common stock.

On September 9, 2014, the Company and the holder of a \$3,500,000 Convertible Debenture due November 2016 agreed to a transaction resulting in the conversion of the principal and accrued interest of the Convertible Debenture into 18,498,943 shares of the Company's common stock, and the conversion of 15,978,943 shares of common stock into 3,500 shares of Series A Convertible Preferred Stock. In addition, a warrant to purchase 9,249,472 shares of common stock, initially issued with the Convertible Debenture and with an exercise price of \$0.3784 per share, was exchanged for a new warrant with an exercise price of \$0.31 per share and with substantially the same terms and exercisable for the same number of shares. The unaudited pro forma balance sheet as of July 31, 2014 shows a positive adjustment to shareholder's equity of approximately \$3,807,000, giving effect to the conversion of the Convertible Debenture, the extinguishment of the related accrued interest and derivative liability, in exchange for the issuance of shares of common stock and shares of Series A Convertible Preferred Stock, as if all such transactions were effected on on July 31, 2014.

See Note 2, Subsequent Events – for additional information regarding these subsequent events.

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

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**ITUS CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**AND COMPREHENSIVE LOSS (UNAUDITED)**

	For the Nine Months Ended	
	July 31,	
	2014	2013
Revenue from patent assertion activities	\$ 1,105,000	\$ -
Display technology development and license fees	1,187,320	-
Total revenue	2,292,320	-
<b>Operating costs and expenses:</b>		
Inventor royalties and contingent legal fees	465,095	-
Litigation and licensing expenses	266,537	21,955
Amortization of patents	233,129	-
Marketing, general and administrative expenses (including non-cash stock option compensation expense of \$2,346,587 and \$2,692,798, respectively)	4,807,154	6,120,474
Total operating costs and operating expenses	5,771,915	6,142,429
Loss from operations	(3,479,595)	(6,142,429)
Change in value of derivative liabilities	(1,460,704)	315,189
Loss on extinguishment of debt	(482,915)	(343,517)
Interest expense	(1,082,041)	(982,688)
Dividend income	47,568	-
Interest income	4,817	113
Loss before income taxes	(6,452,870)	(7,153,332)
Provision for income taxes	-	-
Net loss	\$ (6,452,870)	\$ (7,153,332)
<b>Other comprehensive (loss) income:</b>		
Unrealized (loss) gain on investment in Videocon Industries Limited global depository receipts	(46,371)	(459,226)
Total comprehensive loss	\$ (6,499,241)	\$ (7,612,558)
<b>Net loss per share:</b>		
Basic and diluted	\$ (0.03)	\$ (0.04)
<b>Weighted average common shares outstanding:</b>		
Basic and diluted	215,496,115	192,889,045

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



**ITUS CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**AND COMPREHENSIVE LOSS (UNAUDITED)**

	For the Three Months Ended July 31,	
	2014	2013
Revenue from patent assertion activities	\$ -	\$ -
Display technology development and license fees	1,187,320	-
Total revenue	<u>1,187,320</u>	<u>-</u>
Operating costs and expenses:		
Inventor royalties and contingent legal fees	-	-
Litigation and licensing expenses	162,520	15,205
Amortization of patents	81,289	-
Marketing, general and administrative expenses (including non-cash stock option compensation expense of \$469,481 and \$1,237,838, respectively)	<u>1,103,094</u>	<u>2,203,400</u>
Total operating costs and operating expenses	<u>1,346,903</u>	<u>2,218,605</u>
Loss from operations	(159,583)	(2,218,605)
Change in value of derivative liabilities	850,000	105,189
Loss on extinguishment of debt	-	(343,517)
Interest expense	(280,913)	(125,035)
Interest income	<u>1,497</u>	<u>76</u>
Income (loss) before income taxes	411,001	(2,581,892)
Provision for income taxes	<u>-</u>	<u>-</u>
Net income (loss)	<u>\$ 411,001</u>	<u>\$ (2,581,892)</u>
Other comprehensive (loss) income:		
Unrealized (loss) gain on investment in Videocon Industries Limited global depository receipts	<u>173,518</u>	<u>(1,751,636)</u>
Total comprehensive income (loss)	<u>\$ 584,519</u>	<u>\$ (4,333,528)</u>
Net loss per share:		
Basic and diluted	<u>\$ 0.00</u>	<u>\$ (0.01)</u>
Weighted average common shares outstanding:		
Basic and diluted	<u>223,251,755</u>	<u>201,965,186</u>

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

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**ITUS CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' DEFICIENCY**  
**FOR THE NINE MONTHS ENDED JULY 31, 2014 (UNAUDITED)**

	Common Stock		Additional Paid-in Capital	Loan Receivable From Related Party	Accumulated Deficit	Accumulated Other Comprehensive (Loss)	Total Shareholders' Deficiency
	Shares	Par Value					
Balance, October 31, 2013	209,276,745	\$ 2,092,767	\$ 134,750,048	\$ (5,000,000)	\$ (135,163,408)	\$ -	\$ (3,320,593)
Stock option compensation to employees	-	-	1,562,350	-	-	-	1,562,350
Stock option compensation to consultants	-	-	784,237	-	-	-	784,237
Common stock issued to consultants	130,000	1,300	39,448	-	-	-	40,748
Common stock issued upon exercise of stock options	345,000	3,450	47,775	-	-	-	51,225
Warrants issued in connection with the issuance of convertible debentures	-	-	513,112	-	-	-	513,112
Common stock issued upon exercise of warrants	1,339,950	13,400	286,609	-	-	-	300,009
Sale of common stock, net of expenses of \$326,865	16,000,000	160,000	3,513,135	-	-	-	3,673,135
Common stock issued upon conversion of convertible debentures	8,267,080	82,671	2,652,678	-	-	-	2,735,349
Common stock issued in payment of interest on convertible debentures	263,415	2,634	59,144	-	-	-	61,778
Common stock issued to acquire patent license	1,200,000	12,000	235,600	-	-	-	247,600
Unrealized loss on investment in							

Videocon Industries Limited global depository receipts	-	-	-	-	-	(46,371)	(46,371)
Net loss	-	-	-	-	(6,452,870)	-	(6,452,870)
Balance, July 31, 2014	<u>236,822,190</u>	<u>\$ 2,368,222</u>	<u>\$ 144,444,136</u>	<u>\$ (5,000,000)</u>	<u>\$ (141,616,278)</u>	<u>\$ (46,371)</u>	<u>\$ 149,709</u>

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

**ITUS CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

	For the nine months ended July 31,	
	2014	2013
Reconciliation of net loss to net cash used in operating activities:		
Net loss	\$ (6,452,870)	\$ (7,153,332)
Stock option compensation to employees	1,562,350	2,118,424
Stock option compensation to consultants	784,237	574,374
Common stock issued to consultants	40,748	168,475
Common stock issued to pay interest on convertible debentures	61,778	69,939
Amortization of patents	233,129	-
Amortized interest on patent acquisition obligations to interest expense	286,002	-
Amortization of convertible debenture discount to interest expense	575,210	893,149
Loss on extinguishment of debt	482,915	343,517
Change in value of derivative liability	1,460,704	(315,189)
Common stock issued to acquire patent license	62,000	42,000
Other	(553)	35,490
Change in operating assets and liabilities:		
Accounts receivable	41,667	-
Prepaid expenses and other current assets	60,066	8,574
Accounts payable and accrued expenses	28,101	572,180
Royalties and contingent legal fees payable	(55,343)	-
Deferred revenue	(1,187,320)	-
Net cash used in operating activities	<u>(2,017,179)</u>	<u>(2,642,399)</u>
Cash flows from investing activities:		
Disbursements to acquire short-term investments in certificates of deposit	(3,700,000)	-
Proceeds from sales of short-term investments in certificates of deposit	1,150,000	500,000
Other	(3,798)	(676)
Net cash (used in) provided by investing activities	<u>(2,553,798)</u>	<u>499,324</u>
Cash flows from financing activities:		
Proceeds from issuance of convertible debentures	3,500,000	1,765,000
Proceeds from sale of common stock, net	3,673,135	589,865
Proceeds from exercise of warrants to purchase common stock	300,009	380,800
Proceeds from exercise of employee stock options	51,225	25,610
Proceeds from sale of common stock held by ZQX Advisors LLC	-	24,138
Payments to redeem convertible debentures	(200,000)	-
Net cash provided by financing activities	<u>7,324,369</u>	<u>2,785,413</u>
Net increase in cash and cash equivalents	2,753,392	642,338
Cash and cash equivalents at beginning of year	898,172	339,693
Cash and cash equivalents at end of period	<u>\$ 3,651,564</u>	<u>\$ 982,031</u>

Supplemental disclosure of non-cash investing and

financing activities:		
Non-cash patent acquisition	<u>\$ 3,036,111</u>	<u>\$ -</u>
Common stock to acquire patent license	<u>\$ 247,600</u>	<u>\$ 42,000</u>
Common stock issued upon conversion of convertible debentures	<u>\$ 2,735,349</u>	<u>\$ 1,353,364</u>
Fair value of debenture embedded conversion feature at date of issuance	<u>\$ 1,570,000</u>	<u>\$ 1,180,000</u>
Relative fair value of warrants issued with convertible debentures	<u>\$ 513,112</u>	<u>\$ 214,819</u>

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

**ITUS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. BUSINESS AND FUNDING**

**Description of Business**

As used herein, “we,” “us,” “our,” the “Company”, or “ITUS” means ITUS Corporation and its wholly-owned subsidiaries, unless otherwise indicated. The primary operations of the Company involve the development, acquisition, licensing, and enforcement of patented technologies that are either owned or controlled by the Company. In June 2014, ITUS Patent Acquisition Corporation acquired the exclusive rights to license and enforce our 10<sup>th</sup> patent portfolio called Enhanced Auction Technologies, which covers enhanced presentation and cross selling technologies used by some of the world’s leading auction sites. The Company currently owns or controls 10 patent portfolios including Encrypted Mobile Communication; Enhanced Auction Technologies: ePaper® Electrophoretic Display; Internet Telephonic Gateway; J-Channel Window Frame Construction; Key Based Web Conferencing Encryption; Loyalty Conversion Systems; Micro Electro Mechanical Systems Display; Nano Field Emission Display; and VPN Multicast Communications.

As part of our patent assertion activities and in the ordinary course of our business, the Company has initiated and will likely continue to initiate patent infringement lawsuits, and engage in patent infringement litigation. In September of 2014, the Company initiated its seventh patent assertion campaign, bringing the total number of lawsuits since we implemented our patent monetization business model in January of 2013 to 44.

Our primary source of revenue will come from licenses resulting from the unauthorized use of our patented technologies, including the settlement of patent infringement lawsuits. During the nine months ended July 31, 2014, we entered into 5 license and/or settlement agreements including agreements in connection with our patented Key Based Web Encryption technology and our patented J-Channel Window Frame Construction technology. In September 2014, we entered into 5 additional license and/or settlement agreements with Jeld-Wen, Inc., Atrium Windows and Doors, Inc., Pella Corporation, Ply Gem Industries, Inc. and Simonton Building Products, Inc., all in connection with our patented J-Channel Window Frame Construction technology. These licenses resolved lawsuits that were pending against the aforementioned companies. Since implementing our new business model in January of 2013, the Company has entered into a total of 14 revenue producing license and/or settlement agreements, and 3 of our 7 patent assertion campaigns have now generated revenue.

On August 29, 2014, the Company ended its relationship with Videocon Industries Limited, terminating Videocon’s license to the Company’s patented Nano Field Emission Display technology. On September 3, 2014, the United States District Court for the Eastern District of Texas invalidated two of our Loyalty Conversion Systems patents by ruling that they did not cover patentable subject matter, resulting in the dismissal of 7 of our Loyalty Conversion Systems Corporation’s lawsuits. On September 8, 2014, the Company filed patent infringement lawsuits against Ebay, Vendio, and Auctiva in connection with our patented Enhanced Auction Technologies. The Company currently has 27 pending lawsuits in connection with its patented technologies.

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In addition to continuing to mine and monetize our existing patents, our wholly owned subsidiary, ITUS Patent Acquisition Corporation, will continue to acquire patents and the exclusive rights to license and enforce patents from third parties. When necessary, we will assist such parties in the further development of their patent portfolios through the filing of additional patent applications.

Due to arrangements previously entered into by the Company, certain of our patents contain encumbrances which may negatively impact our patent monetization and patent assertion activities. Where we are able, we will take the steps necessary to remove any encumbrances that may inhibit our patent monetization and patent assertion activities.

### **Name Change**

On September 2, 2014, the Company changed its name to ITUS Corporation. The Name Change was approved by the Company's Board of Directors on May 28, 2014 and was subsequently approved by the Company's stockholders at the Annual Meeting of Stockholders on August 8, 2014. In Greek mythology, ITUS was the God of Protection. The Name Change better aligns the Company's corporate name with its current business and mission to develop, acquire, license and enforce of patented technologies that are either owned or controlled by the Company or one of its wholly owned subsidiaries.

### **Funding and Management's Plans**

In January 2013, we received aggregate gross proceeds of \$1,765,000 from the issuance of 8% convertible debentures due January 25, 2015 in a private placement. During the third quarter of fiscal 2013, \$325,000 of the principal amount of these debentures were converted into 2,166,775 shares of our common stock. During the second quarter of fiscal 2014, \$1,240,000 of the principal amount of the convertible debentures were converted into 8,267,080 of shares of our common stock, and the remaining \$200,000 of convertible debt was repaid in cash.

In November 2013, the Company completed a private placement with a single institutional investor, pursuant to which the Company issued a \$3,500,000 principal amount 6% convertible debenture due November 11, 2016. For details of this debenture, please see Note 3, Convertible Debentures herein.

In July 2014, the Company completed the sale of 16,000,000 shares of its common stock at the offering price of \$0.25 per share. The net proceeds from this sale totaled approximately \$3,673,000. See Note 4, Sale of Common Stock – for additional information regarding this transaction.

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During the nine months ended July 31, 2014, cash used in operating activities was approximately \$2,017,000. Cash used in investing activities during the nine months ended July 31, 2014 was approximately \$2,554,000, which principally resulted from the purchase of certificates of deposit totaling \$3,700,000 which was partially offset by the sale of certificates of deposit totaling \$1,150,000. Our cash provided by financing activities during the nine months ended July 31, 2014 was approximately \$7,324,000, which resulted from the net proceeds from the sale of 16,000,000 shares of the Company's common stock for approximately \$3,673,000, the sale of convertible debentures in a private placement for \$3,500,000, the proceeds from exercise of warrants to purchase common stock of approximately \$300,000, and the proceeds from exercise of stock options of approximately \$51,000 offset by the payment to redeem convertible debentures of \$200,000. As a result, our cash, cash equivalents, and short-term investments at July 31, 2014 increased approximately \$5,304,000 to approximately \$6,202,000 from approximately \$898,000 at the end of fiscal year 2013.

Based on currently available information, the Company believes that its existing cash, cash equivalents, short-term investments, accounts receivable, and expected cash flows from patent licensing and enforcement, and other potential sources of cash flows will be sufficient to enable it to continue our patent licensing and enforcement activities for at least 12 months. However, our projections of future cash needs and cash flows may differ from actual results. If current cash on hand, short term investments and cash that may be generated from patent licensing and enforcement activities are insufficient to satisfy our liquidity requirements, we may seek to sell equity securities or obtain loans from various financial institutions where possible. The sale of additional equity securities or convertible debt could result in dilution to our shareholders. We can give no assurance that we will generate sufficient cash flows in the future (through licensing and enforcement of patents, or otherwise) to satisfy our liquidity requirements or sustain future operations, or that other sources of funding, such as sales of equity or debt, would be available, if needed, on favorable terms or at all. If we cannot obtain such funding if needed or if we cannot sufficiently reduce operating expenses, we would need to curtail or cease some or all of our operations.

### **Basis of Presentation**

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, certain information and footnotes required by generally accepted accounting principles in annual financial statements have been omitted or condensed. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended October 31, 2013, as reported by us in our Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on January 16, 2014. The year-end consolidated balance sheet data was derived from the audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. The condensed consolidated financial statements include all adjustments of a normal recurring nature which, in the opinion of management, are necessary for a fair statement of our financial position as of July 31, 2014, and results of operations and cash flows for the interim periods represented. The results of operations for the three and nine months ended July 31, 2014 are not necessarily indicative of the results to be expected for the entire year.



## **Revenue Recognition**

Revenue is recognized when (i) persuasive evidence of an arrangement exists, (ii) all obligations have been substantially performed pursuant to the terms of the arrangement, (iii) amounts are fixed or determinable, and (iv) the collectability of amounts is reasonably assured.

### **Patent Monetization and Patent Assertion**

In general, revenue arrangements provide for the payment of contractually determined fees in consideration for the grant of certain intellectual property rights for patented technologies owned or controlled by our operating subsidiaries. These rights typically include some combination of the following: (i) the grant of a non-exclusive, retroactive and future license to manufacture and/or sell products covered by patented technologies owned or controlled by our operating subsidiaries, (ii) a covenant-not-to-sue, (iii) the release of the licensee from certain claims, and (iv) the dismissal of any pending litigation. The intellectual property rights granted are perpetual in nature, extending until the expiration of the related patents. Pursuant to the terms of these agreements, our operating subsidiaries have no further obligation with respect to the grant of the non-exclusive retroactive and future licenses, covenants-not-to-sue, releases, and other deliverables, including no express or implied obligation on our operating subsidiaries' part to maintain or upgrade the technology, or provide future support or services. Generally, the agreements provide for the grant of the licenses, covenants-not-to-sue, releases, and other significant deliverables upon execution of the agreement. As such, the earnings process is complete and revenue is recognized upon the execution of the agreement, when collectability is reasonably assured, and when all other revenue recognition criteria have been met.

### **Display Technology Development and License Fees**

We have assessed the revenue guidance of Accounting Standards Codification ("ASC") 605-25 "Multiple-Element Arrangements" ("ASC 605-25") to determine whether multiple deliverables in our arrangements with AUO represent separate units of accounting. Under the AUO License Agreements, we received initial development and license fees of \$3 million, of aggregate development and license fees of up to \$10 million. The additional \$7 million in development and license fees were to be payable upon completion of certain conditions for the respective technologies. We have determined that the transfer of the licensed patents and technology and the effort involved in completion of the conditions for the respective technologies represent a single unit of accounting for each technology. Accordingly, using a proportional performance method, during the third quarter of fiscal year 2011 we began recognizing the \$3 million initial development and license fees over the estimated periods that we expected to complete the conditions for the respective technologies. We have not recognized any portion of the \$7 million of additional development and license fees as either deferred revenue or revenue as it is considered contingent revenue. Each of the license agreements with AUO also provide for the basis for royalty payments on future production, if any, by AUO to CopyTele, which we have determined represent separate units of accounting. We have not recognized any royalty income under the AUO License Agreements.

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At each reporting period we assess our remaining performance obligations under the AUO License agreements and recognize display technology development and license fee revenue over the remaining estimated period that we expect to complete the conditions for the respective technologies. Development and license fee payments received from AUO which are in excess of the amounts recognized as revenue (approximately \$1,187,000 as of October 31, 2013) are recorded as non-refundable deferred revenue on the accompanying condensed consolidated balance sheet. As a result of the AUO/E Ink Lawsuit described below we have not recorded any display technology development and license fee revenue during the period from the fourth quarter of fiscal 2012 through the second quarter of this fiscal year due to uncertainty as to our remaining performance obligations, if any. Based on our assessment for the three month period ended July 31, 2014, we have determined that we have no further performance obligations under the AUO License Agreements and accordingly we have recognized display technology development and license fee revenue of approximately \$1,187,000, representing the balance of the initial \$3 million payment received from AUO.

## Patents

Our only identifiable intangible assets are patents and patent rights. We capitalize patent and patent rights acquisition costs and amortize the cost over the estimated economic useful life. Patent acquisition costs capitalized during the nine months ended July 31, 2014 and 2013, was approximately \$3,036,000 and \$-0-, respectively, and none during the three months ended July 31, 2014 and 2013, respectively. We recorded patent amortization expense of approximately \$233,000 and \$-0- during the nine months ended July 31, 2014 and 2013, respectively, and approximately \$81,000 and \$-0- during the three months ended July 31, 2014 and 2013, respectively.

## 2. **SUBSEQUENT EVENTS**

### **Unwinding of Business Relationship and Interests with Videocon**

On August 29, 2014, the Company and CopyTele International Ltd., a wholly-owned subsidiary of the Company (the "Subsidiary"), terminated their business relationship (the "Business Relationship") with Videocon Industries Limited ("Videocon") and Mars Overseas Limited, an affiliate of Videocon ("Mars" and together with the Company, the Subsidiary and Videocon, the "Parties"). The Business Relationship began in November 2007 and related to a proposed joint development effort between the Company and Videocon to develop a certain Nano Field Emission Display technology (the "Technology"). In connection with the proposed joint venture, (i) the Company granted a non-transferable, worldwide license to Videocon for the Technology (the "License"), (ii) the Subsidiary made a \$5 million dollar loan to Mars (the "Subsidiary Loan"), (iii) Mars made an identical \$5 million dollar loan to the Subsidiary (the "Mars Loan" and together with the Subsidiary Loan, the "Loans"), (iv) the Company sold to Mars 20 million shares of the Company's common stock (the "Shares") and (v) Global EPC Ventures Limited sold to the Company 1,495,845 global depository receipts of Videocon (the "GDRs"). The Shares and GDRs were subsequently used to secure the Loans.

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Because Videocon was unable to continue with its joint development responsibilities, the Technology was not jointly developed by the Parties, and Videocon introduced the Company to AU Optronics Corp. to jointly develop the Technology with the Company. Because the Company entered into a separate agreement with AU Optronics Corp. to jointly develop the Technology, the Business Relationship with Videocon became immaterial to the Company. Accordingly, the Company and Videocon agreed to terminate the Business Relationship. In order to terminate the Business Relationship, the Parties entered into several agreements whereby: (i) the License was terminated, (ii) both of the Loans were canceled and (iii) the Shares and GDRs were exchanged for each other (collectively, the “Termination Transactions”). The result of these Termination Transactions was to undo the initial transactions between the Parties that set forth the Business Relationship. Aside from this business relationship there is no other material relationship between the Parties. In accounting for the unwinding of this business relationship, the Company offset the two loans and then recorded its repurchased shares of common stock at the then current fair value of the GDRs and then retired and cancelled those shares.

### **Preferred Stock**

On September 9, 2014, the Company designated 3,500 shares of Series A Convertible Preferred Stock, par value \$100 per share, in accordance with the Certificate of Designation of Series A Convertible Preferred Stock filed with the Secretary of State of the State of Delaware on September 9, 2014 (the “Series A Convertible Preferred Stock”). On September 9, 2014, 3,500 shares of Series A Convertible Preferred Stock were issued in connection with the conversion of the Convertible Debenture due November 2016, as discussed further, below.

### **Ranking**

The Series A Convertible Preferred Stock ranks senior to the Company’s common stock, to all series of any other classes of equity which may be issued and to any indebtedness, unless the Company has obtained the prior written consent of the Series A Convertible Preferred Stock holder.

### **Optional Conversion**

Holders of the Series A Convertible Preferred Stock may at any time convert their shares of Series A Convertible Preferred Stock into such number of shares of the Company’s common stock in such an amount equal to (a) the stated value (initially \$1,000) of the shares of Series A Convertible Preferred Stock being converted (the “Stated Value”), divided by the conversion price (initially \$0.1892) ( the “Series A Conversion Price”), multiplied by (b) the number of shares of Series A Preferred Stock being converted. In the event the Series A Convertible Preferred Stock is converted in part, the Company shall deliver a new certificate of like tenor in the amount equal to the remaining balance of the Series A Convertible Preferred Stock after giving effect to such partial conversion.

The holder shall not have the right to convert any portion of the Series A Convertible Preferred Stock if after giving effect to such conversion, the holder, together with any affiliate thereof, would beneficially own in excess of 4.99% of the number of shares of common stock outstanding immediately after giving effect to such conversion.

The embedded conversion option has certain anti-dilution protection provisions which would be triggered if the Company issues its common stock, or certain common stock equivalents, (as defined) at a price below \$0.142 per share.

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### **Mandatory Conversion**

At any time after November 11, 2016, if and only if the average of the high and low trading prices of the Company's common stock for any 10 out of 20 consecutive trading days (the "Measurement Period,") exceeds the then Series A Conversion Price, as adjusted, the Company may convert any then outstanding shares of Series A Convertible Preferred Stock into shares of common stock (a "Mandatory Conversion"), provided, however, that any such Mandatory Conversion shall not require a holder to convert a number of shares of Series A Convertible Preferred Stock into an amount of Common Stock that would exceed 50% of the daily average trading volume of the common stock during the Measurement Period. Following November 11, 2016 and subject to the price and volume limitations set forth above, the Company may require such number of successive Mandatory Conversions as are necessary to convert all then outstanding Series A Convertible Preferred Stock.

### **Redemption**

At any time on or after November 11, 2016 (the "Redemption Date"), and upon at least 60 days prior written notice to the Company (a "Redemption Notice"), any holder of the Series A Convertible Preferred Stock shall have a one-time right to require the Company to redeem all or some of its shares of Series A Convertible Preferred Stock (a "Redemption"), for cash generated from a subsequent sale of the Company's equity securities. The redemption price shall be equal to the Stated Value for each share of Series A Convertible Preferred Stock (the "Redemption Purchase Price"). Upon receipt of a Redemption Notice, the Company shall complete a sale or sales of its equity securities for the purpose of accumulating net proceeds sufficient to pay the Redemption Purchase Price (it being understood by the holder of the Series A Convertible Preferred Stock that the Company may only redeem shares of Series A Convertible Preferred Stock with the proceeds from the sale of the Company's equity securities).

### **Board and Observer Rights**

Each holder of Series A Convertible Preferred Stock shall have the right, upon 10 days' prior written notice, to designate one representative, reasonably acceptable to the Company, who shall be entitled to attend and observe meetings of the Company's Board of Directors in a non-voting observer capacity (the "Observer").

### **Accounting for the Series A Convertible Preferred Stock**

The Company determined that the economic characteristics and risks of the conversion feature and the preferred stock instrument were clearly and closely related as equity instruments and accordingly, the conversion feature would not require separate accounting. In addition, the redemption feature is contingent upon Series A Convertible Preferred Stock not being converted into common stock and upon the holders delivering a redemption notice to the Company. Further, the redemption purchase price may only be paid from the proceeds of a subsequent sale of equity securities. Accordingly, the Series A Convertible Preferred Stock was accounted for as an equity instrument.

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**Conversion of the Convertible Debenture due November 2016**

On September 9, 2014, holders of \$3,500,000 and approximately \$173,000 of principal and interest, respectively, of the Convertible Debenture due November 2016, converted their holdings into an aggregate of 18,498,943 shares of common stock the (“Conversion Common Stock”). In addition, the Company exchanged and reissued the warrant for the purchase of 9,249,472 shares of common stock, and upon the reissuance, lowered the exercise price to \$0.31 per share. There was no change to the term of the warrant.

In connection with this conversion, the Company recorded a loss on conversion/exchange of approximately \$1,580,000, as summarized below. This loss represents the excess of the fair value of common stock issued on the date of the conversion over the net book value of the debt on the date of conversion. Since the conversion feature on the Convertible Debenture due November 2016 was determined to be a derivative liability, the net book value includes the value of the debt, net of discount, the derivative liability related to the conversion feature (after being marked to market on the conversion date, and the change in the fair value of the warrant on the date of the conversion.

The loss on extinguishment of debt was determined as follows:

	Conversion Common Stock
<b><u>Securities extinguished:</u></b>	
Face value of convertible debenture converted	\$ 3,500,000
Less: debt discount	(1,693,785)
Plus: accrued interest	173,521
Plus: fair value of derivative liability	1,032,241
Plus: fair value of warrant exchanged in connection with the conversion	1,270,000
Net book value of converted debenture, accrued interest, derivative liability and warrant exchanged	4,281,977
<b><u>Securities issued in conversion/exchange:</u></b>	
Fair value of common stock issued	4,532,241
Fair value of warrant issued September 9, 2014	1,332,000
Subtotal of securities issued in conversion/exchange	5,864,241
(Loss) on conversion/exchange	\$(1,582,264)

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On September 9, 2014, the Convertible Debenture due November 2016 was extinguished in full. However, the Company needed to determine the fair value of the derivative liability for the embedded conversion feature immediately prior to the conversion, in order to determine the change in the fair value of the derivative for the period. The Company determined to measure the derivative immediately prior to the conversion at its intrinsic value, since this method most fairly measured the value of the derivative liability. The intrinsic value computation is provided below.

	On September 9, 2014
Stock price used for valuation	\$ 0.25
	5,285 shares issued per \$1,000 face value
Aggregate gross intrinsic value of the \$3,500,000 of principal outstanding on September 8, 2014, immediately prior to conversion	4,532,241
Less the face value of the convertible debenture	(3,500,000)
Intrinsic value of the derivative conversion feature	<u>\$ 1,032,241</u>

Immediately after the conversion, the holders exchanged 15,978,943 shares of the Conversion Common Stock into 3,500 shares of Series A Convertible Preferred Stock. Shortly thereafter, the Company retired and cancelled the 15,978,943 shares of common stock received in the exchange.

### 3. CONVERTIBLE DEBENTURES

#### Convertible Debenture due January 2015

In January 2013, the Company received aggregate gross proceeds of \$1,765,000 from the issuance of 8% convertible debentures due January 25, 2015 (“Convertible Debenture due January 2015”), of which \$250,000 was received from our current President, Chief Executive Officer and director, and two other directors of the Company. The debentures paid interest quarterly and were convertible into shares of our common stock at a conversion price of \$0.15 per share on or before January 25, 2015. The embedded conversion feature had certain weighted average anti-dilution protection provisions which would be triggered if the Company issues its common stock, or certain common stock equivalents, (as defined) at a price below \$0.15 per share. The Company had the option to pay any interest on the debentures in common stock based on the average of the closing prices of our common stock for the 10 trading days immediately preceding the interest payment date. The Company also had the option to pay any interest on the debentures with additional debentures. The Company had the right to prepay the debentures at any time without penalty upon 30 days prior notice but only if the sales price of the common stock is at least \$0.30 for 20 trading days in any 30-day trading period ending no more than 15 days before the Company’s prepayment notice. In conjunction with the issuance of the debentures, the Company issued warrants (the “Convertible Debenture Warrant”) to purchase 5,882,745 shares of its common stock. Each warrant grants the holder the right to purchase one share of the Company’s common stock at the purchase price of \$0.30 per share on or before January 25, 2016. The Convertible Debenture Warrant may be exercised on a cashless basis only if there is not an effective registration statement covering such shares.

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The Company determined, based upon authoritative guidance, that the conversion feature embedded within the Convertible Debenture due January 2015 should be valued separately and bifurcated from the host instrument and accounted for as a free-standing derivative liability and that the Convertible Debenture Warrant should also be valued and accounted for separately as an equity instrument.

The derivative liability related to the embedded conversion feature was revalued at each reporting period as well as on the date of all conversions. The value of the derivative liability associated with the conversions and repayments of the Convertible Debenture due January 2015 during the three months ended April 30, 2014 was approximately \$1,671,000. As of April 30, 2014, the Company determined the fair value of the derivative liability to be \$-0-, as the full value of the Convertible Debenture due January 2015 was converted and/or repaid in full during the three months ended April 30, 2014. Accordingly, during the three and nine months ended July 31, 2014, the Company recorded losses on the change in fair value of the derivative liability of approximately \$-0- and \$1,131,000, respectively.

During the three months ended April 30, 2014, holders of \$1,240,000 and approximately \$9,000 of principal and interest, respectively, of the Convertible Debenture due January 2015, converted their holdings into an aggregate of 8,267,080 and 29,633 shares of common stock and holders of \$200,000 of principal of the Convertible Debenture due January 2015 consented to prepayment (without conversion) of obligations to them under the instrument's prepayment provisions. In connection with these conversions and prepayments the Company recorded a loss on extinguishment of debt of approximately \$483,000 during the three months ended April 30, 2014. This loss represents the excess of the fair value of Common Stock issued and cash paid on the date of the respective conversions and prepayments over net book value of the debt on the date of conversion and/or repayment. Since the conversion feature on the Convertible Debenture due January 25, 2015 was determined to be a derivative liability, the net book value includes both the value of the debt, net of discount and the portion of derivative liability related to the conversion feature.

The loss on extinguishment of debt was calculated as follows:

	For the Nine Months Ended July 31, 2014
Face value of debt converted and/or prepaid	\$1,440,000
Less: discount	(658,232)
Plus: value of derivative liability	1,670,704
Net book value of debt converted	\$2,452,472
Fair value of Common stock and cash issued	2,935,387
Loss on extinguishment of debt	\$ 482,915

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As of April 30, 2014, the Convertible Debenture due January 2015 was extinguished in full. However, the Company needed to determine the fair value of the derivative liability for the embedded conversion feature immediately prior to the conversion, in order to determine the change in the fair value of the derivative for the period. The Company determined to measure the derivative immediately prior to the conversion at its intrinsic value, since this method most fairly measured the value of the derivative liability. The intrinsic value computation is provided below.

	As of April 30, 2014
Stock price used for valuation	\$ 0.34
	6,667 shares issued per \$1,000 face value
Aggregate intrinsic value of the \$1,150,000 of principal outstanding on April 30, 2014, immediately prior to conversion and repayment	<u>\$ 1,456,797</u>

The amortization of debt discount related to the Convertible Debenture due January 2015 was approximately \$0- and \$233,000 for the three and nine months ended July 31, 2014, respectively, and approximately \$92,000 and \$175,000 for the three and nine months ended July 31, 2013, respectively.

### **Convertible Debenture due November 2016**

In November 2013, the Company received aggregate gross proceeds of \$3,500,000 from the issuance of 6% convertible debentures due November 11, 2016 (“Convertible Debenture due November 2016”). The debentures pay interest annually and are convertible into shares of our common stock at a conversion price of \$0.1892 per share on or before November 11, 2016. The embedded conversion feature has certain weighted average anti-dilution protection provisions which would be triggered if the Company issues its common stock, or certain common stock equivalents, (as defined) at a price below \$0.142 per share. The Company has the option to pay any interest on the debentures in common stock based on 90% of the volume weighted average closing sales price of our common stock for the 30 trading days immediately preceding the interest payment date. In conjunction with the issuance of the debentures, the Company issued warrants (the “Convertible Debenture Warrant”) to purchase 9,249,472 shares of its common stock. Each warrant grants the holder the right to purchase one share of the Company’s common stock at a fixed purchase price of \$0.3784 per share on or before November 11, 2016. The Convertible Debenture Warrant may be exercised on a cashless basis only if there is not an effective registration statement covering such shares.



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The Company determined, based upon authoritative guidance, that the conversion feature embedded within the Convertible Debenture due November 2016 should be valued separately and bifurcated from the host instrument and accounted for as a free-standing derivative liability and that the Convertible Debenture Warrant should also be valued and accounted for separately as an equity instrument.

The Company determined the fair value of each of the three elements included within the Convertible Debenture due November 2016. The debenture portion (without the conversion feature) bearing interest at 6% was determined to be a debt instrument with a fair value of \$2,710,000. The embedded conversion feature was determined to be a derivative liability with a fair value of \$1,570,000. The Convertible Debenture Warrant was determined to be an equity instrument with a fair value of \$740,000. The Company determined the fair value of each of these instruments based upon the assumptions and methodologies as discussed below.

Since the Convertible Debenture Warrant was determined to be an equity instrument, the Company first computed the relative fair value of the Convertible Debenture due November 2016 (including the value of its conversion feature) with a fair value of \$4,280,000 and the Convertible Debenture Warrant with a fair value of \$740,000. Accordingly, the relative fair value of the Convertible Debenture Warrant and the Convertible Debenture due November 2016 (including the value of its conversion feature) was determined to be \$515,936 and \$2,984,064, respectively. Then, from the relative fair value of the Convertible Debenture due November 2016, the Company deducted in full the fair value of the embedded conversion feature of \$1,570,000. The discount of \$2,085,936 applied to the face value of the Convertible Debenture due November 2016 consists of the sum of the relative fair value of the Convertible Debenture Warrant of \$515,936 and the full value of the bifurcated conversion option derivative liability of \$1,570,000. The Convertible Debenture due November 2016 was recorded at a net value of \$1,414,064, representing its face value of \$3,500,000, less aggregate discounts for the derivative liability and warrant of \$2,085,936, as summarized in the table below.

Face value of Convertible Debenture due November 2016		\$ 3,500,000
Fair value of embedded conversion feature	\$ 1,570,000	
Relative fair value of Convertible Debenture Warrant	<u>515,936</u>	
Discount	\$ 2,085,936	<u>(2,085,936)</u>
Proceeds attributable to the Convertible Debenture due November 2016		<u>\$ 1,414,064</u>

Accordingly, the Company accounted for the full amount of the discount as an offset to the Convertible Debenture due November 2016, amortizable under the effective interest method over the term of the debenture.

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The Company calculated the fair value of the embedded conversion feature of the Convertible Debenture due November 2016 using a Monte Carlo simulation, with the observable assumptions as provided in the table below. The significant unobservable inputs used in the fair value measurement of the reporting entity's embedded conversion feature are expected stock prices, levels of trading and liquidity of the Company stock, probability of default of the host instrument, and loss severity in the event of such default. Significant increases in the expected stock prices and expected liquidity would result in a significantly higher fair value measurement. Significant increases in either the probability or severity of default of the host instrument would result in a significantly lower fair value measurement.

	As of November 11, 2013
Stock price on valuation date	\$ 0.20
Conversion price	\$ 0.189
Discount for lack of marketability	35.5%
Term (years)	3.00
Expected volatility	102.8%
Weighted average risk-free interest rate	0.62%
Trials	100,000
Aggregate fair value	\$ 1,570,000

The Company calculated the fair value of the Convertible Debenture Warrant issued on November 11, 2013 using a Black Scholes Model, with the observable assumptions as provided in the table below. The significant unobservable inputs used in the fair value measurement of the reporting entity's warrant value are expected stock prices, levels of trading and liquidity of the Company stock, probability of default of the host instrument, and loss severity in the event of such default. Significant increases in the expected stock prices and expected liquidity would result in a significantly higher fair value measurement. Significant increases in either the probability or severity of default of the host instrument would result in a significantly lower fair value measurement:

	As of November 11, 2013
Stock price on valuation date	\$ 0.20
Exercise price	\$ 0.378
Discount for lack of marketability	22%
Term (years)	3.00
Expected volatility	102.8%
Weighted average risk-free interest rate	0.6%
Number of warrants	9,249,472
Aggregate fair value	\$ 740,000

The Company determined the fair value of the Convertible Debenture due November 2016 by preparing an analysis of discounted cash flows, using a discount rate of 16.0%, which the Company deemed appropriate given the Company's current risk scenarios.

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The derivative liability related to the embedded conversion feature is revalued at each reporting period as well as on the date of all conversions, as discussed below. As of July 31, 2014, the Company determined the fair value of the derivative liability to be \$1,900,000, and accordingly, during the three and nine months ended July 31, 2014, the Company recorded a gain (loss) on the change in the fair value of the derivative liability of approximately \$850,000 and (\$330,000), respectively.

As of July 31, 2014, the Company calculated the fair value of the embedded conversion feature of the Convertible Debenture due November 2016 using a Monte Carlo simulation, with the observable assumptions as provided in the table below. The significant unobservable inputs used in the fair value measurement of the reporting entity's embedded conversion feature are expected stock prices, levels of trading and liquidity of the Company stock, probability of default of the host instrument, and loss severity in the event of such default. Significant increases in the expected stock prices and expected liquidity would result in a significantly higher fair value measurement. Significant increases in either the probability or severity of default of the host instrument would result in a significantly lower fair value measurement.

	As of July 31, 2014
Stock price used for valuation	\$ 0.260
Conversion price	0.189
Discount for lack of marketability	36.3%
Term (years)	2.3
Expected volatility	100.6%
Weighted average risk-free interest rate	0.78%
Trials	100,000
Aggregate fair value	\$ 1,900,000

The amortization of debt discount related to the Convertible Debenture due November 2016 for the three and nine months ended July 31, 2014 was approximately \$129,000 and \$342,000, respectively.

In connection with the issuance of the Convertible Debenture due November 2016, the Company incurred legal costs which were allocated as provided below:

Attributable to:	Accounting Treatment	Amount
The embedded conversion feature (derivative)	Expensed as incurred	\$ 8,593
The 8% Convertible Debenture Warrant	Charged to additional paid-in capital	2,824
The 8% Convertible Debenture	Recorded as deferred issuance costs and amortized under the interest method over the term of the 8% Convertible Debenture	7,739
<b>Total</b>		<b>\$ 19,156</b>

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In connection with the issuance of the Convertible Debenture due November 2016, on February 7, 2014, the Company prepared and filed a registration statement registering for resale the shares of its common stock which may be issued upon the conversion of the debenture and exercise of the warrant consistent with the terms and conditions of the debenture agreement the Company entered into with the holders of the registrable shares listed above.

The Company has agreed to maintain the effectiveness of the registration statement through the earlier of three years from the date of the issuance of the Convertible Debenture due November 2016 or until Rule 144 of the Securities Act is available to the holders to allow them to sell all of their registrable securities thereunder.

See Note 2, Subsequent Events - for discussion of the conversion of the Convertible Debenture due November 2016.

#### 4. **SALE OF COMMON STOCK**

On July 15, 2014, the Company, raised \$4,000,000 of gross proceeds via a registered direct offering of its common stock to certain investors (the “Investors”) (the “Offering”). The Company sold an aggregate of 16,000,000 shares of common stock and warrants to purchase an aggregate of 8,000,000 shares of common stock. The purchase price of one share of common stock and a warrant to purchase ½ of a share of common stock was \$0.25. The warrants are exercisable immediately as of the date of issuance at an exercise price of \$0.40 per share and expire five years from the date of issuance. The exercise price of the warrants is subject to customary adjustment in the case of stock splits, stock dividends, combinations of shares and similar recapitalization transactions. Under certain circumstances, the Company has the right to call for cancellation of warrants for which a notice of exercise has not yet been delivered for consideration equal to \$.001 per share. The Offering was effected as a takedown off the Company’s shelf registration statement on Form S-3, which became effective on April 25, 2014, pursuant to a prospectus supplement filed with the Securities and Exchange Commission.

#### 5. **STOCK BASED COMPENSATION**

The Company maintains stock equity incentive plans under which the Company grants non-qualified stock options, stock appreciation rights, stock awards, performance awards, or stock units to employees, directors and consultants.

## **Stock Option Compensation Expense**

We account for stock options granted to employees and directors using the accounting guidance in ASC 718 “Stock Compensation” (“ASC 718”). In accordance with ASC 718, we estimate the fair value of service based stock options and performance based options on the date of grant, using the Black-Scholes pricing model. For options vesting if the trading price of the Company’s common stock exceeds price targets we use a Monte Carlo Simulation in estimating the fair value at grant date. We recognize compensation expense for service based stock options and options subject to market conditions over the requisite or implied service period of the grant. For performance based awards, compensation expense is recognized over the requisite or implied service period of the grant when the performance target is deemed probable.

We recorded stock-based compensation expense, related to stock options granted to employees and directors, of approximately \$1,562,000 and \$2,118,000, during the nine months ended July 31, 2014 and 2013, respectively, and approximately \$573,000 and \$1,091,000 during the three months ended July 31, 2014 and 2013, respectively. Stock-based compensation expense for the nine months ended July 31, 2014 and 2013 includes approximately \$1,089,000 and \$1,816,000, respectively, and during the three months ended July 31, 2014 and 2013 approximately \$496,000 and \$1,014,000, respectively, related to the amortization of compensation cost for stock options granted in prior periods but vested in the current period. As of July 31, 2014, there was unrecognized compensation cost related to non-vested stock options granted to employees and directors, related to service based options of approximately \$2,767,000, which will be recognized over a weighted-average period of 1.8 years and related to performance based options of approximately \$427,000 which will be recognized when achievement is considered probable.

We account for stock options granted to consultants using the accounting guidance included in ASC 505-50 “Equity-Based Payments to Non-Employees” (“ASC 505-50”). In accordance with ASC 505-50, we estimate the fair value of service based stock options and performance based options at each reporting period, using the Black-Scholes pricing model. For options vesting if the trading price of the Company’s common stock exceeds price targets we estimate the fair value at each reporting period using a Monte Carlo Simulation. We recognize compensation expense for service based stock options and options subject to market conditions over the requisite or implied service period of the grant. For performance based awards, compensation expense is recognized when the performance target is achieved.

We recorded consulting expense, related to stock options granted to consultants, during the nine months ended July 31, 2014 and 2013 of approximately \$784,000 and \$574,000, respectively, and approximately \$(103,000) and \$147,000 during the three months ended July 31, 2014 and 2013, respectively. Stock-based consulting expense for the nine ended July 31, 2014 and 2013 includes approximately \$736,000 and \$574,000, respectively, and during the three months ended July 31, 2014 and 2013 approximately \$(107,000) and \$147,000, respectively, related to the amortization of compensation cost for stock options granted in prior periods but vested in the current period. As of July 31, 2014, there was unrecognized consulting expense related to non-vested stock options granted to consultants, related to service based options of approximately \$1,223,000, which will be recognized over a weighted-average period of 1.3 years.

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**Fair Value Determination**

We use the Black-Scholes pricing model in estimating the fair value of stock options which vest over a specific period of time or upon achieving performance targets. To determine the weighted average fair value of stock options on the date of grant, employees and directors are included in a single group. The fair value of stock options granted to consultants is determined on an individual basis. The stock options we granted during the nine months ended July 31, 2014 consisted of awards with 10-year terms that vest over one year, options with 10-year terms that vest over 36 months, options with 5-year terms which vest immediately and options with 10-year terms which vest upon achievement of performance milestones. The stock options we granted during the nine months ended July 31, 2013 consisted of awards of options with 5-year terms, which vest over one year and options with 10-year terms which vest in three annual installments commencing on the date of grant or over a nine month period.

The following weighted average assumptions were used in estimating the fair value of stock options granted during the nine months ended July 31, 2014 and 2013, and the three months ended July 31, 2014. No stock options were granted during the three months ended July 31, 2013.

	<u>For the Nine Months Ended July 31,</u>		For the Three Months Ended July 31, 2014
	2014	2013	
Weighted average fair value at grant date	\$0.22	\$0.17	\$0.25
Valuation assumptions:			
Expected life (years)	5.79	5.26	5.98
Expected volatility	115.4%	116.5%	115.1%
Risk-free interest rate	1.82%	0.73%	1.93%
Expected dividend yield	0	0	0

The expected term of stock options represents the weighted average period the stock options are expected to remain outstanding. We use the simplified method to determine expected term. The simplified method was adopted since we do not believe that historical experience is representative of future performance because of the impact of the changes in our operations and the change in terms from historical options which vested immediately to terms including vesting periods of up to three years. Under the Black-Scholes pricing model we estimated the expected volatility of our shares of common stock based upon the historical volatility of our share price over a period of time equal to the expected term of the options. We estimated the risk-free interest rate based on the implied yield available on the applicable grant date of a U.S. Treasury note with a term equal to the expected term of the underlying grants. We made the dividend yield assumption based on our history of not paying dividends and our expectation not to pay dividends in the future.

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Under ASC 718, the amount of stock-based compensation expense recognized is based on the portion of the awards that are ultimately expected to vest. Accordingly, if deemed necessary, we reduce the fair value of the stock option awards for expected forfeitures, which are forfeitures of the unvested portion of surrendered options. Based on our historical experience we have not reduced the amount of stock-based compensation expenses for anticipated forfeitures.

We will reconsider use of the Black-Scholes pricing model if additional information becomes available in the future that indicates another model would be more appropriate. If factors change and we employ different assumptions in the application of ASC 718 and ASC 505-50 in future periods, the compensation expense that we record may differ significantly from what we have recorded in the current period.

For options vesting if the trading price of the Company's common stock exceeds price targets, we used a Monte Carlo Simulation in estimating expected term and fair value.

### **Stock Option Activity**

During the nine months ended July 31, 2014 and 2013, we granted options to purchase 13,010,000 and 180,000 shares, respectively, of common stock at weighted average exercise prices of \$0.22 and \$0.20 per share, respectively, pursuant to the ITUS Corporation 2010 Share Incentive Plan (the "2010 Share Plan"). During the nine-month period ended July 31, 2013, in addition to options granted under the 2010 Share Plan, we granted options to our outside directors to purchase 3,000,000 shares at weighted average exercise prices of \$0.21 per share. During the nine-month periods ended July 31, 2014 and 2013, stock options to purchase 345,000 shares and 146,000 shares, respectively, of common stock were exercised with aggregate proceeds of approximately \$51,000 and \$26,000, respectively.

### **Stock Option Plans**

As of July 31, 2014, we have two stock option plans: the ITUS Corporation 2003 Share Incentive Plan (the "2003 Share Plan") and the 2010 Share Plan, which were adopted by our Board of Directors on April 21, 2003 and July 14, 2010, respectively.

The 2003 Share Plan provides for the grant of nonqualified stock options, stock appreciation rights, stock awards, performance awards and stock units to key employees and consultants. The maximum number of shares of common stock available for issuance under the 2003 Share Plan is 70,000,000 shares. The 2003 Share Plan was administered by the Stock Option Committee through June 2004, from June 2004 through July 2010, by the Board of Directors, from July 2010 through August 2012, by the Stock Option Committee, from August 2012 through November 2012, by the Executive Committee of the Board of Directors and since November 2012, by the Board of Directors, which determines the option price, term and provisions of each option. The exercise price with respect to all of the options granted under the 2003 Share Plan since its inception was equal to the fair market value of the underlying common stock at the grant date. In accordance with the provisions of the 2003 Share Plan, the plan terminated with respect to the grant of future options on April 21, 2013. Information regarding the 2003 Share Plan for the nine months ended July 31, 2014 is as follows:

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	Shares	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value
Options Outstanding at October 31, 2013	15,638,845	\$0.72	
Exercised	(265,000)	\$0.145	
Forfeited	(1,389,075)	\$0.63	
Options Outstanding and exercisable at July 31, 2014	<u>13,984,770</u>	\$0.74	\$181,000

The following table summarizes information about stock options outstanding and exercisable under the 2003 Share Plan as of July 31, 2014:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
\$0.07 - \$0.37	1,595,000	2.64	\$0.15
\$0.43 - \$0.70	4,684,770	1.43	\$0.62
\$0.74 - \$0.92	5,450,000	2.35	\$0.86
\$1.04 - \$1.46	2,255,000	1.49	\$1.10

The 2010 Share Plan provides for the grant of nonqualified stock options, stock appreciation rights, stock awards, performance awards and stock units to key employees and consultants. The maximum number of shares of common stock available for issuance under the 2010 Share Plan was initially 15,000,000 shares. On July 6, 2011, the 2010 Share Plan was amended by our Board of Directors to increase the maximum number of shares of common stock that may be granted to 27,000,000 shares, on August 29, 2012, the maximum number of shares was further increased to 30,000,000 shares. On November 8, 2013, the Board of Directors approved an amendment to provide that effective November 8, 2013, the maximum aggregate number of shares available for issuance will be 20,000,000 shares and that on the first business day in 2014 and on the first business day of each calendar year thereafter the maximum aggregate number of shares available for issuance shall be replenished such that 20,000,000 shares will be available for issuance. Accordingly, during the nine months ended July 31, 2014, the number of shares in the 2010 Share Plan was increased by 25,634,980 shares to 55,634,980 shares. In addition, on November 8, 2013, the 2010 Share Plan was amended to provide that on January 2nd of each year commencing on January 2, 2014, each non-employee director of the Company at that time shall automatically be granted a 10 year stock option to purchase 300,000 shares of common stock (400,000 for the Chairman) that will vest in four equal quarterly installments. The 2010 Share Plan was administered by the Stock Option Committee through August 2012, from August 2012 through November 2012, by the Executive Committee of the Board of Directors and since November 2012, by the Board of Directors, which determines the option price, term and provisions of each option. The exercise price with respect to all of the options granted under the 2010 Share Plan was equal to the fair market value of the underlying common stock at the grant date. As of July 31, 2014, the 2010 Share Plan had 13,700,000 shares available for future grants. Information regarding the 2010 Share Plan for the nine months ended July 31, 2014 is as follows:



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	<u>Shares</u>	<u>Weighted Average Exercise Price Per share</u>	<u>Aggregate Intrinsic Value</u>
Options Outstanding at October 31, 2013	2,984,000	\$ 0.25	
Granted	13,010,000	\$ 0.22	
Exercised	<u>(80,000)</u>	\$ 0.16	
Options Outstanding at July 31, 2014	<u>15,914,000</u>	\$ 0.23	\$ 612,000
Options Exercisable at July 31, 2014	<u>5,016,222</u>	\$ 0.23	\$ 229,000

The following table summarizes information about stock options outstanding under the 2010 Share Plan as of July 31, 2014:

<u>Options Outstanding</u>				<u>Options Exercisable</u>		
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
\$0.12 - \$0.37	15,914,000	8.62	\$0.23	5,016,222	6.63	\$0.23

In addition to options granted under the 2003 Share Plan and the 2010 Share Plan, in September 2012, the Board of Directors approved the grant of stock options to purchase 41,500,000 shares and, during the year ended October 31, 2013, the Board of Directors approved the grant of stock options to purchase 3,000,000 shares.

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Of the stock options granted in September 2012, nonqualified options to purchase 40,000,000 shares were issued to our new executive team, consisting of 16,000,000 stock options issued to our new President and Chief Executive Officer, 8,000,000 stock options issued to our new Senior Vice President of Engineering and 16,000,000 stock options issued to a new strategic advisor to the Company who is also a Director. These stock options have an exercise price of \$0.2175 (the average of the high and the low sales price of the common stock on the trading day immediately preceding the approval of such options by the Board of Directors) and have a term of ten years. Half of these stock options vest in 36 equal monthly installments commencing on October 31, 2012, provided that if the grantees are terminated by the Company without cause, an additional 12 months of vesting will be accelerated and such accelerated options will become immediately exercisable. The balance of the stock options will vest in three equal installments upon achievement of a cash milestone, which was satisfied in the fourth quarter of fiscal 2013, and two stock price targets, which were not achieved in fiscal 2013. In November 2013, in light of the cost and expense of revaluing the unvested portion of the performance-based stock options on a quarterly basis for financial reporting purposes, the Board of Directors approved an amendment to the performance-based stock options awarded on September 19, 2012 to the President and Chief Executive Officer, Senior Vice President of Engineering and the strategic advisor. The amendment modifies the option award's vesting conditions to provide that the unvested portion of the stock options vest in 23 consecutive monthly installments commencing November 30, 2013. The fair value of these options was recalculated to reflect the change to service based options as of November 8, 2013 and the unrecognized compensation amount was adjusted to reflect the increase in fair value. As of July 31, 2014, the outstanding options to purchase 40,000,000 shares had an intrinsic value of \$1,660,000. As of July 31, 2014, 24,106,280 of these stock options were exercisable with an aggregate intrinsic value of approximately \$1,000,000. These stock options otherwise have the same terms and conditions as options granted under the Company's 2010 Share Incentive Plan.

The remaining nonqualified stock options granted in September 2012 to purchase 1,500,000 shares consisted of grants of 750,000 stock options to our Chairman in compensation for his service as interim Chief Executive Officer of the Company and as compensation for his prior service as a director, and 750,000 stock options to a director in compensation for his service in recruiting the Company's new management team. These stock options have an exercise price of \$0.2225 (the average of the high and low sales price on September 21, 2012) and an intrinsic value as of July 31, 2014 of approximately \$55,000. The options vest in 3 equal annual installments of 250,000 commencing on September 21, 2012 and have a term of ten years. As of July 31, 2014, 1,000,000 options were exercisable with an aggregate intrinsic value of approximately \$37,000. These stock options otherwise have the same terms and conditions as options granted under the Company's 2010 Share Incentive Plan.

During the year ended October 31, 2013, nonqualified stock options to purchase 3,000,000 shares were granted to our outside directors for service rendered to our Company. Of these options,

(a) In November 2012, nonqualified stock options to purchase 1,000,000 shares were issued to one of our directors as additional compensation for service in recruiting the Company's new management team. These options have an exercise price of \$0.211 (the average of the high and low sales price on date of grant) and vest 333,334 shares upon grant and 333,333 shares in two annual installments commencing November 30, 2013.

(b) In February 2013, nonqualified stock options to purchase 1,000,000 shares were issued to the Chairman of the Board. These stock options have an exercise price of \$0.235 (the average of the high and low sales price on date of grant) and vest 333,334 shares upon grant and 333,333 shares in two annual installments commencing February 15, 2014.

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(c) In March 2013, nonqualified stock options to purchase an aggregate of 1,000,000 shares were granted to the Company's three outside directors. Each of these stock options has an exercise price of \$0.195 (the average of the high and low sales price on date of grant) and vest in four equal quarterly installments commencing March 31, 2013.

As of July 31, 2014, the options to purchase 3,000,000 shares had an intrinsic value of approximately \$136,000 and the portion exercisable of 2,333,334 shares had an intrinsic value of approximately \$112,000. These options otherwise have the same terms and conditions as options granted under the Company's 2010 Share Incentive Plan.

The following table summarizes information about the above stock options outstanding that were not granted under the 2003 Share Plan or the 2010 Share Plan as of July 31, 2014:

		Options Outstanding		Options Exercisable		
Range of Exercise Prices		Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
\$0.195-						
\$0.235	44,500,000	8.16	\$0.22	27,439,614	8.17	\$0.22

## Stock Awards

We account for stock awards granted to employees and consultants based on their grant date fair value, in accordance with ASC 718 and ASC 505-50, respectively. During the nine months ended July 31, 2014 and 2013, we issued 130,000 shares and 665,000 shares, respectively, of common stock to consultants for services rendered pursuant to the 2010 Share Plan. We recorded consulting expense for the nine months ended July 31, 2014 and 2013 of approximately \$41,000 and \$168,000, respectively and for the three months ended July 31, 2014 of approximately \$6,000 and \$117,000, respectively, for the shares of common stock issued to consultants.

## 6. FAIR VALUE MEASUREMENTS

ASC 820 "Fair Value Measurements and Disclosures" ("ASC 820") defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. In accordance with ASC 820, we have categorized our financial assets, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy as set forth below. If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

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Financial assets and liabilities recorded in the accompanying condensed consolidated balance sheets are categorized based on the inputs to the valuation techniques as follows:

Level 1 - Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market which we have the ability to access at the measurement date.

Level 2 - Financial assets and liabilities whose values are based on quoted market prices in markets where trading occurs infrequently or whose values are based on quoted prices of instruments with similar attributes in active markets.

Level 3 – Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management’s own assumptions about the assumptions a market participant would use in pricing the asset and liabilities. We do not currently have any Level 3 financial assets.

The following table presents the hierarchy for our financial assets measured at fair value on a recurring basis as of July 31, 2014:

	Level 1	Level 2	Level 3	Total
Money market funds – Cash and cash equivalents	\$ 3,651,564	\$ -	\$ -	\$ 3,651,564
Certificates of deposit Short-term investments	2,550,000	-	-	2,550,000
Videocon Industries Limited global depository receipts	4,150,970	-	-	4,150,970
Total financial assets	<u>\$ 10,352,534</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,352,534</u>

The following table presents the hierarchy for our financial assets measured at fair value on a recurring basis as of October 31, 2013:

	Level 1	Level 2	Level 3	Total
Money market funds – Cash and cash equivalents	\$ 898,172	\$ -	\$ -	\$ 898,172
Videocon Industries Limited global depository				

receipts	<u>4,197,341</u>	<u>-</u>	<u>-</u>	<u>4,197,341</u>
Total financial assets	<u>\$ 5,095,513</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,095,513</u>

The following table presents the hierarchy for our financial liabilities measured at fair value on a recurring basis as of July 31, 2014:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Derivative liability	\$ -	\$ -	\$ 1,900,000	\$ 1,900,000
Patent acquisition obligation	-	-	3,136,513	3,136,513
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,036,513</u>	<u>\$ 5,036,513</u>

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The following table presents the hierarchy for our financial liabilities measured at fair value on a recurring basis as of October 31, 2013:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Derivative Liability	\$ -	\$ -	\$ 540,000	\$ 540,000

The following table sets forth a summary of the changes in the fair value of the Company's Level 3 financial liabilities that are measured at fair value on a recurring basis:

	<u>For the Nine Months Ended July 31, 2014</u>
Derivative liability:	
Beginning balance	\$ 540,000
Aggregate fair value of bifurcated conversion feature issued	1,570,000
Change in fair value of bifurcated conversion feature	1,460,704
Fair value of bifurcated conversion features related to the extinguishment of debt	(1,670,704)
Ending balance	\$ 1,900,000
Fair value of patent acquisition obligation:	
Beginning balance	\$ -
Initial fair value, discounted to present value	2,850,511
Amortized interest on patent obligation	286,002
Ending balance	\$ 3,136,513

The Company developed the assumptions that were used as follows: The stock price on the valuation date of the Company's common stock was derived from the trading history of the Company's common stock. The stock premium for liquidity was computed as the premium required to adjust for the effect of the additional time that it would be expected to take for the market to absorb the converted shares and warrant exercises, given the Company's current trading volume. The term represents the remaining contractual term of the derivative; the volatility rate was developed based on analysis of the Company's historical volatility; the risk free interest rate was obtained from publicly available US Treasury yield curve rates; the dividend yield is zero because the Company has not paid dividends and does not expect to pay dividends in the foreseeable future.

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Our non-financial assets that are measured on a non-recurring basis include our property and equipment which are measured using fair value techniques whenever events or changes in circumstances indicate a condition of impairment exists. The estimated fair value of accounts payable and accrued liabilities approximates their individual carrying amounts due to the short term nature of these measurements. It is impractical to determine the fair value of the loan receivable and loan payable to the related party given the nature of these loans. The convertible debentures have been reported net of the discount for the beneficial conversion features and related warrants. Cash and cash equivalents are stated at carrying value which approximates fair value. These assets and liabilities were not presented in the preceding table.

### 7. INVESTMENTS

At July 31, 2014, we had marketable securities consisting of certificates of deposit of \$2,550,000, which were classified as "available-for-sale securities" and reported at fair value.

The fair value of investment in Videocon Industries Limited ("Videocon") global depository receipts ('Videocon GDRs') as of July 31, 2014 and October 31, 2013, and the unrealized loss for the nine months ended July 31, 2014, are as follows:

	Investment in Videocon
Fair Value as of October 31, 2013	\$ 4,197,341
Unrealized loss	(46,371)
Fair Value as of July 31 2014	<u>\$ 4,150,970</u>

See Note 2, Subsequent Event – for discussion of the disposition of this investment in August 2014.

### 8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expense consist of the following as of:

	July 31, 2014	October 31, 2013
Accounts payable	\$ 529,340	\$ 527,208
Payroll and related expenses	363,336	345,484
Accrued litigation expense, consulting and other professional fees	209,244	248,730
Accrued other	202,651	155,048
	<u>\$ 1,304,571</u>	<u>\$ 1,276,470</u>

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### 9. NET LOSS PER SHARE OF COMMON STOCK

In accordance with ASC 260, “Earnings Per Share”, basic net loss per common share (“Basic EPS”) is computed by dividing net loss by the weighted average number of common shares outstanding. Diluted net loss per common share (“Diluted EPS”) is computed by dividing net loss by the weighted average number of common shares and dilutive common share equivalents and convertible securities then outstanding. Diluted EPS for all periods presented is the same as Basic EPS, as the inclusion of the effect of common share equivalents then outstanding would be anti-dilutive. For this reason, excluded from the calculation of Diluted EPS for the nine and three months ended July 31, 2014 and 2013, were stock options to purchase 74,398,770 and 63,182,845 shares respectively, and warrants to purchase 25,923,281 and 9,878,759 shares, respectively and debentures convertible into 18,498,943 shares and 9,600,480 shares respectively.

### 10. EFFECT OF RECENTLY ADOPTED AND ISSUED PRONOUNCEMENTS

In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update 2013-11 (“ASU 2013-11”) which requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carry forward that would apply in settlement of the uncertain tax positions. Under the new standard, unrecognized tax benefits will be netted against all available same-jurisdiction loss or other tax carry forwards that would be utilized, rather than only against carry forwards that are created by the unrecognized tax benefits. ASC 2013-11 is effective for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2013. The adoption of ASC 213-11 on November 1, 2014 is not expected to have a material effect on our consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update 2014-09 (“ASU 2014-09”), “Revenue from Contracts with Customers”. The amendments in ASU 2014-9 create Topic 606, Revenue from Contracts with Customers, and supersede the revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance. In addition, the amendments supersede the cost guidance in Subtopic 605-35, Revenue Recognition—Construction-Type and Production-Type Contracts, and create new Subtopic 340-40, Other Assets and Deferred Costs—Contracts with Customers. In summary, the core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASC 2014-09 is effective for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2016. The adoption of ASC 213-11 on November 1, 2017 is not expected to have a material effect on our consolidated financial statements.

### 11. INCOME TAXES

We file Federal, New York State and California State income tax returns. Due to net operating losses, the statute of limitations remains open since the fiscal year ended October 31, 1997. We account for interest and penalties related to income tax matters in marketing, general and administrative expenses. There are no unrecognized income tax benefits as of July 31, 2014 and October 31, 2013.



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### 12. COMMITMENT AND CONTINGENCES

#### Patent Acquisition Obligations

As of July 31, 2014, we have incurred obligations due no later than November 2017 related to the acquisition of patents, which have a discounted present value of approximately \$3,137,000, and which amount will be reduced by royalties paid during the period. The payment due in November 2017 is payable at the option of the Company in cash or common stock.

#### Litigation Matters

On January 28, 2013, we filed a lawsuit in the United States Federal District Court for the Northern District of California against AUO and E Ink in connection with the AUO License Agreements, alleging breach of contract and other charges, and are seeking compensatory, punitive, and treble damages (the "AUO/E Ink Lawsuit"). In addition to numerous material breaches by AUO of the AUO License Agreements, the Complaint alleges that AUO and E Ink conspired to obtain rights to CopyTele's ePaper® Electrophoretic Display technology, and CopyTele's Nano Field Emission Display technology. CopyTele alleges that such activities violated several State and Federal anti-trust and unfair competition statutes for which punitive and/or treble damages are applicable. We can give no assurance as to the potential outcome of this litigation. However, it is reasonably possible that the Company will not prevail on its damages claims in arbitration. Pursuant to the terms of the related arbitration agreement, the Company may be liable for AUO's attorney's fees, which may exceed \$1 million, if the Company does not prevail.

The operations of the Company involve patent licensing and enforcement in connection with the unauthorized use of patented technologies. In connection with any of our patent enforcement actions, it is possible that a defendant may request and/or a court may rule that we have violated statutory authority, regulatory authority, federal rules, local court rules, or governing standards relating to the substantive or procedural aspects of such enforcement actions. In such event, a court may issue monetary sanctions against us or award attorney's fees and/or expenses to a defendant(s), which could be material.

Other than the foregoing, we are not a party to any material pending legal proceedings. We are party to claims and complaints that arise in the ordinary course of business. We believe that any liability that may ultimately result from the resolution of these matters will not, individually or in the aggregate, have a material adverse effect on our financial position or results of operations.

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

**GENERAL**

As used herein, “we,” “us,” “our,” the “Company”, or “ITUS” means ITUS Corporation and its wholly-owned subsidiaries, unless otherwise indicated. The primary operations of the Company involve the development, acquisition, licensing, and enforcement of patented technologies that are either owned or controlled by the Company. In June 2014, ITUS Patent Acquisition Corporation acquired the exclusive rights to license and enforce our 10<sup>th</sup> patent portfolio called Enhanced Auction Technologies, which covers enhanced presentation and cross selling technologies used by some of the world’s leading auction sites. The Company currently owns or controls 10 patent portfolios including Encrypted Mobile Communication; Enhanced Auction Technologies: ePaper® Electrophoretic Display; Internet Telephonic Gateway; J-Channel Window Frame Construction; Key Based Web Conferencing Encryption; Loyalty Conversion Systems; Micro Electro Mechanical Systems Display; Nano Field Emission Display; and VPN Multicast Communications.

As part of our patent assertion activities and in the ordinary course of our business, the Company has initiated and will likely continue to initiate patent infringement lawsuits, and engage in patent infringement litigation. In September of 2014, the Company initiated its seventh patent assertion campaign, bringing the total number of lawsuits since we implemented our patent monetization business model in January of 2013 to 44.

Our primary source of revenue will come from licenses resulting from the unauthorized use of our patented technologies, including the settlement of patent infringement lawsuits. During the nine months ended July 31, 2014, we entered into 5 license and/or settlement agreements including agreements in connection with our patented Key Based Web Encryption technology and our patented J-Channel Window Frame Construction technology. In September 2014, we entered into 5 additional license and/or settlement agreements with Jeld-Wen, Inc., Atrium Windows and Doors, Inc., Pella Corporation, Ply Gem Industries, Inc. and Simonton Building Products, Inc., all in connection with our patented J-Channel Window Frame Construction technology. These licenses resolved lawsuits that were pending against the aforementioned companies. Since implementing our new business model in January of 2013, the Company has entered into a total of 14 revenue producing license and/or settlement agreements, and 3 of our 7 patent assertion campaigns have now generated revenue.

On August 29, 2014, the Company ended its relationship with Videocon Industries Limited, terminating Videocon’s license to the Company’s patented Nano Field Emission Display technology. On September 3, 2014, the United States District Court for the Eastern District of Texas invalidated two of our Loyalty Conversion Systems patents by ruling that they did not cover patentable subject matter, resulting in the dismissal of 7 of our Loyalty Conversion Systems Corporation’s lawsuits. On September 8, 2014, the Company filed patent infringement lawsuits against Ebay, Vendio, and Auctiva connection with our patented Enhanced Auction Technologies. The Company currently has 27 pending lawsuits in connection with its patented technologies.

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In addition to continuing to mine and monetize our existing patents, our wholly owned subsidiary, ITUS Patent Acquisition Corporation, will continue to acquire patents and the exclusive rights to license and enforce patents from third parties. When necessary, we will assist such parties in the further development of their patent portfolios through the filing of additional patent applications.

Due to arrangements previously entered into by the Company, certain of our patents contain encumbrances which may negatively impact our patent monetization and patent assertion activities. Where we are able, we will take the steps necessary to remove any encumbrances that may inhibit our patent monetization and patent assertion activities.

### **Patent Monetization and Patent Assertion**

Patent monetization is the generation of revenue and proceeds from patents and patented technologies (“Patent Monetization”). Patent assertion is a specialized type of Patent Monetization where a patent owner, or a representative of the patent owner, seeks to prohibit or collect royalties from the unauthorized manufacture, sale, and use of the owner’s patented invention (“Patent Assertion”). Our business model is Patent Monetization and Patent Assertion.

### **ITUS’s Patent Portfolios**

#### **Encrypted Cellular Communications**

The Encrypted Cellular Communications patent portfolio covers hardware and software used to encrypt cellular phone calls and other mobile communications. With the increased use of mobile devices, and the increased concerns regarding privacy and the protection of personal information, we believe the demand for secure mobile communications is increasing for both businesses and consumers.

#### **Enhanced Auction Technology**

The Enhanced Auction Technologies patent portfolio covers enhanced presentation and cross selling technologies used by some of the world’s leading auction sites. The enhanced presentation tools covered by these patents enable auction sellers to cross sell and upsell additional items to interested buyers, resulting in incremental sales and higher yields per transaction.

#### **ePaper® Electrophoretic Display**

The ePaper® Electrophoretic Display patent portfolio covers core electrophoretic technology that is used in the world’s most popular eReader devices such as the Nook® and the Kindle. The ePaper patents cover the underlying chemistry that is used to manufacture both the particles and the suspension, two of the key elements that are fundamental to the generation of the black and white eReader display. Our ePaper patents also cover the manufacturing, assembly, and physical structure of the display unit itself, as well as the electronics and internal operation of the device.

### **Internet Telephonic Gateway**

The internet telephonic gateway patent portfolio covers the integration of telephonic participation in web-based audio/video conferences by creating a gateway between the Internet, and cellular or traditional landline telephones. The end result is that participants can join and participate in online, audio/video conferences via a cellular or conventional telephone. This internet telephonic gateway technology is commonly used for web based audio/video events with broad based audience participation such as earnings calls, webinars, and virtual town hall meetings.

### **J-Channel Window Frame Construction**

The J-Channel Window Frame Construction patent portfolio covers vinyl windows with an integrated frame, known in the industry as a “J-Channel”. Such windows are commonly used in modular buildings, mobile homes, and conventional, new home construction, resulting in easier and faster window installation.

### **Key Based Web Conferencing Encryption**

The Key Based Web Conferencing Encryption patent portfolio covers the generation and management of encryption keys. This type of encryption technology is commonly used to encrypt web-based conferencing, email for regulatory compliance purposes, and personal information such as contracts.

### **Loyalty Conversion Systems**

The Loyalty Conversion System patent portfolio covers coalition loyalty awards programs commonly provided by airlines, credit card companies, hotels, retailers, casinos, and others. The portfolio covers the electronic conversion of non-negotiable, loyalty awards points into negotiable funds used to purchase goods and services from third parties, as well as covering the electronic conversions of awards points into points and awards provided by other loyalty program providers. On September 3, 2014, the United States District Court for the Eastern District of Texas invalidated two of our Loyalty Conversion Systems patents by ruling that they did not cover patentable subject matter. We are studying the Court’s opinion, the prospects of an appeal, and the impact of the decision on the other 22 patents in the portfolio.

### **Micro Electro Mechanical Systems Display**

The Micro Electro Mechanical Systems Display patent portfolio covers vanadium dioxide coated pixels that electrically modulate light at extremely high speeds to form an image, as well as the use of electrostatic force to move pixel sized membranes that create a color image. These are emerging, low voltage, display technologies with numerous potential commercial applications.

### **Nano Field Emission Display**

The Nano Field Emission Display patent portfolio covers a new type of flat panel display consisting of low voltage color phosphors, specially coated carbon nanotubes, nano materials to generate secondary electrons, and ionized noble gas, resulting in a bright, sharp, high contrast color image. This emerging technology could result in a flat panel display utilizing less power, with better picture quality and lower manufacturing costs than is currently found in the flat panel display industry.

## **VPN Multicast Communications**

The VPN Multicast Communications patent portfolio covers the multicast, internet delivery of streaming data, media, and other content to large numbers of recipients, within the confines of specialized virtual private networks (“VPN”s). Multicasting is a commonly used content delivery protocol that enables several recipients to simultaneously receive content from a single internet transmission, greatly reducing Internet bandwidth costs. When combined with specialized VPN’s, the content and communications are protected from unwanted disclosure and piracy. Applications for these live, VPN multicast communications include videoconferences, online training and e-learning classes, internet television, web-based corporate events and strategy sessions, and other live transmissions of sensitive or protected content.

## **RESULTS OF OPERATIONS**

### **Nine months ended July 31, 2014 compared to the nine months ended July 31, 2013**

#### ***Revenue from Patent Assertion Activities***

For the nine months ended July 31, 2014, we recorded revenue from patent assertion activities of \$1,105,000, from 5 license agreements issued from our Key Based Web Conferencing Encryption and J-Channel Window Frame Construction patent portfolios. The license agreements provided for one-time, non-recurring, lump sum payments in exchange for a non-exclusive retroactive and future license, or covenant not to sue. Accordingly, the earning process from these licenses was complete and 100% of the revenue was recognized upon execution of the license agreements. There was no revenue from patent assertion activities in the nine months ended July 31, 2013.

The Company currently owns or controls 10 patent portfolios. Since implementing our new business model in January of 2013, the Company has entered into a total of 14 revenue producing license and/or settlement agreements, and 3 of our 7 patent assertion campaigns have generated revenue. The Company currently has 27 pending lawsuits in connection with its patented technologies. Our primary source of revenue will come from licenses resulting from the unauthorized use of our patented technologies, including the settlement of patent infringement lawsuits.

#### ***Display Technology Development and License Fees***

Based on our assessment as of July 31, 2014, we have determined that we have no further performance obligations under the AUO License Agreements and accordingly during the nine months ended July 31, 2014, we have recognized display technology development and license fee revenue of approximately \$1,187,000, representing the balance of the initial \$3 million payment received from AUO in fiscal year 2011. We did not record any display technology development and license fees during the nine months ended July 31, 2013.

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***Inventor Royalties and Contingent Legal Fees***

Inventor royalties and contingent legal fees of approximately \$465,000 during the nine months ended July 31, 2014 are attributable to our patent assertion activities initiated during fiscal 2013, and are expensed in the period that the related revenues are recognized. Inventor royalties and contingent legal fees, as a percentage of revenue from patent assertion activities, will vary between fiscal periods since the economic terms of patent agreements and contingent legal fee arrangements vary across the patent portfolios owned or controlled by our operating subsidiaries. We did not incur any inventor royalties or contingent legal fees during the nine months ended July 31, 2013, as we recognized no patent assertion revenues during this period.

***Litigation and Licensing Expenses***

Litigation and licensing expenses increased by approximately \$245,000 to approximately \$267,000 in the nine months ended July 31, 2014, from approximately \$22,000 in the comparable prior year period. Litigation and licensing expenses other than contingent legal fees, which are attributable to our patent assertion activities initiated during fiscal 2013 and the AUO/E Ink Lawsuit, are expensed in the period incurred.

***Amortization of Patents***

Amortization of patents of approximately \$233,000 in the nine months ended July 31, 2014 is related to patent portfolios acquired in the first quarter of fiscal 2014. We capitalize patent and patent rights acquisition costs and amortize the cost over the estimated economic useful life. We did not incur any patent amortization expense during the nine months ended July 31, 2013.

***Marketing, General and Administrative Expenses***

Marketing, general and administrative expenses decreased by approximately \$1,313,000 to approximately \$4,807,000 in the nine months ended July 31, 2014, from approximately \$6,120,000 in the comparable prior-year period. The decrease in marketing, general and administrative expenses was principally due to a decrease in legal and accounting fees of approximately \$614,000, a decrease in rent expense of approximately \$246,000, a decrease in shareholder relations expense of approximately \$285,000, and a decrease in stock option expense for employees of approximately \$556,000, which were partially offset by an increase in employee compensation and related costs, excluding stock option expense, of approximately \$240,000, which was primarily attributable to employee bonuses, a bonus paid to the Company's strategic advisor and a director of the Company of \$100,000 and an increase in stock option expense for this strategic advisor and director of the Company of approximately \$210,000.

Legal and accounting fees in 2013 included nonrecurring costs related to the Company's restructuring, which commenced in the fourth quarter of the fiscal year 2012.

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The decrease in rent expenses reflects the reduction in facilities requirements as a result of the Company's restructuring. Marketing, general and administrative expense for the nine months ended July 31, 2014 and 2013 includes approximately \$2,347,000 and \$2,693,000, respectively, of non-cash stock option compensation expense.

### ***Change in Value of Derivative Liability***

Change in value of derivative liability was a loss of approximately \$1,461,000 in the nine months ended July 31, 2014 compared to a gain of approximately \$315,000 in the comparable prior year period. The derivative liability represents the bifurcated conversion features of the January 2013 Convertible Debentures through its conversion date and the November 2013 Convertible Debenture. An increase in the price of our common stock results in an increase in derivative liability and a loss from change in value of derivative liability. See Note 3 to the condensed consolidated financial statements for additional information.

### ***Loss on Extinguishment of Debt***

During the nine months ended July 31, 2014, holders of \$1,240,000 of the Convertible Debentures due January 2015 converted their holdings into 8,267,080 shares of Common Stock and holders of \$200,000 of principal of Convertible Debentures due January 2015 consented to prepayment of obligations to them. In connection with these conversions and prepayments, the Company recorded a loss on extinguishment of debt of approximately \$483,000 in the nine months ended July 31, 2014. During the nine months ended July 31, 2013, holders of \$325,000 of the Convertible Debentures due January 2015 converted their holdings into 2,166,775 shares of Common Stock. In connection with these conversions the Company recorded a loss on extinguishment of debt of approximately \$344,000 in the nine months ended July 31, 2013. See Note 3 to the condensed consolidated financial statements for additional information.

### ***Interest Expense***

Interest expense increased by approximately \$99,000 to approximately \$1,082,000 in the nine months ended July 31, 2014 from approximately \$983,000 in the prior year period. Interest expense in the nine months ended July 31, 2014 and 2013 includes approximately \$575,000 and \$195,000, respectively, of amortization of debt discount on convertible debentures, approximately \$286,000 and \$-0-, respectively, of amortized interest on our patent acquisition obligation and approximately \$151,000 and \$-0-, respectively, of accrued interest on the November 2013 convertible debentures and approximately \$62,000 and \$70,000 of common stock issued to pay interest. During the nine months ended July 31, 2013, the convertible debentures due September 2016 were converted into shares of common stock. The conversion of these debentures resulted in a charge to interest expense of approximately \$717,000 during the nine months ended July 31, 2013. There was no charge to interest expense related to the conversion of debentures in the current fiscal period.

### ***Dividend Income***

Dividend income of approximately \$48,000 received in the nine months ended July 31, 2014 was related to the Videocon GDR's. There was no dividend income received in the nine months ended July 31, 2013.

### ***Interest Income***

Interest income increased to approximately \$5,000 in the nine months ended July 31, 2014 compared to approximately \$-0- in the nine months ended July 31, 2013 due to the increased amount of short term investments during the current period.

### **Three months ended July 31, 2014 compared with three months ended July 31, 2013**

#### ***Revenue from Patent Assertion Activities***

The Company currently owns or controls 10 patent portfolios. Since implementing our new business model in January of 2013, the Company has entered into a total of 14 revenue producing license and/or settlement agreements, and 3 of our 7 patent assertion campaigns have generated revenue. The Company currently has 27 pending lawsuits in connection with its patented technologies. Our primary source of revenue will come from licenses resulting from the unauthorized use of our patented technologies, including the settlement of patent infringement lawsuits.

Our license agreements primarily provide for one-time, non-recurring, lump sum payments in exchange for a non-exclusive retroactive and future license, or covenant not to sue. Accordingly, the earning process from these licenses is completed and 100% of the revenue is recognized upon execution of the license agreements. We did not enter into any license agreements during the three months ended July 31, 2014 and 2013 and we did not record any revenue from patent assertion activities during those periods.

#### ***Display Technology Development and License Fees***

Based on our assessment as of July 31, 2014, we have determined that we have no further performance obligations under the AUO License Agreements and accordingly during the three months ended July 31, 2014, we have recognized display technology development and license fee revenue of approximately \$1,187,000, representing the balance of the initial \$3 million payment received from AUO in fiscal year 2011. We did not record any display technology development and license fees during the nine months ended July 31, 2013.

#### ***Inventor Royalties and Contingent Legal Fees***

Inventor royalties and contingent legal fees are attributable to our patent assertion activities initiated during fiscal 2013, and are expensed in the period that the related revenues are recognized. Inventor royalties and contingent legal fees, as a percentage of revenue from patent assertion activities, will vary between fiscal periods since the economic terms of patent agreements and contingent legal fee arrangements vary across the patent portfolios owned or controlled by our operating subsidiaries. We did not incur any inventor royalties or contingent legal fees during the three months ended July 31, 2014 and 2013, as we recognized no patent assertion revenues during these periods.



### ***Litigation and Licensing Expenses***

Litigation and licensing expenses increased by approximately \$148,000 to approximately \$163,000 in the three months ended July 31 2014, from approximately \$15,000 in the comparable prior year period. Litigation and licensing expenses other than contingent legal fees, which are attributable to our patent assertion activities initiated during fiscal 2013 and the AUO/E Ink Lawsuit, are expensed in the period incurred.

### ***Amortization of Patents***

Amortization of patents of approximately \$81,000 in the three months ended July 31, 2014 is related to patent portfolios acquired in the first quarter of fiscal 2014. We capitalize patent and patent rights acquisition costs and amortize the cost over the estimated economic useful life. We did not incur any patent amortization expense during the three months ended July 31, 2013.

### ***Marketing, General and Administrative Expenses***

Marketing, general and administrative expenses decreased by approximately \$1,100,000 to approximately \$1,103,000 in the three months ended July 31, 2014, from approximately \$2,203,000 in the comparable prior-year period. The decrease in marketing, general and administrative expenses was principally due to a decrease in legal and accounting fees of approximately \$163,000, a decrease in shareholder relations expense of approximately \$172,000, decrease in stock option expense for employees of approximately \$517,000, decrease in stock option expense for the Company's strategic advisor and a director of the Company of approximately \$251,000. Marketing, general and administrative expense for the three months ended July 31, 2014 and 2013 includes approximately \$470,000 and \$1,238,000, respectively, of non-cash stock option expense.

### ***Change in Value of Derivative Liability***

Change in value of derivative liability was a gain of approximately \$850,000 in the three months ended July 31, 2014 compared to a gain of approximately \$105,000 in the comparable prior year period. The derivative liability represents the bifurcated conversion features of the January 2013 Convertible Debentures through its conversion date and the November 2013 Convertible Debenture. An increase in the price of our common stock results in an increase in derivative liability and a loss from change in value of derivative liability. See Note 3 to the condensed consolidated financial statements for additional information.

### ***Loss on Extinguishment of Debt***

During the three months ended July 31, 2014 there was no extinguishment of debt. During the three months ended July 31, 2013, holders of \$325,000 of the Convertible Debentures due January 2015 converted their holdings into 2,166,775 shares of Common Stock. In connection with these conversions the Company recorded a loss on extinguishment of debt of approximately \$344,000 in the three months ended July 31, 2014. See Note 3 to the condensed consolidated financial statements for additional information.

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***Interest Expense***

Interest expense increased by approximately \$156,000 to approximately \$281,000 in the three months ended July 31, 2014 from approximately \$125,000 in the prior year period. Interest expense in the three months ended July 31, 2014 and 2013 includes approximately \$129,000 and \$92,000, respectively, of amortization of debt discount on convertible debentures, approximately \$100,000 and \$-0-, respectively, of amortized interest on our patent acquisition obligation and approximately \$53,000 and \$-0-, respectively, of accrued interest on the November 2013 convertible debentures.

***Interest Income***

Interest income increased to approximately \$1,000 in the three months ended July 31, 2014 compared to approximately \$-0- in the three months ended July 31, 2013 due to the increased amount of short term investments during the current period.

**LIQUIDITY AND CAPITAL RESOURCES**

Our primary sources of liquidity are cash, cash equivalents and short term investments on hand generated from our operating activities and proceeds from previous financing.

Based on currently available information, the Company believes that its existing cash, cash equivalents, short-term investments, accounts receivable, and expected cash flows from patent licensing and enforcement, and other potential sources of cash flows will be sufficient to enable it to continue our patent licensing and enforcement activities for at least 12 months. However, our projections of future cash needs and cash flows may differ from actual results. If current cash on hand, short term investments and cash that may be generated from patent licensing and enforcement activities are insufficient to satisfy our liquidity requirements, we may seek to sell equity securities or obtain loans from various financial institutions where possible. The sale of additional equity securities or convertible debt could result in dilution to our shareholders. We can give no assurance that we will generate sufficient cash flows in the future (through licensing and enforcement of patents, or otherwise) to satisfy our liquidity requirements or sustain future operations, or that other sources of funding, such as sales of equity or debt, would be available, if needed, on favorable terms or at all. If we cannot obtain such funding if needed or if we cannot sufficiently reduce operating expenses, we would need to curtail or cease some or all of our operations.

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During the nine months ended July 31, 2014, cash used in operating activities was approximately \$2,017,000. Cash used in investing activities during the nine months ended July 31, 2014 was approximately \$2,554,000, which principally resulted from the purchase of certificates of deposit totaling \$3,700,000 which was partially offset by the sale of certificates of deposit totaling \$1,150,000. Our cash provided by financing activities during the nine months ended July 31, 2014 was approximately \$7,324,000, which resulted from the net proceeds from the sale of 16,000,000 shares of the company's common stock for approximately \$3,673,000, the sale of convertible debentures in a private placement for \$3,500,000, the proceeds from exercise of warrants to purchase common stock of approximately \$300,000, and the proceeds from exercise of stock options of approximately \$51,000 offset by the payment to redeem convertible debentures of \$200,000. As a result, our cash, cash equivalents, and short-term investments at July 31, 2014 increased approximately \$5,304,000 to approximately \$6,202,000 from approximately \$898,000 at the end of fiscal year 2013.

Accounts receivable at July 31, 2014 of approximately \$133,000 are scheduled to be collected in the fourth quarter of fiscal 2014. The majority of royalties and contingent legal fees payable at July 31, 2014 of approximately \$152,000 are scheduled to be paid in the fourth quarter of fiscal 2014.

In April 2013, the Company entered into a common stock purchase agreement (the "Stock Purchase Agreement") with Aspire Capital, which provides that Aspire Capital is committed to purchase up to an aggregate of \$10 million of shares of the Company's common stock over the two-year term of the agreement. In order to sell shares under the Stock Purchase Agreement, the Company was required to have a registration statement covering the shares issued to Aspire Capital declared effective by the Securities and Exchange Commission (the "SEC"). Such registration statement was declared effective by the SEC in June 2013 and a post-effective amendment was declared effective by the SEC in February 2014. Under the Stock Purchase Agreement there are two ways that the Company can elect to sell shares of common stock to Aspire Capital. On any business day the Company can select: (1) through a regular purchase of up to 200,000 shares (but not to exceed \$200,000) at a known price based on the market price of the Company's common stock prior to the time of each sale, and (2) through a volume-weighted average price, or VWAP, purchase of a number of shares up to 30% of the volume traded on the purchase date at a price equal to the lesser of (i) the closing sale price on the purchase date or (ii) 95% of the VWAP for such purchase date. The Company can only require a VWAP purchase if the closing sale price for our Common Stock on the notice day for the VWAP purchase is higher than \$0.50. The number of shares covered by and the timing of, each purchase notice are determined by the Company at its sole discretion. The Company cannot execute any sales under the Stock Purchase Agreement when the closing for our common stock is less than \$0.15. Aspire Capital has no right to require any sales from us, but is obligated to make purchases as directed in accordance with the Stock Purchase Agreement. During fiscal year 2013, the Company sold 5,380,000 shares of our common stock to Aspire Capital for approximately \$1,092,000. No shares of our common stock were sold to Aspire Capital during the nine months ended July 31, 2014.

On July 15, 2014, the Company, raised \$4,000,000 of gross proceeds via a registered direct offering of its common stock to certain investors (the "Investors") (the "Offering"). The Company sold an aggregate of 16,000,000 shares of common stock and warrants to purchase an aggregate of 8,000,000 shares of common stock. The purchase price of the common stock was \$0.25 per share. The warrants are exercisable immediately as of the date of issuance at an exercise price of \$0.40 per share and expire five years from the date of issuance. The exercise price of the warrants is subject to customary adjustment in the case of stock splits, stock dividends, combinations of shares and similar recapitalization transactions. Under certain circumstances, the Company has the right to call for cancellation all or any portion of each warrant for which a notice of exercise has not yet been delivered for consideration equal to \$.001 per share. The Offering was effected as a takedown off the Company's shelf registration statement on Form S-3, which became effective on April 25, 2014, pursuant to a prospectus supplement filed with the Securities and Exchange Commission.

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The following table presents our expected cash requirements for contractual obligations outstanding as of July 31, 2014:

Contractual Obligations	Payments Due by Period				Total
	Less than 1 year	1-3 years	3-5 years	After 5 years	
Non-cancelable Operating Leases	\$ 60,092	\$ -	\$ -	\$ -	\$ 60,092
Convertible Debentures due 2016 (1)	-	3,500,000	-	-	3,500,000
Patent acquisition obligation	-	-	3,136,513	-	3,136,513
Secured Loan Obligation to Mars Overseas (1)	5,000,000	-	-	-	5,000,000
Total Contractual Cash Obligations	<u>\$ 5,060,092</u>	<u>\$ 3,500,000</u>	<u>\$ 3,136,513</u>	<u>\$ -</u>	<u>\$ 11,696,602</u>

(1) See Note 2 to the condensed consolidated financial statements, Subsequent Events – for subsequent conversion of the convertible debenture and cancellation of the secured loan obligation to Mars Overseas Limited.

**Critical Accounting Policies**

The Company's condensed consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. In preparing these financial statements, we make assumptions, judgments and estimates that can have a significant impact on amounts reported in our consolidated financial statements. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis, we evaluate our assumptions, judgments and estimates and make changes accordingly.

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We believe that, of the significant accounting policies discussed in Note 2 to our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended October 31, 2013, the following accounting policies require our most difficult, subjective or complex judgments:

- Revenue Recognition;
- Investment Securities;
- Stock-Based Compensation; and
- Convertible Debentures

### **Revenue Recognition**

Revenue is recognized when (i) persuasive evidence of an arrangement exists, (ii) all obligations have been substantially performed pursuant to the terms of the arrangement, (iii) amounts are fixed or determinable, and (iv) the collectability of amounts is reasonably assured.

### **Patent Monetization and Patent Assertion**

In general, revenue arrangements provide for the payment of contractually determined fees in consideration for the grant of certain intellectual property rights for patented technologies owned or controlled by our operating subsidiaries. These rights typically include some combination of the following: (i) the grant of a non-exclusive, retroactive and future license to manufacture and/or sell products covered by patented technologies owned or controlled by our operating subsidiaries, (ii) a covenant-not-to-sue, (iii) the release of the licensee from certain claims, and (iv) the dismissal of any pending litigation. The intellectual property rights granted are perpetual in nature, extending until the expiration of the related patents. Pursuant to the terms of these agreements, our operating subsidiaries have no further obligation with respect to the grant of the non-exclusive retroactive and future licenses, covenants-not-to-sue, releases, and other deliverables, including no express or implied obligation on our operating subsidiaries' part to maintain or upgrade the technology, or provide future support or services. Generally, the agreements provide for the grant of the licenses, covenants-not-to-sue, releases, and other significant deliverables upon execution of the agreement. As such, the earnings process is complete and revenue is recognized upon the execution of the agreement, when collectability is reasonably assured, and when all other revenue recognition criteria have been met.

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### Display Technology Development and License Fees

We have assessed the revenue guidance of Accounting Standards Codification (“ASC”) 605-25 “Multiple-Element Arrangements” (“ASC 605-25”) to determine whether multiple deliverables in our arrangements with AUO represent separate units of accounting. Under the AUO License Agreements, we received initial development and license fees of \$3 million, of aggregate development and license fees of up to \$10 million. The additional \$7 million in development and license fees were to be payable upon completion of certain conditions for the respective technologies. We have determined that the transfer of the licensed patents and technology and the effort involved in completion of the conditions for the respective technologies represent a single unit of accounting for each technology. Accordingly, using a proportional performance method, during the third quarter of fiscal year 2011 we began recognizing the \$3 million initial development and license fees over the estimated periods that we expected to complete the conditions for the respective technologies. We have not recognized any portion of the \$7 million of additional development and license fees as either deferred revenue or revenue as it is considered contingent revenue. Each of the license agreements with AUO also provide for the basis for royalty payments on future production, if any, by AUO to CopyTele, which we have determined represent separate units of accounting. At each reporting period we assess our remaining performance obligations under the AUO License agreements and recognize display technology development and license fee revenue over the remaining estimated period that we expect to complete the conditions for the respective technologies.

### **Investment Securities**

We classify our investment securities as available-for-sale. Available-for-sale securities are recorded at fair value. Unrealized gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a component of accumulated other comprehensive income (loss) until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis. Dividend and interest income are recognized when earned.

We monitor the value of our investments for indicators of impairment, including changes in market conditions and the operating results of the underlying investment that may result in the inability to recover the carrying value of the investment. In evaluating our investment in Videocon GDR’s at October 31, 2013, we determined that based on both the duration and continuing magnitude of the market price decline compared to the carrying cost basis of approximately \$5,382,000, and the uncertainty of its recovery we recorded a write-down of the investment of approximately \$1,185,000 and established a new cost basis of approximately \$4,197,000. During the nine months ended July 31, 2014, we recorded an unrealized loss on our investment of approximately \$46,000.

### **Stock-Based Compensation**

We account for stock options granted to employees and directors using the accounting guidance in ASC 718. We recognize compensation expense for stock option awards over the requisite or implied service period of the grant. We recorded stock-based compensation expense, related to stock options granted to employees and directors, of approximately \$1,562,000 and \$2,118,000 during the nine months ended July 31, 2014 and 2013, respectively, and approximately \$573,000 and approximately \$1,091,000 during the three months ended July 31 2014 and 2013, respectively. We account for stock options granted to consultants using the accounting guidance under ASC 505-50. We recognized stock-based compensation expense for stock options granted to non-employee consultants during the nine months ended July 31, 2014 and 2013, of approximately \$784,000 and \$574,000, respectively, and for the three months ended July 31, 2014 and 2013 of approximately \$(103,000) and approximately \$147,000, respectively.

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Determining the appropriate fair value model and calculating the fair value of stock-based awards requires judgment, including estimating stock price volatility, forfeiture rates and expected term. If factors change and we employ different assumptions in the application of ASC 718 and ASC 505-50 in future periods, the compensation expense that we record may differ significantly from what we have recorded in the current period. See Note 3 to the condensed consolidated financial statements for additional information.

### **Convertible Instruments**

The Company accounts for hybrid contracts that feature conversion options in accordance with applicable generally accepted accounting principles (“GAAP”). ASC 815 “Derivatives and Hedging Activities,” (“ASC 815”) requires companies to bifurcate conversion options from their host instruments and account for them as free standing derivative financial instruments according to certain criteria. The criteria includes circumstances in which (a) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument.

Conversion options that contain variable settlement features such as provisions to adjust the conversion price upon subsequent issuances of equity or equity linked securities at exercise prices more favorable than that featured in the hybrid contract generally result in their bifurcation from the host instrument.

The Company accounts for convertible instruments, when the Company has determined that the embedded conversion options should not be bifurcated from their host instruments, in accordance with ASC 470-20 “Debt with Conversion and Other Options” (“ASC 470-20”). Under ASC 470-20 the Company records, when necessary, discounts to convertible notes for the intrinsic value of conversion options embedded in debt instruments based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note. The Company accounts for convertible instruments (when the Company has determined that the embedded conversion options should be bifurcated from their host instruments) in accordance with ASC 815. Under ASC 815, a portion of the proceeds received upon the issuance of the hybrid contract are allocated to the fair value of the derivative. The derivative is subsequently marked to market at each reporting date based on current fair value, with the changes in fair value reported in results of operations.

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### **EFFECT OF RECENTLY ISSUED PRONOUNCEMENTS**

In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update 2013-11 (“ASU 2013-11”) which requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carry forward that would apply in settlement of the uncertain tax positions. Under the new standard, unrecognized tax benefits will be netted against all available same-jurisdiction loss or other tax carry forwards that would be utilized, rather than only against carry forwards that are created by the unrecognized tax benefits. ASC 2013-11 is effective for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2013. The adoption of ASC 213-11 on November 1, 2014 is not expected to have a material effect on our consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update 2014-09 (“ASU 2014-09”), “Revenue from Contracts with Customers”. The amendments in ASU 2014-9 create Topic 606, Revenue from Contracts with Customers, and supersede the revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance. In addition, the amendments supersede the cost guidance in Subtopic 605-35, Revenue Recognition—Construction-Type and Production-Type Contracts, and create new Subtopic 340-40, Other Assets and Deferred Costs—Contracts with Customers. In summary, the core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASC 2014-09 is effective for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2016. The adoption of ASC 213-11 on November 1, 2017 is not expected to have a material effect on our consolidated financial statements.

### **FORWARD-LOOKING STATEMENTS**

Information included in this Quarterly Report on Form 10-Q (this “Report”) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements are not statements of historical facts, but rather reflect our current expectations concerning future events and results. We generally use the words “believes,” “expects,” “intends,” “plans,” “anticipates,” “likely,” “will” and similar expressions to identify forward-looking statements. Such forward-looking statements, including those concerning our expectations, involve risks, uncertainties and other factors, some of which are beyond our control, which may cause our actual results, performance or achievements, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These risks, uncertainties and factors include, but are not limited to, those factors set forth in our Annual Report on Form 10-K for the fiscal year ended October 31, 2013 and the condensed consolidated financial statements included in this Report. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. You are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in this Report.



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

At July 31, 2014, our investment in Videocon GDRs is recorded at fair value of approximately \$4,151,000 and has exposure to additional price risk. The fair value of the Videocon GDRs is based on the underlying price of Videocon's equity shares which are traded on stock exchanges in India with prices quoted in rupees. Accordingly, the fair value of the Videocon GDRs is subject to price risk and foreign exchange risk. The potential loss in fair value resulting from a hypothetical 10% adverse change in prices of Videocon equity shares quoted by Indian stock exchanges and in foreign currency exchange rates, as of July 31, 2014, amounts to approximately \$415,000.

**Item 4. Controls and Procedures.**

We carried out an evaluation, under the supervision and with the participation of our management including our President and Chief Executive Officer and our Vice President – Finance and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13-15(b) of the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our President and Chief Executive Officer and our Vice President – Finance and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report.

There was no change in our internal control over financial reporting during the third quarter of fiscal year 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

On January 28, 2013, we filed a lawsuit in the United States Federal District Court for the Northern District of California against AUO and E Ink in connection with the EPD License Agreement and the Nano Display License Agreement, alleging breach of contract, breach of the implied covenant of good faith and fair dealing, fraudulent inducement, unjust enrichment, unfair business practices, attempted monopolization, and other charges, and we are seeking compensatory, punitive, and treble damages.

In addition to numerous and continual material breaches by AUO of the EPD License Agreement, and the Nano Display License Agreement, the Complaint alleges that AUO and E Ink conspired to obtain rights to ITUS's ePaper® Electrophoretic Display technology, and ITUS's Nano Field Emission Display technology, through an elaborate scheme whereby AUO obtained certain rights to the technologies under the guise of jointly developing products with ITUS, which products would compete with certain products manufactured by AUO and certain products manufactured and sold by E Ink. Instead of jointly developing products with ITUS and competing with E Ink, AUO clandestinely agreed to sell its electrophoretic display business to E Ink, and attempted to include a license to ITUS's ePaper® Electrophoretic Display technology as part of the sale, with ITUS receiving no consideration. ITUS alleges that such activities violated several State and Federal anti-trust and unfair competition statutes for which punitive and/or treble damages are applicable.

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Other than the foregoing and the suits we bring to enforce our patent rights, which are an integral part of our business plan, we are not a party to any material pending legal proceedings other than that which arise in the ordinary course of business. We are party to claims and complaints that arise in the ordinary course of business. We believe that any liability that may ultimately result from the resolution of these matters will not, individually or in the aggregate, have a material adverse effect on our financial position or results of operations.

**Item 1A. Risk Factors.**

There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the fiscal year ended October 31, 2013.

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

During the three months ended July 31, 2014, the Company issued an aggregate of 20,000 shares of our common stock to various companies in payment of public relations and investor relations services and 200,000 shares of our common stock to inventors in connection with the acquisition of patents. In all instances, the common stock was issued in reliance on an exemption from registration under Section 4(2) of the Securities Act.

**Item 3. Defaults Upon Senior Securities. None.**

**Item 4. Mine Safety Disclosures. Not Applicable.**

**Item 5. Other Information.**

(a) None.

(b) There have been no material changes to the procedures by which security holders may recommend nominees to the Company's board of directors.

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**Item 6. Exhibits.**

31.1 Certification of Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated September 15, 2014.

31.2 Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated September 15, 2014.

32.1 Statement of Chief Executive Officer, pursuant to Section 1350 of Title 18 of the United States Code, dated September 15, 2014.

32.2 Statement of Chief Financial Officer, pursuant to Section 1350 of Title 18 of the United States Code, dated September 15, 2014.

**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.

ITUS CORPORATION

By: /s/ Robert A. Berman  
Robert A. Berman  
President and Chief Executive  
Officer  
(Principal Executive Officer)

September 15, 2014

By: /s/ Henry P. Herms  
Henry P. Herms  
Vice President - Finance and  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

September 15, 2014

Exhibit 31.1

CERTIFICATION

I, Robert Berman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ITUS Corporation;
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(s) 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(s) 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.

/s/ Robert A. Berman

Robert A. Berman  
President and Chief  
Executive Officer  
(Principal Executive  
Officer)

September  
15, 2014



Exhibit 31.2

CERTIFICATION

I, Henry P. Herms, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ITUS Corporation;
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(s) 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(s) 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.

/s/ Henry P. Herms  
Henry P. Herms  
Vice President - Finance and  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

September 15,  
2014





Exhibit 32.1

Statement of Chief Executive Officer  
Pursuant to Section 1350 of Title 18 of the United States Code

Pursuant to Section 1350 of Title 18 of the United States Code, the undersigned, Robert A. Berman, the President and Chief Executive Officer of ITUS Corporation., hereby certifies that:

1. The Company's Form 10-Q Quarterly Report for the period ended July 31, 2014 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Robert A. Berman  
Robert A. Berman  
President and Chief  
Executive Officer  
(Principal Executive  
Officer)

September  
15, 2014

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Exhibit 32.2

Statement of Chief Financial Officer  
Pursuant to Section 1350 of Title 18 of the United States Code

Pursuant to Section 1350 of Title 18 of the United States Code, the undersigned, Henry P. Herms, the Vice President - Finance and Chief Financial Officer of ITUS Corporation, hereby certifies that:

1. The Company's Form 10-Q Quarterly Report for the period ended July 31, 2014 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Henry P. Herms  
Henry P. Herms  
Vice President - Finance and  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

September 15,  
2014

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